

Foreign investment funds can get Dutch dividend withholding tax refund, on strict terms

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The Dutch Supreme Court recently issued its ruling in the Köln Aktienfonds Deka (KA DEKA) case. Taking into account the ECJ's decisions in *KA DEKA* and *Fidelity Funds*, the Dutch Supreme Court – reversing its [2015 decision](#) – ruled that foreign investment funds qualifying as Undertakings for Collective Investment in Transferable Securities (UCITS) are in principle objectively comparable with Dutch resident Fiscal Investment Institutions (FIIs). This means that, based on the EU principle of free movement of capital, foreign investment funds may be eligible for a refund of Dutch withholding tax paid on dividends derived from investments in shares in Dutch companies. This is conditional on these funds meeting the shareholder and distribution requirements that apply to Dutch FIIs. In addition, the foreign funds must agree to make a “substitute payment” to the Dutch tax authorities (DTA) to qualify for an actual refund.

Although the ruling acknowledges foreign investment funds' right to a refund, it remains to be seen how many of them will be able to validate their claims in practice. Furthermore, it is not certain whether the requirements that must be met to actually qualify for the refund are compatible with EU law in all respects.

Background

This case began when KA DEKA claimed a refund from the DTA of Dutch dividend withholding tax – currently 15% – paid between 2002 and 2008 on dividends derived from investments in shares in Dutch companies. Dutch FIIs are eligible for a Dutch dividend withholding tax refund, whereas foreign investment funds are not. KA DEKA argued, based on it being comparable to an FFI, that this different treatment was contrary to the free movement of capital.

In 2017, the Dutch Supreme Court asked prejudicial questions to the ECJ about the FII legislation's compatibility with free movement of capital. While these questions were pending, the ECJ ruled in the *Fidelity Funds* case in 2018 that foreign and domestic investment funds cannot be deemed incomparable merely because foreign investment funds do not have to withhold dividend withholding tax in the jurisdiction from which they derive dividends (Denmark in the *Fidelity Funds* case). Per the *Fidelity Funds* case, a foreign investment fund cannot be denied a Dutch dividend withholding tax refund merely because that fund was not required to withhold this tax on any distributions it made.

As it could not be derived from the *Fidelity Funds* case whether foreign investment funds should comply with the FII requirements in order to be comparable to FIIs, the Dutch Supreme Court in the

KA DEKA case maintained its prejudicial questions to the ECJ on the compatibility of two particular requirements of the FFI regime with the principle of free movement of capital. These were the distribution requirement and the shareholder requirement (see our earlier article [here](#)).

Distribution requirement

An FII is required to distribute its profits within eight months after the end of its financial year. In response to the questions raised by the Dutch Supreme Court, the ECJ [ruled](#) on 30 January 2020 that the distribution requirement is incompatible with the free movement of capital if: (i) the distribution requirement's objective is to tax the FII's profits at the same level as the shareholders, and (ii) a foreign investment fund's profits are – irrespective of any actual distributions – taxed at the level of the shareholders.

Taking into account the ECJ's decision, the Dutch Supreme Court has now ruled that:

- the distribution requirement's objective is indeed to tax the FII's profits at the same level as the shareholders;
- a foreign investment fund complies with the distribution requirement when taxation at the level of the shareholders is based on a deemed profit distribution or inclusion in the shareholders' tax base otherwise; and
- whether the amount of the distribution is sufficient to conclude that the foreign investment fund in question complies with the distribution requirement, must be assessed on the basis of Dutch rules.

Shareholder requirement

In its answer to the Dutch Supreme Court, the ECJ held that this requirement does not discriminate because foreign investment funds and FIIs are subject to the same requirement, but that this requirement is only compatible with the free movement of capital if a foreign investment fund is *de facto* able to meet it.

The Dutch Supreme Court interpreted the ECJ decision by ruling that a foreign investment fund must meet the applicable shareholder requirement in order to be eligible for a refund of Dutch dividend withholding tax, as this requirement is not materially nor *de facto* applied in a restrictive manner. A requirement between 2002 and 2006 that shares be listed on the Amsterdam stock exchange was invalidated by the Supreme Court because it was too burdensome for foreign investment funds. With regard to this period, the Dutch Supreme Court ruled that foreign investment funds were not required to list their shares on the Amsterdam stock exchange if they also had a listing outside of the Netherlands.

Refund amount calculation

According to the Dutch Supreme Court, if a foreign investment fund complies with the distribution and shareholder requirements, it is eligible for a Dutch dividend withholding tax refund. However, the court has mandated that as a condition for the refund, foreign investment funds must be prepared to make a “substitute

payment”, in the form of a reduction of the Dutch dividend withholding tax refund. The practical effect of the substitute payment is that a foreign investment fund will only apply for a refund of Dutch dividend withholding tax if and insofar as the refund is higher than that payment. With the introduction of the substitute payment, the Dutch Supreme Court intends to maintain the internal cohesion of the Dutch tax system in a proportionate manner.

The amount of the substitute payment must be calculated as follows:

- First, determine the amount of Dutch dividend withholding tax that the foreign investment fund would have had to withhold on the distribution of all its distributable profits in the year of its refund request if the fund and its shareholders/participants that reside in the same country as the foreign investment fund, had been established/resident in the Netherlands (Amount A).
- Amount A minus foreign (that is, non-Dutch) withholding tax paid = the substitute payment.

Where the claim for a refund of Dutch dividend withholding tax exceeds the amount of the substitute payment, the DTA will refund the excess amount to the foreign investment fund.

Is this the end of the discussion?

The Dutch Supreme Court’s ruling in the KA DEKA case provides the approximately 7000 foreign investors in pending Dutch court cases with the answer to the question of whether they are objectively comparable to a Dutch FFI. In addition, these foreign investment funds may be eligible for a Dutch dividend withholding tax refund if they meet the shareholder requirement and they are not bound to the Dutch domestic distribution requirement. Instead, it is sufficient if their profits are deemed distributed or otherwise taxed at shareholder level.

To validate a claim for Dutch dividend withholding tax refund, however, foreign investment funds will have to calculate the substitute payment. This will lead to a significant administrative burden. If the substitute payment exceeds the refund claim, Dutch dividend withholding tax will effectively be non-refundable. In addition, in order to prove that it meets the distribution requirement, a foreign investment fund will have to determine whether the amount distributed or deemed distributed by it is sufficient under Dutch tax rules. A deficit in distribution will cause the foreign investment fund to fail the distribution requirement and, technically, not to be comparable to a FII.

The question is whether the requirements to (i) make a substitute payment, and (ii) comply with the distribution requirement as if the foreign investment fund were a resident in the Netherlands, meet the proportionality requirement under EU law. It is also possible that the substitute payment may cause double taxation as it is effectively a deduction from the Dutch dividend withholding tax refund. Finally, whether the method of calculating the substitute payment results in a proportionate measure is questionable. Some foreign investment funds among the 7000 pending cases before the Dutch courts may well try to challenge

these and other aspects of the Dutch Supreme Court ruling. In other words, the Dutch dividend withholding tax refund saga may not be over just yet.

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