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US Investment Funds May Be Entitled to Refunds of EU Tax Withholding on Dividends

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In a recent ruling, the European Court of Justice determined that France may no longer require 30% withholding on dividends paid to non-resident investment funds meeting the requirements of a UCIT because it does not withhold on such funds if they are domestic. The ruling does not limit its application to investment funds/UCITS resident in an EU country, and it has retroactive effect, which under French law allows refund claims for French withholding tax paid as of January 1, 2009 and later.

Background

The U.S. Internal Revenue Code requires that dividends paid to non-US equity holders are subject to a 30% withholding tax, even though for US holders there is generally no withholding on dividends. Many other countries have similar withholding requirements for dividends paid to foreign entities. Thus, for a US holder of a non-US corporation equity security, there may be foreign tax withholding (at various rates) on any dividends paid.

For US qualified pension plans, there are many treaties that protect the funds from this dividend withholding. For example, the US income tax treaties with Germany, Belgium, Switzerland, Sweden and the UK reduce withholding on dividends paid to US qualified plans to zero in most situations. However, for other plans and funds that do not have treaty protection, the withholding taxes can be very significant.[1] In addition, some treaties reduce the withholding on dividends to US pension plans, but not to zero: France is one of those countries.[2]

The European Court of Justice ("ECJ") recently handed down a decision calling into question the withholding rules for companies in EU countries (*Santander et al., May 10, 2012*), even if the holder of the equity is not a resident of an EU country.

[1] Withholding rates on dividends paid by Swedish corporations – 30%; Italian corporations are 20%, Irish corporations-- 20%; and The Netherlands – 15%. Note the United Kingdom does not withhold on dividends.

[2] France requires withholding on dividends at 30% (effective January 1, 2012)

The case was brought by a number of funds (including a US fund) against the French taxing authorities (other similar cases are pending in other EU jurisdictions). In the French case the ECJ determined that France may no longer require tax withholding on dividends paid to non-resident funds which are Undertakings for Collective Investment in Transferrable Securities ("UCITS") because it does not withhold on such funds if they are domestic, and therefore the withholding discriminates against non-resident investment funds/UCITS in violation of the EU Directive [principle] on the Free Movement of Capital.

The ECJ held that the French tax withholding rules on non-resident UCITS are contrary to EU Law[3]:

> Articles 63 TFEU and 65 TFEU must be interpreted as precluding the legislation of a Member State which provides for the taxation, by means of a withholding tax, of nationally-sourced dividends when they are received by undertakings for collective investments in transferable securities resident in another State, whereas such dividends are exempt from tax when received by undertakings for collective investments in transferable securities resident in the Member State in question.

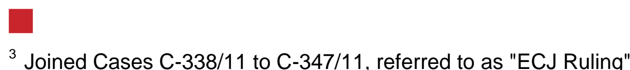
Further, although the French government argued to the contrary, the ECJ held that (i) the tax treatment of the investors does not need to be taken into account when comparing the tax treatment of French and non-French investors, (ii) the effect of this decision does not need to take into account the financial consequences which its judgment may have on France, and (iii) the judgment must be applied by the courts to "legal relationships which arose and were established" before the current judgment ruling, "provided the conditions for bringing a dispute relating to the application of that rule before the competent courts are satisfied." Thus, the ECJ Ruling has retroactive effect which under French law allows such claims for French withholding tax paid as of January 1, 2009 and later.

Application to US Investment and Pension Funds

One of the cases before the ECJ was on behalf of a US investment fund. The ECJ Ruling does not limit its application to investment funds/UCITS resident in an EU country. Thus, provided a US fund, including a pension fund, qualifies as a UCIT, then refunds of withholding taxes previously paid with respect to French-sourced dividends may be available. As indicated above, in general a UCIT is a collective investment vehicle investing in transferable securities, including open-ended investment companies and special investment companies.

Because of the significant financial effect the ECJ Ruling will have on French tax revenues, the French withholding rules may be changed to conform the tax treatment of resident and non-resident UCITs, eliminating the prohibitory discrimination found to exist by the ECJ. Thus, US investment funds and pension funds should consider making a claim as soon as reasonable.

We have investigated whether the ECJ Ruling or other EU rulings, tax laws and administration may provide an opportunity for making claims for refunds in other EU countries. For example, it appears that France, Italy, The Netherlands and Sweden would permit claims for refunds of prior withholding taxes. Because each EU country independently implements EU law, the same result may not be available in every country. However, the principle laid down in the ECJ Ruling should apply across the EU.



[3] Joined Cases C-338/11 to C-347/11, referred to as "ECJ Ruling"

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