K-A DEKA: DUTCH WITHHOLDING TAXES ON DIVIDENDS BEFORE THE CJEU AGAIN!

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Part I

Introduction

In *Köln-Aktienfonds Deka v Staatssecretaris van Financiën ("K-A Deka"),*[2] the Court of Justice of the European Union (CJEU) determined that Dutch withholding taxes on dividends paid to non-resident funds were incompatible with the freedom of establishment in situations where a refund of the withholding tax was granted to a resident fund that met certain legal conditions, namely that the proceeds of its investments were distributed in full to its shareholders or participants on an annual basis within eight months of the end of its financial year; whereas a non-resident fund was denied such a refund in situations where it did not distribute the proceeds of its investments, but such proceeds were deemed to have been distributed and taken into consideration for tax purposes as though that profit had been distributed.

The Court held that in such circumstances, the non-resident fund could be in a comparable situation to a resident fund, and thus entitled to no less favourable tax treatment. This was a matter for the national referring court to verify.

Background

K-A Deka is a German investment fund and is exempt from tax in Germany on its profits. It makes investments on behalf of individuals and its share price is listed on the German Stock Exchange, but its shares are traded via a separate system. From

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2 *Köln-Aktienfonds Deka v Staatssecretaris van Financiën ("K-A Deka"),* C-156/17, ECLI:EU:C:2020:51.

2002-2008, K-A Deka received dividends from companies established in the Netherlands. Tax was limited to 15% under the Netherlands-Germany double tax convention. This was withheld at source in the Netherlands. K-A Deka did not qualify for a repayment of that withholding tax since it was non-resident in the Netherlands and did not meet the Netherlands' qualification requirements. It submitted that this less favourable tax treatment was contrary to the free movement of capital contained in Article 63 TFEU. Consequently, a preliminary ruling was sought from the CJEU.

Restriction on the Free Movement of Capital

In determining whether a restriction on the free movement of capital existed, the CJEU highlighted, in paragraphs 42-44, that –

> "it is for each Member State to organise, in compliance with EU law, its system for taxing distributed profits and to define, in that context, the tax base and the tax rate which apply to the shareholder receiving them ...
>
> Member States are free to provide for, for the purposes of encouraging the use of collective investment undertakings, a specific tax regime applicable to those undertakings and to the dividends received by them, and to define the material and formal conditions which must be respected to benefit from such a regime ...
>
> it is inherent in the principle of the fiscal autonomy of Member States that they determine the evidence that must be provided to establish that the conditions in order to benefit from such a regime have been respected".

However, the Court stressed that the Member State must comply with EU law, in particular, the free movement of capital, when it exercises these taxing powers.

The Conditions for the Refund of the Withholding Tax

The Court noted, in paragraph 49, that –

> "the measures prohibited by Article 63(1) TFEU, as restrictions on the movement of capital, include those which are such as to discourage non-residents from making investments in a Member State or to discourage that Member State's residents from doing so in other States".

This was a mere expression of its settled case law. Therefore, the Court concluded, in paragraph 50, that it was necessary to verify whether the conditions laid down by a Member State for a fund to be able to reclaim the withholding tax on dividends paid to it by Netherlands' companies were –

> "likely to discourage a non-resident investment fund from making investments in that Member State. In the second place, it will be necessary to

> consider whether the evidence which must be provided for that purpose by non-resident investment funds discourages them from making investments in that Member State".

The Court noted that the conditions in question established shareholder participation thresholds which were not to be exceeded in order for the fund to qualify for the zero corporation tax rate and the right to a refund of the withholding taxes paid on dividends received from Netherlands' companies, so-called "Fiscal Investment Enterprise" or "FIE" status. The Court observed that these thresholds differed depending on whether the fund's shares were listed on the Amsterdam Stock Exchange.

The Court noted, in paragraph 54, that the Netherlands' rules –

> "did not distinguish between resident investment funds and non-resident investment funds, in that the conditions for the refund of dividend tax applied without distinction to those two types of fund".

In other words, the Court accepted that the Netherlands' rules were "even handed". However, the Court went on to point out, in paragraphs 55 and 56, that –

> "national legislation which applies without distinction to resident and non-resident operators may constitute a restriction on the free movement of capital. It follows from the Court's case-law that even a differentiation based on objective criteria may de facto disadvantage cross-border situations ...
>
> That is the case where national legislation which applies without distinction to resident and non-resident operators reserves a tax advantage in situations in which an operator complies with conditions or obligations which are, by their nature or in fact, specific to the national market, in such a way that only operators present on the national market are capable of complying with those conditions or obligations, and non-resident operators which are comparable do not generally comply with those conditions or obligations".

The Court pointed out the conditions for the funds whose shares were not listed on the Amsterdam Stock Exchange were stricter in nature. Therefore, it concluded, in paragraph 58, that it was a matter for the referring court –

> "to ascertain whether the condition relating to shareholders which was based on the listing of the shares or participations of the investment fund on the Amsterdam Stock Exchange could, by its nature or de facto, be met only by resident investment funds, whereas non-resident investment funds, whose shares and participations were listed not on the Amsterdam Stock Exchange but on another stock exchange, did not generally meet that condition".

Regarding the national rules applicable from 1 January 2007, the Court noted, in paragraph 59, that the shares of the fund –

> “must be admitted to trading on a market in financial instruments, as referred to in the Law on financial markets and their supervision. Under that legislation, the regime also applies to a fund or its manager which is authorised or exempt from authorisation under that law”.

Therefore, the Court concluded, in paragraph 60, that it was a matter for the national court to verify whether –

> “the conditions laid down by that legislation are not, by their nature or de facto, likely to be met only by resident investment funds and do not, de facto, exclude non-resident investment funds which meet similar conditions in their Member State of establishment from benefitting from that regime”.

Proof required of non-resident funds

With respect to the proof that was needed for a non-resident fund to meet the conditions for the withholding tax refund, the Court highlighted, in paragraph 61, that –

> “the tax authorities of a Member State are entitled to require the taxpayer to provide such proof as they may consider necessary in order to determine whether the conditions for a tax advantage provided for in the legislation at issue have been met and, consequently, whether to grant that advantage”.

However, the Court pointed out, in paragraph 62, that –

> “in order not to make it impossible or excessively difficult for a non-resident taxpayer to obtain a tax advantage, it cannot be required to produce documents which comply in all respects with the form and degree of detail of the documentary evidence laid down in the national legislation of the Member State conferring that advantage if the documents provided by that taxpayer do enable that Member State to ascertain, clearly and precisely, that the conditions for obtaining the tax advantage in question”.

The Court stressed that non-resident funds could not be subjected to excessive administrative burdens that make it impossible for them to benefit from the tax refund in question.

The Court indicated that K-A Deka was unable to meet the condition relating to shareholders because the share trading system chosen did not enable it to know its shareholders. This was not a problem for the Member State because it related to the choice of the share trading system. Consequently, the Court held, in paragraphs 66 and 67, that –

> “In so far as the evidential requirements at issue … also appear to be imposed on resident investment funds which have chosen a share trading system similar to that adopted by KA Deka … which it is for the national court to verify, the refusal to grant a non-resident investment fund a refund of the

> dividend tax which it has paid, on the ground that that investment fund has failed to establish sufficiently that it has met those conditions, does not constitute unfavourable treatment of a non-resident investment fund …
>
> Article 63 TFEU must be interpreted as not precluding legislation of a Member State which provides that a non-resident investment fund cannot be granted, on the ground that it has not provided proof that its shareholders or participants meet the conditions laid down by that legislation, a refund of dividend tax withheld on dividends which it has received from corporate bodies established in that Member State, provided that those conditions do not de facto disadvantage non-resident investment funds and provided that the tax authorities require proof of compliance with those conditions to be provided also by resident investment funds, which it is for the referring court to verify".

Redistribution Issue

On the final issue, the CJEU had to determine whether the German rules, that imposed tax on a deemed distribution of dividend income received, were comparable to an actual distribution requirement in the paying State.
The Court noted, in paragraphs 69 and 70, that –

> "the condition for the refund of dividend tax relating to the redistribution of a fund's profits is worded in general terms and does not distinguish between resident and non-resident investment funds. Both resident and non-resident investment funds must meet that condition in order to receive the refund of dividend tax paid …
>
> it must be ascertained whether, while being applicable without distinction, such a condition is likely to place non-resident investment funds at a de facto disadvantage".

The Court replied, in paragraph 73, that –

> "making the possibility of obtaining a refund of withholding tax subject to strict compliance with the conditions laid down by national legislation, irrespective of the legal conditions to which non-resident investment funds are subject in their State of establishment, would amount to reserving the possibility of benefiting from an advantageous treatment of dividends only to resident investment funds. Subject to verification by the referring court, resident investment funds would generally be likely to meet all the conditions laid down by the legislation of their State of establishment, whereas non-resident investment funds would generally be likely to meet only the conditions laid down by their Member State of establishment".

The Court pointed out that even though the non-resident fund in this situation could not meet the conditions imposed by the dividend paying-State's legislation, it might be still in a comparable situation to a resident fund that met those conditions.
Therefore, the Court concluded, in paragraph 75, that –

> "in order to ensure that the conditions laid down by the legislation of a Member State, while applying without distinction to resident and non-resident investment funds, do not de facto disadvantage non-resident investment funds, the latter must be able to prove that they are, in particular because of the regulatory framework in force in their State of establishment, in a situation that is comparable to that of resident investment funds meeting those conditions".

Comparability

The Court confirmed its settled case law that the comparability of a cross-border situation with a purely internal one must be analysed having regard to the aim pursued by the national legislation, as well as its purpose and content.
The Court noted, in paragraph 77, that –

> "the condition relating to the redistribution of profits is linked to the objective of the FIE regime, which is that the return on investments made by a private individual through an investment undertaking must be the same as the return on investments made individually through a direct investment … the national legislature considered it essential for investment undertakings to pass on the profits of investments as quickly as possible to the savers whose funds they have invested".

The Court also indicated that the obligation to redistribute profits triggered the application of profit tax. It concluded that it was a matter for the national court to determine the main objective underlying the condition for the redistribution of profits.

Objective of the national legislation

The Court highlighted two possibilities. First, if the objective of the national legislation was to ensure that the profits of the investment funds reached the investors as quickly as possible, then, the situations might not be comparable since one involved an actual distribution and the other involved a deemed distribution for tax purposes only. Therefore, the latter situation was not objectively comparable to the former situation.

Second, if the objective of the national legislation lies primarily in the taxation of profits, both situations are comparable, since a resident investment fund makes an actual distribution of its profits and a non-resident fund makes a deemed distribution of its profits which is also taxed. In such circumstances, comparability is established as the level of taxation is transferred from the investment fund to its shareholders.

In the latter situation, since comparability has been established, the two situations should be treated in a similar way. Therefore, the non-resident fund should receive a refund of its dividend withholding tax otherwise there was a restriction on the free movement of capital.

Justification in the general interest

The Court noted that the Netherlands government did not attempt to justify its rules any further.

The Court's Conclusion

Accordingly, the Court held that in situations where the non-resident fund was in a comparable situation to a resident one, there was a breach of Article 63 TFEU for it to be denied a refund of the withholding tax in question.

Part II

Analysis

The *K-A Deka* judgment is a significant judgment concerning the comparability of resident and non-resident investment funds that receive dividends from the Netherlands. It raises a number of questions concerning so-called "even-handed" rules that apply in the same way to resident and non-resident funds, but which impose conditions on the granting of a refund of withholding taxes on dividends that, de facto, only resident funds can meet.

The judgment also makes it clear that Member States are entitled to design their own tax regimes for investment funds, including the conditions required to benefit from any tax advantages and the evidence or proof required to demonstrate compliance with the conditions at issue. However, the Court stressed that such a regime must comply with EU law, in particular, in this case, with the free movement of capital contained in Article 63 TFEU. It also pointed out, in paragraphs 71 and 72, that fiscal neutrality is not guaranteed when a fundamental freedom, like the free movement of capital, is exercised.

The Court also highlighted that non-resident taxpayers must not be subjected to excessive administrative burdens that make it impossible to benefit from a tax advantage granted to resident investment funds. Therefore, the Court held that strict compliance with the provisions laid down by the Netherlands' legislation in this case, irrespective of the legal conditions that those non-resident funds are subject to in Germany, would amount to reserving the tax advantage in question only to resident

funds. In a situation where the non-resident investment fund was in a comparable situation to a resident fund, this denial of the tax advantage constituted a restriction on the free movement of capital.

Comparability of resident and non-resident investment funds

The Dutch legislation at issue in *K-A Deka* applied to resident and non-resident investment funds. In other words, they were "even-handed" rules like the rules seen in *CaixaBank,*[3] which involved a host Member State that had an "even-handed" rule, that applied in the same way to resident and non-resident banks operating in France.

CaixaBank

In *CaixaBank*, the Court determined that the rules in question constituted a restriction on the freedom of establishment because they represented a serious obstacle for banks established in other Member States to the pursuit of their activities in France via a subsidiary.

The Court explained, in paragraph 14, that –

> "Where credit institutions which are subsidiaries of foreign companies seek to enter the market of a Member State, competing by means of the rate of remuneration paid on sight accounts constitutes one of the most effective methods to that end. Access to the market by those establishments is thus made more difficult by such a prohibition".

Thus, the French rules at issue regarding the payment of interest on current accounts constituted a restriction on the freedom of establishment, even though they applied in a "even-handed" way to French banks as well as Spanish banks.

Biehl

The Court's earlier *Biehl* judgment [4] also dealt with an "even handed" Luxembourg rule, which provided that a taxpayer, who overpaid his taxes and left Luxembourg during the tax year, was unable to obtain a tax refund from the tax authorities. This rule applied to Luxembourg nationals and to nationals of other Member States who had come to work in Luxembourg.

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3 *CaixaBank France v Ministère de l'Économie, des Finances et de l'Industrie ("CaixaBank"),* C-442/02, ECLI:EU:C:2004:586.

4 *Klaus Biehl v Administration des contributions du grand-duché de Luxembourg ("Biehl"),* C-175/88, ECLI:EU:C:1990:186. See Tom O'Shea, *Understanding EU Tax 2020* (Avoir Fiscal Publications, London, 2020. ISBN 978-0-9559164-6-5), p19. Copies available from the author – email: tom@drtomoshea.com .

The Court accepted that this rule was not directly discriminatory. However, it pointed out, in paragraph 14, that –

> "there is a risk that it will work in particular against taxpayers who are nationals of other Member States. It is often such persons who will in the course of the year leave the country or take up residence there".

Consequently, the Court determined that the Luxembourg rule constituted indirect discrimination on grounds of nationality. Even though the rule at issue was an "even-handed" rule, it mainly affected foreigners who came to Luxembourg to obtain employment. Therefore, it breached the free movement of workers.

K-A Deka

The situation in *K-A Deka* was very similar. The Dutch rules applied to resident and non-resident investment funds, both were subject to the same conditions in order to obtain the withholding tax' refund, but non-resident funds had difficulties meeting these conditions and providing the necessary proof or evidence requested by the Dutch tax authorities that the necessary conditions for the grant of the refund had been met. The Court accepted that strict compliance with the conditions laid down by the Dutch legislation without taking into account the legal conditions that non-resident funds were subject to in Germany, would amount to reserving the benefit of the Dutch withholding tax refund rules to investment funds that were resident in the Netherlands.

Objective Comparability

But the hurdle of objective comparability still had to be jumped. In the *K-A Deka* situation, a non-resident investment fund was not necessarily in a comparable situation to that of a resident fund. This applied particularly to non-resident funds that did not distribute their profits to their shareholders or participants within the period specified in the Dutch rules. These non-resident funds were not comparable to resident funds, and thus, under the Dutch rules, were not entitled to the tax refund.

However, in the *K-A Deka* situation, under German law, the profits of German investment funds were deemed to be distributed, and tax was imposed on these deemed distributions of profits from the investment funds to their shareholders or participants. Accordingly, in certain situations the German investment funds could be in a comparable situation to a Netherlands' resident fund.

The Purpose of the National Rule

The Court applied its settled case law, in paragraph 76, where it stated that –

> "the comparability of a cross-border situation with an internal situation must be examined having regard to the aim pursued by the national provisions at issue, as well as the purpose and content of the latter".

The Court noted that the Netherlands' rules at issue, relating to redistribution of the profits of the fund to its shareholders or participants could have two different objectives. First, the purpose may be to ensure that the profits reach the investors as soon as possible. This meant that a non-resident investment fund that actually did not distribute profits to its members was not in a comparable situation to a resident investment fund that was under an obligation to redistribute. Second, the purpose could be mainly related to the taxation of profits made by shareholders in investment funds. In such a case, the fact that profits have not been distributed, but are merely deemed to be distributed for tax purposes (as in the *K-A Deka* situation), does not make the non-resident investment fund different for comparability-analysis purposes.

The Court explained, in paragraph 81, that –

> "if the objective pursued lies principally in the taxation of profits made by a shareholder in an investment fund, a resident investment fund which makes an actual distribution of its profits, and a non-resident investment fund whose profits are not distributed but are deemed to have been distributed and are taxed as such in respect of the shareholder in that fund, must be regarded as being in an objectively comparable situation. In both cases, the level of taxation is transferred from the investment fund to the shareholder".

The Court referred this matter back to the national court to verify whether that was the case in *K-A Deka*. The Court stressed that if the two situations were comparable then it would be a restriction on the free movement of capital to treat the non-resident investment fund less favourably. It also noted that the Netherlands did not submit any justifications for maintaining its legislation that was in breach of the free movement of capital in such circumstances.

The national court was also asked to determine, in paragraphs 58, 60 and 73, whether –

> "the condition relating to shareholders which was based on the listing of the shares or participations of the investment fund on the Amsterdam Stock Exchange could, by its nature or de facto, be met only by resident investment funds, whereas non-resident investment funds, whose shares and participations were listed not on the Amsterdam Stock Exchange but on another stock exchange, did not generally meet that condition …
>
> whether the conditions laid down by that legislation are not, by their nature or de facto, likely to be met only by resident investment funds and do not, de facto, exclude non-resident investment funds which meet similar conditions in their Member State of establishment from benefitting from that regime …
>
> making the possibility of obtaining a refund of withholding tax subject to strict compliance with the conditions laid down by national legislation, irrespective of the legal conditions to which non-resident investment funds are subject in their State of establishment, would amount to reserving the possibility of benefiting from an advantageous treatment of dividends only to

resident investment funds. Subject to verification by the referring court, resident investment funds would generally be likely to meet all the conditions laid down by the legislation of their State of establishment, whereas non-resident investment funds would generally be likely to meet only the conditions laid down by their Member State of establishment".

Final thoughts

French Digital Services Tax

K-A Deka is a significant judgment for the French digital services tax (DST)[5] which applies to resident and non-resident tech companies that meet certain criteria. These criteria are objective in nature and de facto apply to resident and non-resident companies in a non-discriminatory way. However, it is clear from *K-A Deka* and *Sofina* [6] cases that related tax advantages cannot be reserved for purely domestic operators to the disadvantage of cross-border situations when the cross-border situation is comparable to the purely domestic one. The French DST would be deductible for corporate income tax purposes in France but probably not deductible for non-resident companies. This tax advantage which is restricted to French companies may be in breach of EU law, in light of the above cases, where cross-border and purely domestic situations are in a comparable situation and should be treated in a similar way in relation to tax advantages because they are taxed in a similar way. This argument is worth investigating further in advance of the French DST taking effect.

5 For some information in English on the French DST – see: https://www.bdo.global/en-gb/microsites/tax-newsletters/world-wide-tax-news/issue-52-september-2019/france-digital-services-tax-introduced; https://home.kpmg/xx/en/home/insights/2019/03/tnf-france-draft-proposal-for-digital-services-tax.html ; https://www.ey.com/gl/en/services/tax/international-tax/alert--frances-parliamentary-commission-agrees-on-digital-services-tax ; https://www.pwc.com/us/en/tax-services/publications/insights/assets/pwc-its-france-dst.pdf .

6 *Sofina SA and Others v Ministre de l'Action et des Comptes publics ("Sofina"),* C-575/17, ECLI:EU:C:2018:943. For analysis of this case, see Tom O'Shea,