

MEMO# 28035

April 14, 2014

EU Court of Justice Rules in Favor of US Fund in Tax Reclaims Case

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TO: TAX MEMBERS No. 8-14

INTERNATIONAL MEMBERS No. 12-14

ICI GLOBAL TAX COMMITTEE No. 7-14 RE: EU COURT OF JUSTICE RULES IN FAVOR OF US FUND IN TAX RECLAIMS CASE

Overview

On 10 April 2014 the Court of Justice of the European Union (the “ECJ”) ruled in DFA Emerging Markets [\[1\]](#) that an EU member state may not prevent a fund domiciled in a non-EU state from receiving the benefits of a tax exemption on dividends that is available to local funds and other EU funds provided that the EU member state and non-EU state have in place a bilateral agreement providing for mutual administrative assistance.; Where a mutual administrative assistance procedure exists, such disparate treatment of dividends received by a non-EU investment fund would constitute an impermissible restriction on the freedom of movement of capital under Article 63 of the Treaty on the Functioning of the European Union.

The case, which originated in Poland, was referred back to the Polish courts to determine whether or not the mutual administrative assistance provision of Poland’s tax treaty with the U.S. is capable of providing the Polish tax authorities with information sufficient to determine that the non-EU fund is operated within a regulatory framework equivalent to that of the EU.

Background and Analysis

The European Court of Justice decision in Santander [\[2\]](#) addressed France’s taxation of dividends paid to non-French funds and found that such taxation violated the principle requiring free movement of capital so long as the funds are “objectively comparable.” Since that ruling, U.S. funds seeking tax reclaims for withheld taxes have faced inquiries from EU member states’ tax authorities regarding the comparability of U.S. funds and local country funds. EU member states generally have been unwilling to acknowledge that U.S. funds are comparable to the relevant local country funds and, in fact, have asserted numerous

possible distinctions between U.S. and local funds.

In DFA Emerging Markets, the ECJ has addressed the issue of the objective comparability of non-EU funds. The ECJ rejected the contention that non-EU resident funds are automatically not objectively comparable because they are not subject to regulation under the UCITS directive. The court's ruling states that following such an approach would "deprive the principle of free movement of capital of any practical effect." A comparison of the regulatory framework governing a specific non-EU fund and the uniform framework governing UCITS-compliant funds "is of no relevance." The court concluded that where a member state's tax legislation adopts "as the main distinguishing criterion the place of residence of investments funds, according to which criterion tax is or is not deducted at source on dividends paid to them by Polish companies, non-resident investment funds are in a situation which is objectively comparable to that of investments funds whose registered office is situated in Poland."

The Need for Mutual Administrative Assistance

The ECJ also allowed that there is a need to allow Poland to verify information and evidence submitted by a non-EU fund, in order to exercise effective fiscal supervision. The court concluded that this requirement is met where an EU member state and a non-member state "are bound by an obligation under a convention on mutual administrative assistance which enables the national tax authorities to verify any information which may be transmitted by the investment fund." The ECJ stated that the information exchange agreements in place between Poland and the U.S.—contained in Article 23 of the U.S.-Poland tax treaty [\[3\]](#)—may provide the necessary mutual assistance mechanism.

However, the ECJ referred the case back to the lower Polish court to determine whether or not this agreement does in fact enable Poland to verify the information provided by a U.S. fund regarding their formation and operation.

The ICI has worked with members to develop responses to information document requests (IDRs) that U.S. members have received from the IRS. These IDRs relate to requests from Poland for information regarding U.S. members that are seeking tax reclaims in Poland. The ECJ noted that the U.S. has responded to the Polish requests.

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endnotes

[\[1\]](#) Cited in full as C-190/12 Emerging Markets Series of DFA Investment Trust Company (10 April 2014).

[\[2\]](#) See Institute Memorandum [#26165](#), dated May 18, 2012.

[\[3\]](#) The Convention between the Government of the Republic of Poland and the Government of the United States of America for the avoidance of double taxation and to prevent tax evasion.

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