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ATOZ TAX ALERT

Fidelity Funds vs the Danish Ministry – CJEU rules in favour of taxpayers

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Yesterday, the European Court ruled in favour of a Fidelity investment fund that had suffered Danish withholding tax at a higher rate than a comparable Danish investment fund. The ruling is of importance for all foreign funds investing in Denmark and also has implications for cases against other EU states, notably the Netherlands.

On 21 June 2018, the Court of Justice of the European Union ("**CJEU**") rendered its decision in the case of Fidelity Funds v. Skatteministeriet (Case C-480/16).

The case concerned the difference in tax treatment between the distribution of dividends from Danish companies to Danish resident undertakings for collective investment in transferable securities ("**UCITS**") and the same distribution to non-resident UCITS. The case involved portfolio investments that did not exceed 10% of the capital in a given company.

The preliminary question raised to the CJEU was:
"Is a tax regime, such as that in the main proceedings, under which non-Danish [UCITS] covered by Directive [85/611] ... are taxed at source on dividends from Danish companies, contrary to Article 56 EC (Article 63 TFEU) on free movement of capital or Article 49 EC (Article 56 TFEU) on freedom to provide services, where equivalent Danish [UCITS] can obtain an exemption for tax at source, either because they in fact make a minimum distribution to their members in return for retention of tax at source, or technically a minimum distribution is calculated, on which tax at source is retained in relation to the undertakings' members?"

Danish internal law provides that UCITS may be exempt from withholding tax on dividends distributed by Danish resident companies subject to two conditions being met:

i) The UCITS is resident in Denmark; and

ii) The UCITS has the status of Article 16C of the law on the assessment of income tax ("**Article 16C fund**"). In order to be an Article 16C fund, the fund would need to make/calculate a minimum distribution annually.

Following the conditions listed above, a non-resident UCITS would never be able to qualify for an exemption from withholding tax (condition i)). Therefore, it would be difficult for the condition ii) to be met as there would be no incentive to do so given that the non-resident UCITS would never be able to benefit from the exemption due to their residency status.

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The CJEU reconfirmed that the tax treatment of dividends received by UCITS falls primarily within the scope of the free movement of capital (Article 63 TFEU) and in a second instance within the freedom to provide services (Article 56 TFEU). However, the free movement of capital would prevail.

Article 63 TFEU prohibits measures that would discourage non-residents from investing in a Member State. In this case, the dividends paid out to non-resident UCITS are treated disadvantageously when compared to resident UCITS and therefore, this discrimination is prohibited as it restricts the free movement of capital.

The Danish Ministry tried to argue that due to the need to safeguard the coherence of the tax system and ensure a balanced allocation of power to tax between Member States, such discrimination would be justified. This would have been one of the few justifications for a discriminatory tax treatment.

The Danish Ministry further argued that the difference in tax treatment was justified by the direct link between the exemption from withholding tax on dividends paid to resident UCITS and the need to deduct Danish withholding tax on distributions paid out by the UCITS to its investors.

The CJEU refuted this argument on the grounds that levying withholding tax on distributions from Danish companies to non-resident UCITS and these UCITS levying withholding tax on the distributions made to their investors actually creates a series of charges to tax on the dividends paid ultimately to the UCITS investor, which is contrary to the objective of the Danish tax law (the objective being to avoid cascading layers of tax).

The CJEU further pointed out that that the Danish legislation went beyond what was necessary to ensure coherence of the tax system in Denmark. The law could have been deemed compliant with European law if a non-resident UCITS had been able to receive the exemption if it levied withholding tax on dividends paid out to its investors. However, this was not the case.

A suggestion had been made by the Advocate General in his opinion that in order to make a claim for refund, the foreign funds should have tried to satisfy condition ii) even if they had no way to satisfy condition i). However, this suggestion was not followed by the Court.

Conclusions

The Fidelity case reconfirms the fact that withholding tax on dividends paid to UCITS falls squarely within Article 63 TFEU.

For third-country funds (i.e. non-European funds), this clause is essential in order to be able to benefit from the non-discrimination clause as all other freedoms are only available to European member states.

The argument of the Danish Ministry that the link between withholding tax on portfolio dividends and the withholding tax on Danish UCITS justifies discrimination against foreign funds was roundly rejected.

We expect the cases at the Danish Eastern High Court to be processed and to apply this CJEU ruling to the pending cases. The Danish Eastern High Court's actions will then act as guidelines to the Danish lower courts.

The case also allows insight into the pending CJEU case in relation to Dutch withholding tax. The rebuttal of the argument that the non-resident fund has to levy Danish tax in order to benefit from the Danish withholding tax exemption bodes well for the Dutch case that is currently being pursued in the national courts as well as at the CJEU level.

Funds with investments in Denmark and the Netherlands that have suffered discriminatory withholding tax should review their situation and consider whether to make further claims.

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