DUTCH LOWER COURT REQUESTS DUTCH SUPREME COURT TO RECONSIDER ITS VERDICT OF 10 JULY 2015 ("*SICAV* CASE")

Taxand Netherlands
17 August 2016

On 10 July 2015, the Dutch Supreme Court rendered an important verdict as regards the comparability of foreign investment companies with Dutch fiscal investment companies ("*fiscale beleggingsinstellingen*, or **fbi's**"). In short, the Supreme Court held that a Dutch dividend withholding tax obligation is one of the key conditions for foreign investment companies to be comparable to Dutch fbi's. The verdict has been widely criticized throughout the industry. Despite the negative Supreme Court verdict, we have continued to argue that a Dutch withholding tax obligation is not relevant for comparing a foreign investment fund to a Dutch fbi. Foreign funds seldom have a Dutch dividend withholding tax obligation, but, in our view, can still be objectively comparable to Dutch fbi's.

On 1 August 2016, the Dutch lower court has responded to the discussions in literature and has requested the Dutch Supreme Court for a preliminary ruling, reconsidering, or at least clarifying, its verdict in the *SICAV* case.

In this Tax Alert, we will first briefly outline the background of the discussions related to recovering Dutch dividend withholding tax by foreign investment funds (paragraph 1). Subsequently, we will summarize the verdict of 10 July 2015 (paragraph 2). Thirdly, we will discuss the developments that ultimately led to the request for a preliminary ruling. In this respect, we will also briefly discuss the ECJ ruling in the *Miljoen* case (paragraph 3). Next, we will discuss the two cases in which the Dutch lower court requested the Dutch Supreme Court for a preliminary ruling (paragraph 4) and we will conclude with our Taxand's Take, highlighting the potential impact of the preliminary rulings for cases that are still pending (paragraph 5). We will focus in particular on the impact for US regulated investment companies ("RICs").

1. Background

Tax wise, investing through an investment company is only beneficial if such investment does not trigger additional taxation compared to a direct investment. Under the Dutch tax framework, special tax rules have been incorporated to ensure that investments through a Dutch fbi can be made in a tax neutral way (i.e. with no additional tax burden by interposing an investment company).

Foreign investment companies, however, are not able to benefit from these special tax rules. Consequently, they are not able to provide their investors the same return on investment as Dutch fbi's.

Over the past years, thousands of refund requests have been filed by foreign investment companies claiming that they should receive the same beneficial tax treatment as Dutch fbi's for their Dutch investments.

These claims are based on article 63 TFEU (free movement of capital). For a successful article 63 TFEU claim, one of the key elements is that the foreign investment company is objectively comparable to a Dutch investment company. In the *SICAV* case and the cases pending before the Dutch lower court, the objective comparability is the key item for discussion between the taxpayer and the tax administration.

Groupement d'intérêt économique - RCS : C 68
1B, Heienhaff - L – 1736 Senningerberg (Luxembourg)
Banque et Caisse d'Epargne de l'Etat, Luxembourg
IBAN LU49 0019 2855 1871 6000, BIC : BCEELULL
VAT identification : LU 220 135 38

2. Summary of the *SICAV* case

In the *SICAV* case, a Luxembourg SICAV requested a refund of Dutch dividend tax arguing that it was comparable with a Dutch fbi. In its verdict of 10 July 2015, the Supreme Court, however, held that the Luxembourg SICAV was not comparable to a Dutch fbi.

The Supreme Court's main argument was that the Luxembourg SICAV was not obligated to withhold Dutch dividend tax on distributions to its shareholders, whereas a Dutch fbi is obligated to do so. The Supreme Court considered this a major difference between the Luxembourg SICAV and a Dutch fbi and concluded that the two were not objectively comparable. As a result, the refund was denied to the Luxembourg fund.

Albeit one not shared by us, the main conclusion that may be drawn from this verdict is that the dividend withholding tax obligation is one of the key conditions for foreign investment companies to be comparable to Dutch fbi's.

3. Criticism on the *SICAV* case

Foreign investment companies will, in principle, not withhold Dutch dividend tax on distributions to their shareholders. The Supreme Court verdict in the *SICAV* case causes foreign investment funds to be unable to meet the criteria for objective comparability as set by the Supreme Court. Consequently, foreign investment funds would not be able to invoke their rights under article 63 TFEU.

Not surprisingly, the *SICAV* verdict has led to a lot of discussion in Dutch literature. Complaints have been filed with the European Commission and the *SICAV* verdict was challenged even further after the ECJ ruling in the joint cases *Miljoen*, *X* and *Société Générale* (17 September 2015).

In the *Miljoen* case, a refund was claimed by foreign investors who directly held shares in Dutch companies. The foreign investors were subject to a 15% Dutch dividend tax on dividend distributions stemming from their Dutch shareholdings.

The key question in the *Miljoen* case was whether foreign investors could also offset the Dutch dividend tax, as Dutch resident investors would have been able to do by fully offsetting it against their personal income tax or corporate tax due. In the event that the dividend tax withheld exceeds the personal of corporate tax ultimately due, a Dutch resident investor is eligible for a refund.

The ECJ held that a comparison should be made between the ultimate tax burden on the dividends suffered by Dutch resident investors and by non-resident investors. According to the ECJ, this effectively meant that the Dutch dividend tax liability for the foreign investors should be compared to the ultimate personal or corporate tax liability for resident investors. In the event that the ultimate income tax position for a Dutch resident investor would be lower than the dividend tax withheld from a foreign investor, the foreign investor should receive a refund amounting to the difference.

4. Requests for a preliminary ruling

4.1. Dividend withholding tax obligation

Although the *Miljoen* case concerned a direct investment and the *SICAV* case concerned an investment through an investment company, many discussions arose in Dutch literature on whether the *SICAV* case was overruled by the more recent ECJ verdict in the *Miljoen* case.

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In the two cases for which the Dutch lower court requested the Supreme Court for a preliminary ruling, a German and a UK investment company had requested for a refund of Dutch dividend tax, arguing that they should receive the same beneficial tax treatment as Dutch fbi's. Both the German and the UK investment fund did not meet the condition set by the Supreme Court in the *SICAV* case – the German and UK fund did not withhold Dutch dividend tax on their dividend distributions.

In response to the increasing number of cases brought before court – even after the *SICAV* verdict – and the discussions in literature about the *SICAV* case, the Dutch lower court decided to request the Supreme Court for a preliminary ruling.

The Dutch lower court requested the Supreme Court to reconsider, or at least clarify, its verdict in the *SICAV* case. In particular, the Dutch lower court requested the Supreme Court to address how the *SICAV* verdict relates to the more recent ECJ verdict in the *Miljoen* case.

For the situation where the Supreme Court decides to maintain its verdict in the *SICAV* case, the court requested the Supreme Court to clarify whether the *SICAV* verdict would then also be applicable in the event where Dutch investors (rather than foreign investors) invest through a foreign investment fund in Dutch companies.

4.2. Other criteria for the comparability

The Dutch lower court also addressed a few other criteria as regards the comparability to Dutch fbi's.

In the case of the German fund, the Dutch lower court requested the Dutch Supreme Court to clarify how the redistribution requirement that applies to Dutch fbi's should be considered when determining whether a foreign investment company is objectively comparable with a Dutch fbi. In particular, the Dutch lower court requested the Supreme Court to clarify whether the redistribution requirement will be met if the foreign fund has a legal obligation or a statutory obligation to redistribute its income. The court also requested whether it would be sufficient if the fund *de facto* redistributed its income (without the existence of a legal or statutory obligation).

Furthermore, the lower court requested the Dutch Supreme Court to advise what evidence should be provided for the so-called shareholders requirement that applies to Dutch fbi's. The court, in particular, requested the Supreme Court to clarify if a fund is automatically non-comparable to a Dutch fbi when it is unable to provide evidence that it meets the shareholders requirement.

5. Taxand's Take

Please find below Taxand's Take. We have in particular focused on the impact of the requests for preliminary rulings for US RICs.

- Although initially it seemed that the chances of success for foreign investment companies to obtain a refund based on article 63 TFEU had been significantly reduced as a result of the *SICAV* case, the recent developments are backing our initial response to the *SICAV* verdict. As we have argued over the past year, the *SICAV* verdict should not create an obstacle for RICs arguing comparability with a Dutch fbi. The recent developments also show that even a negative Supreme Court verdict did in fact not stop most of the foreign investment funds in pursuing their claims – especially funds with material claims. The number of "fbi" claims brought before court is still increasing, despite the fact that (presumably) none of the foreign funds met the criterion set by the Supreme Court in its verdict in the *SICAV* case.

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- Regardless of the many discussions about the SICAV verdict, the Dutch tax administration continues to reject claims on the basis that the foreign funds do not meet the criterion set by the Supreme Court in the *SICAV* case. Considering the potential withdrawal / amendment of the *SICAV* verdict, we recommend to object against the decision of the Dutch tax administration to secure your rights. We would of course be happy to assist you in securing your rights.

- The lower court has, in principle, been reluctant to stay all related proceedings until a few selected test cases have been fully litigated (some proceedings have been stayed, but the majority will need to be litigated). Pending the request for a preliminary ruling, the lower court may however stay more proceedings. With these new developments and potential withdrawal / amendment of the *SICAV* verdict, we recommend to closely monitor the progress and make sure that all rights are secured (e.g. by filing a timely appeal, etc.). Please note that procedures that are stayed pending the preliminary requests will need to be substantiated at a later stage.

- For RICs, we are of the view that the *SICAV* verdict is the main obstacle to successfully argue that a US RIC and Dutch fbi are objectively comparable. Based on our experience, US RICs have a very strong technical position as regards some of the other requirements (e.g. re-distribution requirement, equal profit distribution requirement, etc.) since the Dutch and US frameworks are very similar (if not almost identical). If the *SICAV* verdict were to be withdrawn, we feel that the chances of success for US RICs will significantly increase. Of course, once the objective comparability between a RIC and an fbi has been established, other hurdles (based on the EU framework) will still need to be passed before a RIC can obtain its refund. We recommend to closely monitor the developments in this respect and make sure that your rights are secured.

- We would like to point out that even if the Dutch Supreme Court considers that the *Miljoen* verdict of the ECJ does not overrule its verdict in the *SICAV* case, this does not necessarily close the door on objective comparability. In other words, we feel that for specific situations other arguments than the *Miljoen* case may also result in a (partial) withdrawal of the *SICAV* case. Please feel free to reach out in case you would like to further discuss your options.

- For US RICs, we furthermore feel that the preliminary questions about the redistribution requirement are less relevant, since most of the US RICs will both legally and *de facto* meet the Dutch requirements as a result of applying the RIC regime.

- As regards the question considering the shareholders requirement, we again feel that the specific position of RICs should be considered. In particular, the shareholder disclosure requirements and the strict regulatory oversight by the SEC should be taken into account. Since the question to the Supreme Court is very general, a negative outcome may be disregarded for RICs specifically, e.g. by requesting additional preliminary questions that are more tailored for RICs.

- There is a possibility that the Dutch Supreme Court will not address the request from the lower court directly, but instead request for a preliminary ruling with the ECJ. We will of course keep you updated on the process.

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Should you have any further questions, we would be happy to assist you. For more information, please contact:

Gertjan Hesselberth

E: Gertjan.Hesselberth@taxand.nl

T: +31 20 435 64 16

Marlot Witjes

E: Marlot.Witjes@taxand.nl

T: +31 20 435 64 01

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