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CJEU rules on Dutch dividend withholding tax cases

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The Court of Justice of the European Union (CJEU) issued its decision on 17 September 2015 in three joined cases involving the Dutch dividend withholding tax provisions. According to the CJEU, withholding tax imposed on a nonresident generally may not exceed the individual income tax burden imposed on a resident taxpayer. Where this is not achieved even after a tax credit has been granted by the residence state under the provisions of a "qualifying" tax treaty, it is the responsibility of the source state to ensure that the impact of the withholding tax is "neutralized." The CJEU largely follows the opinion of AG Jääskinen released on 25 June 2015 (for prior coverage, see the alert dated 29 June 2015).

The compatibility with EU law of dividend withholding tax levied by one EU member state on shareholders resident in another EU member state has been an ongoing issue for several years; specifically, whether such taxes infringe the freedom of establishment and free movement of capital provisions in the Treaty on the Functioning of the European Union. The CJEU has ruled in previous cases that a foreign shareholder cannot be subject to a heavier tax burden than a similarly situated domestic shareholder. The CJEU's decision in the three Dutch cases sheds more light on the appropriate comparison to be made between cross-border and domestic situations.

Background and facts

When a Dutch resident company distributes dividends to its individual and corporate portfolio shareholders, Dutch dividend withholding tax is due at a rate of 15%. When dividends are paid to nonresident shareholders, the tax is considered a final levy, whereas when dividends are paid to Dutch resident shareholders, the 15% withholding tax is neutralized because the shareholders can credit the tax against their individual or corporate income tax liability, as appropriate. This could lead to a more advantageous treatment of the dividend payment in domestic situations. The Dutch Supreme Court referred the three cases to the CJEU in 2013 for a preliminary ruling on whether the Dutch tax treatment infringes EU law.

Two of the cases before the CJEU involve the Dutch dividend withholding tax levied on individual shareholders in Dutch companies, and the third involves the withholding tax levied on a French bank. The facts of the cases can be summarized as follows:

- *Miljoen case* (C-10/14): The taxpayer, a Dutch national who resided in Belgium, received dividends from Dutch companies and was subject to the 15% withholding tax. The taxpayer claimed a refund for the portion of the withholding tax that exceeded the income tax he would have paid had he been resident in the Netherlands.
- *X case* (C-14/14): In a similar case, a Dutch national resident in Belgium also was subject to a 25% Belgian income tax on the net dividends. The Dutch withholding tax was not included in the Belgian income tax base; Belgium refused to credit the Dutch withholding tax against the taxpayer's Belgian income tax liability, based on the provisions of the Netherlands-Belgium tax treaty.
- *Société Générale* case (C-17/14): A French bank received dividends from a Dutch company and was subject to Dutch withholding tax. The bank was able to credit the Dutch withholding tax against its French corporate income tax; however, it was not able to do so in the last year at issue, because of a tax loss in France that year. Had the dividends been paid to a Dutch company, the 15% withholding tax still would have applied, but the Dutch recipient effectively would have been able to deduct related expenses, since the Dutch dividend withholding tax is only an advance levy of the Dutch corporate income tax. In contrast, the French bank incurred various costs (mainly hedging costs) in relation to its investments, but these were not taken into account in the Netherlands, since the Dutch withholding tax is levied on a gross basis.

CJEU decision

The CJEU ruled that a comparison should be made between the final 15% dividend withholding tax levied in a cross-border situation and the combined levy of dividend withholding tax and income tax in a domestic situation. According to the CJEU, the comparison should be made on an annual basis, taking into account the dividends in the fiscal year in which they are distributed and the tax-free allowance that would be available to a domestic taxpayer. Under this approach, the relevant domestic tax treatment would be taken into account, and Dutch law would be considered incompatible with EU law to the extent of any difference between the tax burden that would arise in a domestic situation and the burden resulting from the imposition of the 15% flat-rate dividend withholding tax.

An important point from the *Société Générale* case relates to the determination of the expenses to be considered for purposes of the comparison. It is settled case law that certain expenses, such as business expenses that are directly linked to an activity that has generated taxable income in an EU member state, must be taken into account in comparing the tax burden of companies. The CJEU now has clarified that, for income received in the form of dividends, such a link exists only if the expenses (which, in some circumstances, may be directly linked to a sum paid in connection with a securities transaction) are considered directly linked to the actual "collection/obtaining"[1] of the dividend income. It follows that only those expenses must be taken into account for the purposes of comparing the tax burden of companies. For example, financing costs concern ownership of the shares (on which dividends are paid) per se, so these costs would not be considered directly linked to the actual payment of the dividends arising from those shares.

Role of tax treaties

The CJEU also addressed the role of tax treaties, indicating that the elimination of double taxation, as provided for in an applicable tax treaty, possibly could justify the different treatment between cross-border and domestic situations in the Netherlands.

However, in respect of the X case, the CJEU ruled that, since Belgium unilaterally grants a set-off for the Dutch withholding tax, the Netherlands cannot rely on the Netherlands-Belgium tax treaty to claim that it has neutralized the restriction in question. In respect of the *Société Générale* case, the outcome was different because the set-off under the Netherlands-France tax treaty is not granted unilaterally. In this case, the Netherlands could rely on the elimination of double taxation under the treaty, but only if the full amount of the tax on dividends paid in the Netherlands actually has been neutralized in France. The Dutch Supreme Court must ascertain whether this occurred in the case.

Comments

The CJEU has clarified how to make the proper comparison between domestic and cross-border situations involving dividend withholding tax. Under the combined approach (taking both income tax and creditable withholding tax into account), whether discrimination exists is to be determined on a case-by-case basis.

In practice, this generally will involve comparing the Dutch withholding tax liability (15% on the gross dividend income) with the corporate/personal income tax liability had the nonresident been a resident of the Netherlands. To the extent the withholding tax liability is higher, a nonresident will be eligible for a refund. As a result, numerous nonresident individuals may be eligible for a refund of Dutch dividend withholding tax. For nonresident companies, the result will be less straightforward, because the scope of costs that may be taken into account for companies is limited (only costs that are directly linked to the "collection/obtaining" of the dividend income).

The joined cases are relevant for individuals and companies that have filed similar challenges and protective claims in the Netherlands. The *Société Générale* also is important for companies that have filed such requests in other EU member states. Many banks and insurance companies already have filed protective claims to preserve their possible dividend withholding tax refund rights at a pan-European level. The key question for these pending claims is: which costs must be taken into account by the source state for comparison purposes? The CJEU's interpretation in the *Société Générale* case seems more restrictive in terms of the costs that may be taken into account as compared to its 2010 decision in *Commission v. Finland* (case C-342/10). Additional clarification on this matter is expected in response to a case in which the European Commission has initiated an infringement procedure against the Netherlands. According to the Commission, the Netherlands should allow EU/EEA-based insurance companies operating a unit-linked business to be taxed on a net basis, resulting in a full refund of the underlying dividend withholding tax.

Parties that are considering whether to file EU withholding tax claims should be aware that claims generally may cover several past years and that, in many EU member states, one claim year will expire if no protective claim is filed on or before 31 December 2015. In addition to withholding tax refunds, an award of related interest may be available.

[1] The official CJEU translation is “payment,” but we believe that the wording above (“collecting/obtaining”) better reflects the meaning of the word used in the leading Dutch version of the decision.