



Asset Management

Financial institutions can claim EU refunds of WHT on dividends & interest

November 2010 – Latest developments

Did you know that based on EU Law you can claim back withholding taxes which you have already paid? Too good to be true? Not quite. Essentially, in many cases where an EU withholding tax cannot fully be credited in the residence State of the recipient there is an EU argument to apply for a refund.

Today, we are seeing the first results of the parallel pressure at EU and national level with the first systematic refunds being granted by the Dutch, Polish and Norwegian tax authorities and sporadic payouts and promising developments in an increasing number of other EU countries. Also, a considerable number of EU countries have made their domestic legislation more EU proof, yet, at the same time, many of them continue to reject claims filed for previous years in their jurisdictions. Recent European Court of Justice (ECJ) and national Supreme Court decisions in different EU countries have been decided in favour of the European Commission (EC)'s position. If the ECJ also follows the EC, which is increasingly likely, EU/EEA based financial institutions should get refunds if their applications have been filed correctly and in time.

PwC has assisted many clients with filing requests and protective claims for pension funds, investment funds, insurance companies, charities, banks etc. across many European jurisdictions for the recovery of EU withholding taxes on dividends and interest. Following recent favourable ECJ case law and national court decisions, clients can look forward to refunds of millions of Euros. To safeguard their rights, clients will need to file protective claims within local statutory time limitations ranging from 3 months to 5 years. It might take several years until refunds are granted and in certain cases, court procedures in national courts are necessary. In order to avoid losing out on any payments due to statutory time limitations, it is strongly recommended to take quick action as the 2010 year-end is approaching fast. Contact your PwC adviser now to do a cost-benefit analysis of your company's position.

Pension funds

A pioneering study by PwC in 2005 found that 18 EU member states had regimes in place whereby non-resident pension funds effectively paid higher taxes on interest or dividends than comparable resident pension funds. This is prohibited under EU free movement of capital rules, as laid down in article 63 of the Treaty on the Functioning of the European Union (TFEU). Based on this study PwC and the European Federation for Retirement Provision lodged complaints with the EC in December 2005. The EC agreed with us and started infringement proceedings in 2007. A number of ECJ cases support the EC's view. In the Denkavit case for instance, the ECJ confirmed that outbound dividends must not be subject to higher taxation in the source State than domestic dividends.

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In February 2009, the Dutch tax authorities started refunding dividend withholding tax claims to foreign EU based pension funds systematically for the years 2003 to 2006 following a Supreme Court decision and recent ECJ case law decisions.

In the Aberdeen case PwC successfully assisted a Luxembourg SICAV in claiming back Finnish withholding tax. Following these developments, the Norwegian Finance Ministry conceded in December 2009 that foreign investors were taxed in violation of EU Law and that it would start granting dividend withholding tax refunds. Systematic refunds to pension funds began in June 2010.

On 25 February 2010 the Head of the Warsaw Tax Office issued 3 decisions concerning a foreign (Dutch) pension fund confirming that the Polish corporate income tax law, which exempts only Polish pension funds from taxation, was breaching the free movement of capital, and that consequently the dividend withholding tax unduly withheld paid to the Dutch pension fund by Polish companies should be refunded. Consequently, EU/EEA pension and investment funds investing in Poland have strong arguments to claim back withholding tax. Systematic refunds to pension funds started in March 2010.

EU countries which have changed their law due to continued EC pressure in the meantime include: Slovenia (November 2008), Austria (June 2009), Czech Republic, Estonia, Latvia, Poland and Spain (January 2010), and Lithuania (September 2010).

In Austria, despite initial promising payouts in 2008 and the amendment of the law in line with EU rules in June 2009, the tax authorities announced they now require additional proof that the foreign pension funds are covered by EU Directive 2003/41/EC (institutional supervision) and that pensions paid out do not exceed 80 % of the last salary of the beneficiaries.

On 23 June 2009, Italy's parliament approved a legislative amendment which introduced a new specific tax regime for dividends paid to EU/EEA pension funds following the EC's infringement procedure against Italy. Previously, the Italian-source dividends paid out to foreign pension funds were subject to a withholding tax of 27% of the dividend gross amount if the dividend was related to ordinary shares. The new regime provides for the application of a 11% withholding tax on dividends paid to foreign EU/EEA pension funds included in a white list. The aim is to guarantee the same tax treatment on dividends paid out to both Italian and EU/EEA pension funds. The new regime does not completely remove the discriminatory effects suffered by the latter, and there are good arguments for claiming that the application of the 11% withholding tax does not actually guarantee the same tax treatment for Italian resident and non-resident EU/EEA pension funds for instance taxing based on a net or, respectively, a gross basis.

Spain changed its legislation on 2 March 2010 with retrospective effect to 1 January 2010 regarding pension funds and investment funds following the ECJ referral of Spain by the EC in November 2008. A deduction of expenses from the income not obtained through a PE by a taxpayer resident in another EU country is allowed when calculating the taxable base. Therefore, the taxpayer will be taxed on a net basis instead of a gross basis. To apply this deduction, taxpayers must prove that the expenses are directly linked to income obtained in Spain and have a direct economic relation with the activity carried out in Spain. Secondly, outbound dividends which are not received through a PE by a pension fund resident in another EU country are now exempt from withholding tax in Spain. The same tax treatment applies to dividends which are not received through a PE by an UCITS resident in another EU country. However, it is stated by the Spanish that this exemption cannot lead to a lower taxation than the amount that would have been payable in

Spain if the dividends had been received by a UCIT resident in Spain. The Spanish court of appeal recently delivered a judgment about withholding taxes levied on 3 foreign (Dutch) pension schemes in Spain: the Spanish dividends distributed to them were subject to a 15% withholding tax, whereas resident pension funds are not subject tax under the corporate income tax law. The court concluded that the Spanish Tax Authorities (STA) should not have levied withholding tax on the dividends distributed to the foreign pension funds and they will therefore have to refund the withholding tax. The court confirmed that the Spanish regulations have indeed discriminated against foreign EU pension funds. The court's reasoning may apply for other investment vehicles such as UCITS. The judgment has already been appealed by the STA. EU/EEA pension funds are advised to file protective claims. Litigation may still be needed in order to obtain refunds in Spain. Late payment interest can be accrued. In general, follow-up requests for correspondence and re-confirmation of already filed claims is not uncommon in Spain.

On 13 February 2009, the French Supreme Court ruled that the tax treatment of French dividends received by French pension funds under domestic tax law should be extended to EU non-profit organisations of the same nature. 4 Dutch pension funds had asked for annulment of French statements of practice issued in 2005 which deny a withholding tax exemption on French source dividends to non-resident pension funds. Since September 2009, the tax authorities require foreign EU pension funds who have filed claims in France to complete a questionnaire to establish the comparability with French non-profit bodies. Claimants were required to respond within 90 days or lose their rights. So far, there no official reaction on the questionnaires has been received. On 18 March 2010, the EC sent France a reasoned opinion requesting it to amend its legislation which the EC opines leads to the discriminatory treatment of foreign EU/EEA pension funds and investment funds in France.

On 28 October 2010, the EC sent Sweden a reasoned opinion as well. EU countries who have been referred to the ECJ by the EC include Finland (May 2010), Germany (June 2010 – dealing with its rules on taxation of dividend (and certain interest) payments to foreign EU/EEA resident "Pensionskassen" and "Pensionsfonds"), and Portugal (November 2008, although the EC

only sent the referral to the ECJ on 1 Dec. 2009). An EC referral of Denmark to the ECJ is expected.

Investment funds

Similarly, a study by PwC analysed to what extent investment funds face tax discrimination when making investments across Europe. PwC found that the imposition of withholding taxes on dividends to such funds in many EU countries could constitute an infringement of the free movement of capital. As a result, since 2006, PwC has filed complaints with the EC against 7 EU countries for their discriminatory fiscal treatment of foreign investment funds.

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Previously, PwC has successfully argued that UK OIECs are comprised by the Norwegian tax exemption method ("TEM") and thus entitled to a refund of withholding tax imposed in violation of the EEA Agreement. The Norwegian tax authorities have interpreted the TEM narrowly and as a result, several non-resident tax payers have been excluded from its scope of application. In spite of the favourable outcome for the taxpayer in the Aberdeen case, the tax authorities have been reluctant to grant actual refunds to investment funds. Therefore, PwC is pleased to have successfully assisted a Luxembourg SICAV in obtaining a withholding tax refund in Norway through settlement in January 2010. Similar refund claims that have been filed were put on hold pending the underlying case. Given the positive outcome of the underlying case, it is expected that the tax authorities will also proceed with refunding withholding tax in these cases. Pending the outcome of a case with the Norwegian Supreme Court, it may however be possible to claim back for as far as 10 years instead of the current 3 years. Even though the underlying case specifically relates to investment funds, it should also have a positive effect for other portfolio investors.

On 22 September 2010, the French Tribunal Administratif suggested an exceptional procedure, considering the large number of "Fokus Bank" claims pending with/rejected by the French tax authorities. This procedure consists in hearing a first "test case" before year-end and the Tribunal will consider if the case meets the conditions for an "Avis to the Conseil d'Etat" to be requested. After that, on basis of the "Avis", the Tribunal would then render "serial decisions" i.e. a "Main Case" would be identified for each situation (type

of UCITS / UCITS v. non-UCITS / country) for which the Tribunal would make decisions before the end of 2011. The Main Cases would be “duplicated” for all similar funds possibly using a specific proceeding known as “Ordonnance” to speed up the process. In a case rendered on 22 April 2010, a French Tribunal ruled that withholding taxes levied on French source dividends paid to investment funds established in the EU (Irish UCITS in the case under consideration) are incompatible with the EU’s rules on the free movement of capital, and ordered a refund of unduly withheld dividend withholding taxes to investment funds. This decision should be read in the light of the aforementioned infringement proceeding which the EC launched against France regarding the discriminatory treatment of EU collective investment funds in March 2010 which tends to strengthen the argument of the taxpayer. The French tax authorities have lodged an appeal against the decision.

The EC recently sent a reasoned opinion to Belgium regarding discriminatory aspects of its taxation of foreign investment companies. Under Belgian law, Belgian investment companies do not effectively pay tax on their Belgian-sourced interest and dividend income and get a refund for any Belgian withholding taxes on their Belgian-sourced interest and dividend income. Foreign investment companies have to pay withholding taxes of 15 or 25 % on their Belgian-sourced interest and dividend income and cannot claim refunds. The EC considers that the Belgian law is discriminatory and restricts the free movement of capital and the freedom of establishment.

Banking and Insurance Companies

Banks are usually taxable entities in their country of residence and can therefore in general receive a credit for foreign withholding tax suffered. In recent years however, many banks have been suffering losses and therefore could not receive a credit for foreign withholding tax suffered. Recent ECJ cases provide arguments for refund claims. Insurance companies are usually taxable entities in their country of residence, with different treatment of non-life insurance, non-linked life insurance and unit-linked life insurance companies. A PwC study on discriminatory taxation of dividend and interest payments to foreign insurance companies found that ECJ case law and EU legislative developments in this area provide strong arguments for refund requests.

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On 17 June 2010, the ECJ ruled in the case of Commission v. Portugal (C-105/08). On 6 March 2008, the EC referred Portugal to the ECJ claiming that by taxing payment of interest abroad on a gross basis while taxing the payment of interest to entities resident in Portuguese territory on a net basis, payment of interest abroad were taxed more heavily, as a result of which Portugal imposes unjustifiable restrictions on the provision of mortgage and other loan services by financial institutions resident in other EU and EEA countries. The ECJ observed that taxing payment of interest abroad on a gross basis while taxing payment of interest to entities resident in Portuguese territory on a net basis is incompatible with the free movement of capital, provided payments of interest abroad are taxed more heavily. The ECJ however dismissed the action brought by the EC because it failed to demonstrate that payments of interest to entities abroad were indeed taxed more heavily.

On 3 August 2010, the Dutch District Court of Haarlem rendered an interesting decision on withholding tax. The legal principle on which the company based its claim, the net taxation argument, was clearly supported by the judgment. The court rejected the tax authority’s argument that the different treatment was permissible because it involved different types of tax (withholding and income). The claim however was turned down on the facts of the case (burden of proof lies with the non-resident taxpayer). The above-mentioned case provides legal arguments for banks and insurance companies who cannot get a credit for foreign withholding tax in their country of residence to file refund claims for withholding tax suffered in other EU countries.

On 28 October 2010, the EC announced it had requested the Czech Republic to end its discriminatory treatment of non-resident pension insurance schemes in line with EU rules. Under Czech legislation, taxpayers can deduct their pension insurance contributions from their income tax base if contributions are paid to a pension fund established in the Czech Republic. Also, if an employer, on behalf of its employees, pays into a pension insurance fund established in the Czech Republic, the contributions do not need to be included in the taxpayers’ income tax base. Foreign pension schemes cannot deduct such contributions, which are on top of this considered as taxable income if paid by the employer.

Real estate investments

In 2009, PwC decided to broaden its focus with respect to pension funds to real estate investments. In Europe, pension funds are generally exempt from corporate income tax under the so-called EET-system. In a domestic context a pension fund usually also has the right to claim a refund of dividend withholding tax suffered when it invests in equity. A distinction is made between direct and indirect real estate investments. The tax implications of indirect cross-border real estate investments mainly relate to taxing rights on dividends and capital gains. When investors such as pension funds invest in cross-border real estate directly, they are not only confronted with issues specific to real estate such as depreciation and roll-over relief but also source state exemptions available to domestic pension funds. A first high-level survey by PwC of the regimes in the EU-27, Switzerland and Norway revealed many potential EU discriminations.

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On 5 July 2010, the French Supreme Court held that, insofar as capital gains derived from immovable property by domestic not-for-profit organizations are not subject to tax, the application of a withholding tax on such gains derived by non-resident not-for-profit organizations (i.e. a Greek museum) results in higher taxation which is contrary to the non-discrimination rule in the French-Greece treaty. Following the ECJ's decision in the *Stichting Unilever Pensioenfond Progress* case, a non-resident taxpayer has successfully challenged the French withholding tax on capital gains derived from the transfer of immovable property (Art. 244 bis A of the General Tax Code) on the basis of a treaty non-discrimination rule similar to Art. 24(1) of the OECD Model Tax Convention.

On 30 September 2010, the EC announced it has requested the Netherlands to change several rules which tax non-residents less favourably compared to residents. The EC considers that foreign charities and church organisations should also be exempt from corporate tax same as Dutch equivalents when investing directly in Dutch real estate. The Netherlands should change the rule that foreign charities and church organisations are deemed to carry on an enterprise in the Netherlands when investing in Dutch real estate and rights concerning Dutch real estate. The Dutch legislation infringes EU rules on free of movement of capital. Secondly, the EC has

requested the Netherlands to change a tax rule regarding indirect real estate income for non-resident charities which taxes income from substantial interests not forming part of the business capital of companies established in the EU/EEA or EFTA, whereas income held by domestic companies is exempt, regardless of whether it forms part of their business capital. The EC believes this is a breach of the EU's free movement of capital rules and, in the case of controlling participations, of the EU's freedom of establishment. In addition the EC finds the Dutch legislation contrary to EU Directive 90/435/EEC (parent-subsidiary directive) in as far it pertains to dividends, since this Directive does not provide for a "business capital" test. Lastly, the EC considers the aforementioned substantial interest taxation rules to be non-compliant with EU rules also for other investors than charities in the EU/EEA or EFTA. Also for foreign pension funds for instance these substantial interest taxation rules are considered contrary to EU Law.

In May 2010, the EC sent a reasoned opinion to Spain requesting it to change the imposition of a real estate transfer tax on the issuance of shares by a 'real estate company'. The EC opines that the issuance of new shares by such companies should not trigger Spanish real estate transfer tax on the acquisition of the new shares in addition to Spanish capital duty. The EC considers that the Spanish legislation at issue is not in line with Council Directive 2008/7/EC as it provides for another tax to be levied in addition to capital duty on certain contributions of capital that fall under the Directive. As many EU countries tax the acquisition of shares in real estate companies with real estate transfer tax, this case may have a great impact on share deals.

Secondly, in July 2010, a preliminary question about real estate transfer tax on share deals was referred by the Spanish Supreme Court to the ECJ. In this case (*Immogolf*), the court asked whether Directive 2008/7/EC allows EU countries to automatically impose a real estate transfer tax on share deals without the need to demonstrate that the transaction is tax driven, and whether the Directive allows a real estate transfer tax on the acquisition of the majority of shares in a 'real estate company' in a situation which concerns a normal operating company, the real property of which cannot be disassociated from their economic activities. The ECJ ruled in *Immogolf* on 6 October 2010 that the Directive

does not preclude an EU country to charge duties with the aim to avoid tax evasion within the framework of transfers of securities which subjects these transactions to tax on capital transfers, as transfers of assets for consideration, provided that they represent part of the capital of companies in which at least 50% of the assets comprise immovable property and where the purchaser, as a result of that transfer, obtains a position which enables him to exercise control position over the entity, even though there is no intention of fraud or the company acquired carries on an economic activity and its real estate assets cannot be disassociated from its activity. However, the ECJ noted that EU countries must interpret the Directive in line with the EU's freedoms. As the latter was not the aim of this preliminary ruling, the ECJ stopped its analysis there.

Recently, the introduction of Real Estate Investment Trusts (REITs) in Finland has been authorised by the EC. A Finnish REIT regime will be introduced in order to encourage investment in affordable rental housing. Although these REITs will be exempted from Finnish corporate income tax, the EC is satisfied that the scheme does not involve state aid as any profits made by the REITs must be distributed immediately and will be subject to tax at shareholders' level. It is key that the Finnish REIT regime is so designed that the tax treatment of an investment in a REIT is put at par with the taxation of a direct investment by individuals in real estate. In other words, the Finnish REIT regime is fiscally neutral, which means that collective investments in real estate are not treated worse (nor better) than individual investments in real estate. This is encouraging news for current European REITs. Provided that the respective REIT-regimes are fiscally neutral, this case sheds new light on the state aid question.

Non-EU investors

Non-EU/EEA based investors in for instance the U.S. or Switzerland, may also file protective claims as EU rules prohibit restrictions on capital movements between EU and non-EU countries. In recent years this rule has been subject to numerous ECJ judgments such that it now seems that it applies to (potentially) all non-EU portfolio investors. The EC is of the opinion that non-EU investors have strong arguments and has started test cases against two EU member states in 2009.

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 EU direct tax law specialists who are able to determine the possibilities based on the actual facts and 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 dividends and interest payments.

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