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Investment Management Tax Alerts

EU Reclaims

The DFA case decision released, positively impacting U.S. and other non-EU resident funds pursuing EU withholding tax claims

On April 10, 2014, the Court of Justice of the European Union (the "CJEU") released its much anticipated decision in the *Emerging Markets Series of DFA Investment Trust Company v. Dyrektor Izby Skarbowej w Bydgoszczy* (C-190/12). This is a landmark case which could make it easier for non-EU investment funds to recover significant levels of withholding taxes (WHT) from EU member states.

The CJEU's decision

The Court decided that U.S. funds (and other funds outside of the EU in a similar position) are entitled to rely on the free movement of capital principles in the EU. It confirmed that the higher tax charge on Polish dividends paid to a U.S. investment fund, DFA, as compared to the tax on Polish dividends paid to a similarly situated Polish fund constitutes a restriction on the free movement of capital. This decision is based upon the recipient funds being comparable.

This case follows other similar rulings in regards to EU resident investment funds in recent years, as a result of which many have now received significant refunds of WHT from a number of EU member states.

The CJEU confirmed that there is no justification for the restriction on the movement of capital imposed by the Polish rules, including the defense of fiscal supervision, in a case such as this where an exchange of information agreement exists in the tax treaty between the states. The Court found that as information exchange provisions in the undertakings for the collective investment of transferable securities (UCITS) Directive to which some EU funds are subject are not capable of applying to non-EU funds; that those powers do not cover taxation anyway, qualifying under the UCITS Directive is irrelevant for fiscal supervision purposes.

Comparability

Regarding whether a Polish and U.S. fund are comparable and whether the U.S. fund should now recover the WHT claimed, the Court stated that it was up to the Polish courts to decide on the facts and assess and verify the evidence provided. The Polish courts should consider the relevant legal and regulatory framework under which the funds are established in each country in order to determine whether the U.S. funds do meet the conditions for the Polish tax exemption.

Therefore, the case will in all probability be decided on whether the Polish authorities are provided with the evidence to support comparability of the legal and regulatory framework by the claimant and whether they have the ability to verify the facts and evidence provided with the U.S. tax authorities. The Court held that it was up to the Polish courts to test whether the provisions for exchange of information in the U.S.-Poland tax treaty are capable of allowing the appropriate verifications to take place on the evidence provided.

This is important as it means that it is up to claimants to provide what evidence they can demonstrate to prove comparability between funds, in addition to the cooperation of the tax authorities in the state of residence of the claimant fund.

In Deloitte's view, *DFA*'s status as a highly regulated investment fund in the U.S. should be favorable in this analysis as such funds would seem to have aims and objectives in line with regulated funds established in the EU. In addition it will be important that the Internal Revenue Service ("IRS") provides sufficient response to questions raised by the Polish authorities under the tax treaty provisions. Without dual cooperation the claims may not succeed. The case indicates that the IRS has already received requests for information to support the claims from the Polish tax authorities.

The case will now return to the Polish courts for a finding on the facts with the door for the success of the claims based on that factual assessment having been left open by the CJEU decision.

Recommended actions

The ruling may be relevant for similar cases proceeding against a number of member states at present:

- U.S. mutual funds and other collective investment funds, in the U.S. or in another territory outside of the EU, that have incurred WHT on EU dividend income in recent years should consider whether they may now have a claim for a refund of such taxes over and above their tax treaty entitlements;

- Investment funds outside of the EU that have already filed similar claims based on EU law should consider the levels of evidence needed to prove comparability to funds based in the source state and whether existing claims made contain sufficient detail, whether in Poland, or in any other member state where claims have been filed. This evidence is likely to be key in the assessment of claims.

For claims to succeed it will be important to show that local authorities will be able to cooperate and respond to questions raised through the administrative assistance criteria as set out in the relevant tax treaties, or other administrative assistance mechanisms. In this regard, the drive for increased transparency and cooperation between tax authorities globally, at present, should be helpful.

Conclusion

This is certainly not the end of the road for the case as it has been remanded to the Polish courts. In essence, the CJEU has stated that if a U.S. fund can prove comparability in that the legal and regulatory framework for U.S. funds is equivalent to that for Polish funds that obtain an exemption from WHT, and that proof can be sufficiently verified with U.S. authorities under administrative assistance provisions in the U.S.-Poland tax treaty, then the case should succeed.

It will be interesting to see now what the Polish courts determine with respect to the burden of proof and what cooperation is requested and received via the exchange of information provisions in the treaty.

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