

Operational Tax News

Denmark – Decision of the ECJ on the taxation of dividends paid to non-residents UCITS

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On 21 June 2018, the Court of Justice of the European Union (ECJ) issued a decision in the case *Fidelity Funds v. Denmark*, C-480/16 (intervener : NN (L) SICAV).

Under the legislation at issue in the main proceedings (the “Danish Legislation”), the dividends distributed by companies resident in Denmark to a non-resident UCITS are subject to withholding tax. However, a UCITS resident in Denmark may be eligible for an exemption from withholding tax on those dividends if it makes a minimum distribution to its members, or technically calculates a minimum distribution, and withholds on that actual or notional minimum distribution the tax payable by its members.

By its question, the referring court asked whether Article 56 and 63 TFUE must be interpreted as precluding legislation of a member state, such as the Danish Legislation.

According to the ECJ, by levying a withholding tax on dividends paid to non-resident UCITS and giving only resident UCITS the possibility of obtaining exemption from the tax, the Danish Legislation results in the dividends paid to non-residents being treated disadvantageously.

Therefore, the Danish Legislation constitutes a restriction on the free movement of capital as such disadvantageous treatment may discourage, on the one hand, non-resident UCITS from investing in Danish companies and, on the other hand, investors resident in Denmark from acquiring shares in non-resident UCITS.

The Danish and the Netherlands governments consider that the restriction on the free movement of capital is justified by:

- 1/The need to preserve the balanced allocation of power to impose tax between Member states
 - According to those governments, excluding non-resident UCITS from the exemption at issue in the main proceedings ensures a balanced allocation of power to impose taxes according to the fact that Denmark does not collect taxes more than once on dividends distributed to non-resident UCITS, and that, the transfer of the tax

2/The need to preserve the coherence of the Danish tax system

- According to those governments, there is a direct link between the exemption from withholding tax as regards dividends paid to resident UCITS and the obligation of those UCITS to deduct withholding tax on dividends that they distribute to their members

According to ECJ, although the Danish legislation is intended to move the level of taxation from the investment vehicle to the shareholder, the restriction resulting from the application of this legislation cannot be justified by the need to preserve the allocation of the power to impose tax between member states, neither by the need to safeguard the coherence of the tax system.

In light of the foregoing, the answer to the question referred is that Article 63 TFEU must be interpreted as precluding legislation such as the Danish Legislation.

Practical implications

The ECJ decision is favorable to non-Danish investment funds as it implies that under certain conditions non-Danish funds would be eligible for an exemption from withholding tax on Danish dividends. Funds that have already suffered Danish withholding tax should be in a position to reclaim excess withholding tax. The practical requirements for the application of the exemption or filing of the reclaims are not known at this stage. We recommend to closely monitor further developments in this respect.

It is worth noting that the decision in the Fidelity Funds case may also have indirect implications for funds investing in Dutch equities and suffering Dutch withholding tax on dividends. The Netherlands applies a taxation mechanism that is somewhat similar to the Danish one. As a result, the ECJ decision in the Fidelity Funds case could potentially be relied on for any future litigations involving Dutch withholding tax.

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