

Asset Management

Non-EU financial institutions may be able to obtain refunds of dividends and interest on withholding taxes originating in the EU

The EC Treaty contains an express prohibition of national laws which restrict the free movement of capital between EU Member States and third countries. Over the last few years this rule has been subject to a number of judgments of the European Court of Justice (ECJ) such that it now seems that the free movement of capital applies to investors based outside the EU making portfolio investments into Europe. This broader applicability of the free movement of capital creates opportunities for non-EU resident investors to file refund claims in respect of withholding tax suffered on their portfolio investments around Europe,

Importantly, in a recent judgment regarding an intra-EU dividend payment, in the *Aberdeen Property Fininvest Alpha Oy, (Aberdeen)* case, the ECJ negated most of the arguments presented by Member States' tax authorities when denying non-resident investment funds the benefit of exemptions from withholding tax.

Background

Article 56 of the EC Treaty provides that:

"all restrictions on the movement of capital between Member States and between Member States and third countries shall be prohibited."

So far as taxation is concerned, the ECJ has over a number of years handed down judgments from which it is clear that:

- The payment of a dividend and interest is a movement of capital.
- A withholding tax is a prohibited restriction where a resident recipient of the same dividend or interest payment would not have suffered the same effective tax burden on the dividend or the interest payment, either withholding tax or corporate income tax. That is to say, outbound dividends or interest payments cannot be subject to higher taxation than domestic dividends.

Thus it was held in a case called *Denkavit*, that a 5% French withholding tax on a dividend paid to a Dutch recipient was unlawful because a comparable French recipient would not have been taxed on the same dividend.

Third country residents

It is clear from its wording that Article 56 EC has application to dividends and interest payments paid by a company resident in the EU to a resident in a third country.

There are, however, certain caveats to the broader application of this rule, namely:

- The dividend or interest payment must be paid in respect of a portfolio investment.
- It would strengthen the position of the taxpayer filing the protective reclaim if there is an exchange of information clause in the double tax treaty between the paying and recipient states.

European Commission

The Commission believes that third country investors outside the EU may in many cases have some strong arguments.

Although the Commission's focus remains primarily on intra-EU situations, it recently also started to pursue the first discrimination complaints filed by non-EU third country investors against EU Member States based on Article 56 EC.

Recent developments

EU based PwC clients have been filing protective reclaims with various EU Member States' national tax authorities since 2004. Over the last few months various countries have either started to make repayments or suffered defeats in their domestic courts. PwC clients have received or are due to receive money from various countries such as The Netherlands Austria, Poland and Norway.

In the case of *Aberdeen*, the plaintiff asked whether the imposition of withholding tax by Finland on dividends paid to a non-resident company constituted as a Luxembourg SICAV, while exempting Finnish resident parent companies and investment funds from such taxes, is contrary to the EC Treaty. The ECJ ruling was to dismiss the arguments presented by the Finnish Government, concluding that the taxes infringe on the principle of the freedom of establishment in Member States.

In reaching the ruling in *Aberdeen*, the ECJ removed the blockers to previous claims that had been presented by Member States' tax authorities in denying the benefit of exemption from withholding tax, namely:

- 'Our law is consistent with the Parent Subsidiary Directive 90/435'
- 'The recipient investment fund is not subject to tax in its home Member State and so is not comparable to a domestic investment fund'
- 'There is no such legal entity recognized in domestic law and as a result the non-resident cannot be comparable'
- 'The imposition of a withholding tax is necessary to prevent tax avoidance/evasion by residents who invest in non-resident investment funds'

Who can claim?

The extension to third country residents potentially applies to all portfolio investors outside the EU, such as:

- Investment funds
- Pension funds
- Charities or endowments
- Insurance companies: and
- Sovereign wealth funds

Implications for portfolio investors

Given the various developments that have taken place in the EU, portfolio investors investing in EU Member States may wish to consider filing protective reclaims with the relevant European taxation authorities to reclaim withholding taxes suffered on dividends and interest payments received from companies resident in those countries.

PwC has extensive experience in filing refund claims for a great number of EU based pension funds, investment funds, insurance companies, charities, government-owned organisations etc. and in dealing with the local tax authorities on behalf of these clients with the purpose of reclaiming withholding tax on dividends and interest payments levied in past years.

How can PwC help?

PwC has extensive experience in assisting our clients in filing protective withholding tax reclaims with tax authorities throughout Europe. Our international client servicing teams are a mix of dedicated Financial Services professionals and leading EC direct tax law specialists who are able to determine the possibilities based on the actual facts & circumstances that will be an essential element in preparing the cost benefit analysis that should be the starting point for any investor that has suffered withholding tax on EU source dividend and interest payments.

Contacts:

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