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## Update on European Union Withholding Taxes—Recent Successes in Sweden and Finland for U.S. RICs

**As this article explains, an evolving area of European Union (“EU”) tax law could allow U.S. mutual funds to claim tax refunds from EU member countries. U.S. mutual funds should be aware of the possibility of obtaining these refunds, and the U.S. foreign tax credit ramifications of doing so.**

Responding to recent favorable European court decisions, U.S. investment funds (e.g., U.S. open-end funds or U.S. closed-end funds, also referred to as “regulated investment companies” or “RICs”) have filed withholding tax reclaims (commonly referred to as “Fokus Bank claims”<sup>1</sup>) seeking to recover tax withheld by EU Member States on dividends paid by EU resident companies in breach of EU law. This article outlines the basis of Fokus Bank claims for U.S. RICs and discusses recent positive decisions in Sweden and Finland relating to Fokus Bank claims filed by U.S. RICs. It also provides details on *Emerging Market Series*, the groundbreaking decision in which the Court of Justice of the European Union (“CJEU”) conclusively confirmed that under EU law, EU “Member States” cannot discriminate against third country investment funds, including U.S. RICs.

For completeness, Fokus Bank claims differ from the withholding tax relief provided under the U.S. income tax treaty network to U.S. RICs, either before (i.e., “at source”) or after the payment of a dividend. For example, if a U.S. RIC is entitled to a dividend payment of 100 from a French resident company, France may withhold tax at a 25 percent statutory rate when the dividend is paid. Under the U.S.-France Income Tax Treaty, the withholding

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<sup>1</sup> The first case to address discriminatory EU withholding taxes imposed on dividends paid by EU issuers to non-residents was the 2004 *Fokus Bank* case decided by the European Free Trade Association (“EFTA”) Court (Case E-1/04 Fokus Bank ASA v. Norway, EFTA Court Report 11, Nov. 23, 2004).

tax rate is reduced to 15 percent.<sup>2</sup> Therefore, under the U.S.-France Income Tax Treaty, a withholding tax claim will be filed on behalf of the U.S. RIC for the 10 percent difference between the 25 percent statutory withholding rate and the 15 percent applicable treaty rate. However, a claim will not be filed for the 15 percent withholding tax permitted under the U.S.-France Income Tax Treaty. As discussed below, it is this 15 percent withholding tax which, if withheld by France in breach of EU law, may be recovered by a U.S. RIC through a Fokus Bank claim.

### Basis for Fokus Bank Claims under EU Law

Dividend withholding taxes imposed on dividends paid by companies resident in EU Member States to non-resident shareholders must comply with the non-discrimination, freedom of establishment, and free movement of capital rules in the Treaty on the Functioning of the European Union (“TFEU”).<sup>3</sup> Article 18 of the TFEU provides that “any discrimination on grounds of nationality shall be prohibited.” Article 63 prohibits all restrictions on the movement of capital or payments between Member States and between Member States and third countries.<sup>4</sup> Article 63 is the only provision of the TFEU that by its terms may apply to payments to residents of non-Member States, and thus, provides a basis for challenging a withholding tax imposed by a Member State on a dividend paid by a company resident in a Member State to a U.S. RIC.

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<sup>2</sup> Convention between the United States of America and the Government of the French Republic for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital (1994), as amended by the 2009 Protocol, Article 10(2)(b).

<sup>3</sup> TFEU Articles 18, 49, and 63 (previously Articles 12, 43, and 56 respectively of the Treaty establishing the European Community, also referred to as the “EC Treaty”). For the purposes of this article, we will not discuss Article 49, freedom of establishment.

<sup>4</sup> Article 64 (previously 57 in the EC Treaty) restricts the applicability of Article 63 in situations when the law in question was enacted prior to December 31, 1993, and involves “direct investments.” A “direct investment is not defined in the TFEU, but case law from the CJEU indicates that, for the purposes of Article 64, direct investments are defined as investments which an investor holds with a view of establishing lasting and direct economic links and investments in respect of which the investor is able to effectively participate in the management of the company invested in. See, for example, Case C-446/04 Test Claimants of the FII Group Litigation v Commissioners of Inland Revenue or Case C-436/08 Haribo Lakritzen Hans Riegel BetriebsgmbH v Finanzamt Linz. This position is also supported by Annex I to the EU Directive 88/361. As such, it can be concluded that a portfolio investment by a U.S. RIC does not constitute a direct investment within the meaning of Article 64.

When applying the Article 63 restriction, European courts, including the CJEU, have ruled that absent appropriate justifications, EU Member States are not permitted to impose a higher level of taxation on non-resident investors, including investors resident in other EU Member States or third countries (such as the United States), than on “objectively comparable” resident investors.<sup>5</sup>

## Recent Developments

### *Emerging Market Series Case*

In May 2012, the CJEU issued its decision in the *Santander* case, holding that the French withholding tax rules operate in breach of EU law when dividends paid by French resident companies to investment funds domiciled in Belgium, Germany, Spain, and the United States were subject to French withholding tax, but such dividends were exempt from French tax when paid to French investment funds.<sup>6</sup> Two years later, on April 10, 2014, the CJEU issued its decision in the *Emerging Market Series* case.<sup>7</sup> In its judgment, the CJEU found that the different tax treatment for dividends paid by a Polish resident company to a third country investment fund, as compared to a Polish investment fund, also constitutes a restriction on the free movement of capital. The CJEU rejected the justifications put forward by the Polish government for the different treatment.

The *Emerging Market Series* case was filed by the KPMG International member firm in Poland, working together with KPMG LLP in the United States and the KPMG International member firm in the United Kingdom on behalf of Emerging Markets Series of the DFA Investment Trust Company (a U.S. RIC) and Dyrektorizby Skarbowej w Bydgoszczy (the Director of the Bydgoszczy tax authority) in relation to Polish withholding tax applied to dividends paid by Polish resident companies to the U.S. RIC during 2005 and 2006.

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<sup>5</sup> See Case C-338/11–C-347/11 *Santander Asset Management SGIIC SA and others* (May 2012) ECR I-0000 and Case C-190/12 *Emerging Market Series of DFA Investment Trust Company* (April 2010).

<sup>6</sup> *Santander*, *supra*, note 5.

<sup>7</sup> *Emerging Market Series*, *supra*, note 5.

Dividends paid by Polish resident companies to Polish investment funds were exempt from Polish Corporation Tax.<sup>8</sup> Further, on November 25, 2010, and in effect from January 1, 2011, a similar exemption from tax was introduced for EU and European Economic Area “EEA”<sup>9</sup> resident investment funds that satisfied certain conditions regarding their formation and business operations. Dividends paid by a Polish resident company to a third country investment fund, including a U.S. RIC, however, continued to suffer a 19 percent final withholding tax, unless a reduced withholding tax rate applied under an applicable income tax treaty. In the *Emerging Market Series* case, the Polish withholding tax of 19 percent was reduced to 15 percent under the U.S.-Poland Income Tax Treaty.<sup>10</sup>

In December 2010, the U.S. RIC filed Fokus Bank claims with the Polish tax office (“KPUS”) requesting a refund of an overpayment of withholding tax that had been applied at a rate of 15 percent under the U.S.-Poland Income Tax Treaty. On May 2, 2011, the KPUS rejected these requests on the basis that a U.S. RIC did not satisfy the conditions for tax exemption under Polish law. These decisions were confirmed on October 6, 2011, by the Dyrektor Izby Skarbowej w Bydgoszczy. As a result, the U.S. RIC brought an action for annulment of the KPUS decisions before the Wojewódzki Sad Administracyjny w Bydgoszczy (the “Polish Administrative Court”). The Polish Administrative Court decided to stay proceedings, and sought a preliminary ruling from the CJEU on, among other things, whether the different tax treatment provided under Polish law for dividends paid by Polish resident companies to resident and non-resident investment funds was in breach of EU law.

On April 10, 2014, the First Chamber of the CJEU held that the withholding tax applied to dividends paid by a Polish resident company to

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<sup>8</sup> Under Article 6(1) of the law on Corporation Tax of February 15, 1992, in respect of dividends received in 2005 and 2006.

<sup>9</sup> The EEA, through the EEA agreement, unites the EU Member States and the three European Free Trade Association (“EFTA”) member states (Iceland, Liechtenstein, and Norway). The purpose of the Agreement is to incorporate these States into the European Internal Market, principally by including the requirement to adhere to the four fundamental freedoms as set out in the TFEU: the free movement of goods, people, services, and capital (excluding the extension to third countries). Certain provisions of the TFEU do not extend to these States, e.g., fisheries and agriculture.

<sup>10</sup> Convention Between the Government of the United States of America and the Government of the Polish People’s Republic for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income (1976).

a third country fund, as compared to the exemption from such tax applied to a domestic investment fund, constituted a restriction on the free movement of capital that “may discourage, on the one hand, investment funds established in a non-Member country from investing in companies established in Poland, and, on the other hand, investors resident in Poland from acquiring shares in non-resident investment funds.”<sup>11</sup> Additionally, the CJEU held that the grandfather rule in Article 64(1) TFEU did not apply because the national legislation at issue in the main proceeding exempting Polish investment funds from withholding tax on dividends paid by Polish resident companies was introduced in 1997, which was after the cut-off date of December 31, 1993, for applying the grandfathering clause.<sup>12</sup>

Further, the CJEU held that non-resident investment funds, including U.S. RICs, were in a situation that was objectively comparable to that of Polish investment funds.<sup>13</sup> The CJEU rejected the defense that the restriction could be justified on the grounds of overriding reasons relating to the public interest, including the need to ensure the effectiveness of fiscal supervision.

### *Justifications for Restrictions*

A restriction to a fundamental freedom can be permissible if justified by overriding reasons in the public interest. The restriction also must be appropriate to attain the aims of the national legislation and must not go beyond what is necessary to attain these aims.

In *Emerging Market Series*, the Polish government put forward three main arguments to justify the restriction on the free movement of capital:

- The need to guarantee the effectiveness of fiscal supervision
- The need to preserve the coherence of the tax system
- The allocation of the power to tax and safeguarding tax revenue<sup>14</sup>

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<sup>11</sup> *Emerging Market Series* paragraph 42, *supra*, note 5.

<sup>12</sup> On application of Article 64 refer to comments in note 4 above.

<sup>13</sup> *Emerging Market Series*, see, in particular, paragraphs 67 to 69, *supra*, note 5.

<sup>14</sup> This defense was made in a brief filed by the German government, as an interested party, with the CJEU in support of Poland’s positions in the case.

The CJEU rejected each of these justifications. The CJEU held that restrictions on the movement of capital in relation to third countries in the absence of arrangements for mutual assistance may be justified by the need to guarantee the effectiveness of fiscal supervision. However, contrary to the Attorney General's ("AG's") Opinion,<sup>15</sup> the CJEU found that the inapplicability of the EU Undertakings for Collective Investments in Transferable Securities ("UCITS") Directive<sup>16</sup> to non-EU funds was not relevant. Furthermore, the CJEU found that in this case, there was a regulatory framework of mutual assistance between Poland and the United States that allowed the exchange of information required for the application of tax legislation (namely, Article 23 of U.S.-Poland Income Tax Treaty and Article 4 of the Convention of the Organization for Economic Co-Operation and Development ("OECD") and the Council of Europe on Mutual Assistance in Tax Matters, signed in 1998, to which Poland and the United States are parties). Nevertheless, the CJEU held that the national courts should examine whether the agreed mechanism for exchange of information enables the tax authorities to verify that the information provided by the non-resident investment fund demonstrates that it is comparable with the domestic fund and operates in a regulatory framework equivalent to that of the EU. Therefore, the CJEU returned the case to the District Administrative Court of Bydgoszcz ("DAC of Bydgoszcz") to make this determination.

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<sup>15</sup> The AG, in his Opinion of 6 November 2013, concluded that a different tax treatment for dividends paid by Polish resident companies to third country rather than domestic investment funds constituted a restriction on the free movement of capital. However, this restriction could be justified by the need to ensure the effectiveness of fiscal supervision. According to the AG, the absence of a framework for the exchange of information on regulatory matters equivalent to the UCITS Directive (85/611/EEC) justified such restriction to third country capital movements, as the Polish tax authorities would not be able to verify that a third country investment fund carried out its activities under conditions comparable to those provided under Polish law for investment funds. Neither could the Polish tax authorities assess the extent and effectiveness of the supervision of the third country investment fund by comparison with the mechanism provided by the UCITS Directive for investment funds resident in the EU. Further, according to the AG's opinion, it was irrelevant that there were mechanisms in place for exchange of information in tax matters.

<sup>16</sup> UCITS are investment funds regulated at EU level by European Directives. The first UCITS Directive was adopted in 1985, and has subsequently been amended.

Another justification—the need to ensure the coherence of the Polish tax system—was rejected because accepting the justification would require a direct link between a tax advantage and a tax levy to compensate for that tax advantage. The Polish government maintained that the withholding tax exemption provided for dividends paid by companies resident in Poland to Polish investment funds (advantage) was closely linked to the taxation of distributions made by the Polish investment funds to their shareholders (compensating tax levy). However, as noted in paragraph 93 of the CJEU’s decision, the applicability of such an exemption did not require that the dividends paid by Polish resident companies to the Polish investment fund concerned were redistributed by the fund to its unit-holders such that the tax liability of the unit-holders in respect of such dividends could offset the withholding tax exemption provided to the Polish investment fund on those same dividends. As a result, this justification failed.

With respect to the need to safeguard the allocation of the power to tax and tax revenue, the CJEU found that since Poland has chosen not to tax Polish investment funds on dividends paid by Polish resident companies, the restriction on non-resident investment funds cannot be justified. Likewise, the CJEU found that a decrease in tax revenue cannot be regarded as an overriding reason in the public interest capable of justifying the discrimination in this case.

### *Rejection of Request to Limit the Effect of the Judgment*

The CJEU also rejected the request of the Polish government for a temporal limitation<sup>17</sup> of its judgment as nothing in the submissions provided by Poland to the CJEU supported the argument that this judgment would likely cause serious economic difficulties.<sup>18</sup>

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<sup>17</sup> A temporal limitation is a limit in time of the effects of a judgment, e.g, the CJEU could decide to limit the temporal effects of its judgment, but not for those claimants that have already taken legal action or filed claims. Rarely the CJEU may, in application of the general principle of legal certainty inherent in the legal order of the EU, accept this defense. Two essential criteria must be fulfilled before such a limitation can be imposed: Those concerned must have acted in good faith, and there must be a risk of serious difficulties (see, for example, *Santander*, *supra* note 4, paragraph 59).

<sup>18</sup> The Polish government failed to provide either in its written observations or at the hearing any data that could enable the Court to assess whether in fact the judgment will cause serious economic difficulties.

### *Position of Polish Courts*

As noted above, the case was returned to the DAC of Bydgoszcz. In June 2014,<sup>19</sup> the DAC of Bydgoszcz issued several judgments providing that the Polish tax authorities may need to apply to the IRS for exchange of information to assess whether the U.S. RICs are comparable to Polish investment funds. In its judgments, the DAC of Bydgoszcz also included guidelines on the factors to be included in a comparability analysis for this purpose. Following the DAC of Bydgoszcz judgments, IS Bydgoszcz (Bydgoszcz Tax Chamber) issued decisions in November 2014 in which it cancelled the previous negative decisions of KPUS and sent the case back to KPUS for reconsideration. The decisions of the Bydgoszcz Tax Chamber provided certain guidelines for KPUS to apply with respect to exchange of information procedures with the IRS and the analysis comparing the U.S. RICs to Polish investment funds. KPUS did not initiate a tax information exchange procedure with the IRS. Instead, KPUS requested information to determine the comparability of U.S. RICs to Polish investment funds from another Polish tax office (Krakow MUS), which had previously gone through a tax exchange of information procedure for this purpose with the IRS. At the time of writing, final decisions are yet to be issued by KPUS, but are expected soon.

Since the CJEU's decision in the *Emerging Market Series* case and DAC of Bydgoszcz judgments, we have seen positive developments at the level of other district administrative courts (e.g., Warsaw, Poznan, Krakow) when the courts have overturned negative decisions from the Polish Tax Chambers. However, none of the district administrative court decisions have granted repayments yet.<sup>20</sup> Instead, the district administrative courts have ordered that an analysis be performed comparing U.S. RICs to Polish investment funds. These decisions have confirmed that performing a comparability analysis for this purpose does not mean confirming every small detail or regulation applicable to U.S. RICs and Polish investment funds. Instead, the district administrative court decisions have held that a general comparison of differences and similarities should be made and

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<sup>19</sup> There were 12 separate proceedings involving two different U.S. RICs (one per year). All the judgments were issued in June 2014.

<sup>20</sup> See, for example, Warsaw DAC judgments dated September 18, 2014, case no: III SA/Wa 1691/14 and III SA/Wa 1692/14; Poznan DAC judgment dated October 16, 2014, case no: I SA/Po 295/14; Krakow DAC judgment dated November 14, 2014, case no: I SA/Kr 1542/14 and I SA/Kr 1543/14).

that comparability does not require a finding that a foreign legal system is identical to a national one.<sup>21</sup>

It is worth noting there are positive Supreme Administrative Court decisions in Poland recognizing that U.S. RICs are comparable to Polish investment funds and should enjoy the same withholding tax exemption on dividends paid by Polish resident companies<sup>22</sup>

### Positive Decisions from the Swedish Administrative Court of Appeal in Fokus Bank Claims Filed on Behalf of U.S. RICs

In December 2014, the Swedish Administrative Court of Appeal (“ACA, 2<sup>nd</sup> tier”) issued three decisions in favor of Fokus Bank claims filed on behalf of three U.S. RICs, including one case filed by the KPMG International member firm in Sweden working together with KPMG LLP and the KPMG International member firm in the United Kingdom. The ACA, 2<sup>nd</sup> tier rejected each of the arguments put forward by the Swedish Tax Agency (“STA”) in support of its position that the U.S. RICs were not comparable to Swedish investment funds, and granted repayments of Swedish withholding tax to the three U.S. RICs, as requested. The STA had two months to appeal the decisions of the ACA, 2<sup>nd</sup> tier in favor of the three U.S. RICs to the Swedish Supreme Administrative Court. However, the STA did not do so by the required deadlines of February 16 and 18, 2015. Therefore, these decisions are now final, and the three U.S. RICs are entitled to keep the repayments of Swedish withholding tax.

In the cases at hand, the ACA 2<sup>nd</sup> tier found that the claimant U.S. RICs had shown that they were equivalent to Swedish investment funds.<sup>23</sup> In assessing whether the claimant U.S. RICs were comparable to a Swedish investment fund, the following attributes were considered relevant by the ACA, 2<sup>nd</sup> tier:

- Do the U.S. RICs have permission to operate under regulatory or other supervision in their country of residence?

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<sup>21</sup> See, for example, Poznan DAC judgment dated October 16, 2014, and Krakow DAC judgment dated November 14, 2014, *supra*, note 20.

<sup>22</sup> See Supreme Administrative Court judgments dated June 4, 2014, case no: II FSK 1702/12 and II FSK 1284/12.

<sup>23</sup> The regulations governing Swedish investment funds are found in the Investment Fund Act 2004 (“IFA”). This legislation is based on the EU UCITS Directive.

- Do the U.S. RICs only invest in assets in which Swedish investment funds are also allowed to invest?
- Can the U.S. RICs raise capital from the public or only from a specifically identified and limited group of investors?
- Do the U.S. RICs apply the principle of risk spreading?
- Can the U.S. RICs repurchase or redeem shares at the demand of the investors using the U.S. RICs' money or assets?
- Do the U.S. RICs provide certain enumerated items of information to their holders (e.g., prospectus, semi-annual and annual reports)?
- If the U.S. RICs are not organized as corporations under domestic law, are their assets administered by an authorized management company?
- Are assets of the U.S. RICs entrusted to a depository (i.e., custodian)?

The ACA, 2<sup>nd</sup> tier drew attention to the fact that when assessing whether the Swedish and non-resident investment funds are comparable, the regulations applicable to U.S. RICs did not have to be identical to those applicable to Swedish investment funds. Further, the fact that there are differences between the two sets of legal frameworks cannot by itself imply that the Swedish investment funds and U.S. RICs are not comparable for this purpose.

To assess whether the claimant U.S. RICs met the criteria identified above, the ACA, 2<sup>nd</sup> tier reviewed the Prospectus, Statement of Additional Information and other information provided by the U.S. RICs to the ACA, 2<sup>nd</sup> tier in the course of the proceedings. On this basis, the ACA, 2<sup>nd</sup> tier concluded that there was enough evidence to conclude that the U.S. RICs were comparable to a Swedish investment fund for the periods covered in the claims.

The ACA, 2<sup>nd</sup> tier held that the difference in tax treatment was a restriction of the free movement of capital, which was not neutralized by the

U.S.-Sweden Income Tax Treaty.<sup>24</sup> In the ACA, 2<sup>nd</sup> tier's view, the difference in tax treatment could only be justified if the Swedish withholding tax could be fully credited against tax paid by the claimant U.S. RICs in the United States.<sup>25</sup> However, as the claimant U.S. RICs did not pay tax in the United States, no such credit for foreign tax could be granted.

As to whether the difference in treatment could be justified, the ACA, 2<sup>nd</sup> tier considered the following:

- Does the difference in treatment cover situations that are not objectively comparable?
- Can the difference in treatment be justified by the need to guarantee the effectiveness of fiscal supervision?
- Can the difference in treatment be justified by the need to preserve the coherence of the tax system?
- Can the difference in treatment be justified by the need to safeguard the allocation of the power to tax?

As to whether the situations of the claimant U.S. RICs and Swedish investment funds were objectively comparable, the ACA, 2<sup>nd</sup> tier referred to the *Emerging Market Series* case in holding that the fact that the U.S. RICs were not covered by the EU UCITS Directive was not by itself enough to find that the situations were not objectively comparable.

Similar to the *Emerging Markets Series* case, the ACA, 2<sup>nd</sup> tier rejected the justification of the need to guarantee the effectiveness of fiscal supervision given that the U.S.-Sweden Income Tax Treaty includes an Exchange of Information Article (Article 26). As such, the STA can verify the information provided by the U.S. RICs.

The ACA, 2<sup>nd</sup> tier also rejected the justification of the need to ensure the coherence of the Swedish tax system. For Swedish investment funds to avoid taxation they must distribute their income. However, there is no requirement that the distributed income is subject to tax in the hands of the Swedish fund investors. Due to the lack of such a taxation

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<sup>24</sup> See Article 23 of the U.S.-Sweden Income Tax Treaty. The U.S. RICs in question did not pay income tax in the United States, so no credit for foreign tax can be granted.

<sup>25</sup> See Case C-540/07 *Italy v. Commission*.

requirement, the direct link required to conclude that the legislation is motivated by the need to maintain the coherence of the tax system was not established.

Finally, the ACA, 2<sup>nd</sup> tier rejected the justification of the need to safeguard the allocation of the power to tax since Sweden chose not to tax resident investment funds on dividends paid by Swedish resident companies.

These three judgments are the first of a total of 108 cases (for 27 U.S. RICs) that are now pending before the ACA, 2<sup>nd</sup> tier and for which judgments are expected soon.

It is important to note that in the above decisions the ACA, 2<sup>nd</sup> tier ruled that a U.S. RIC has the burden of proof to show that it is objectively comparable to a Swedish investment fund. As such, claims filed by U.S. RICs (or other funds resident in third countries) should continue to be assessed individually. However, given that the successful U.S. RIC claimants included both U.S. RICs offered to retail investors and as investments supporting variable annuity products, it is expected that many U.S. RICs should benefit from these decisions of the ACA, 2<sup>nd</sup> tier.

### Positive Decisions from the Supreme Administrative Court of Finland in Fokus Bank Claims Filed on Behalf of U.S. RICs

In January 2015, the Supreme Administrative Court of Finland issued two decisions in favor of Fokus Bank claims filed on behalf of two U.S. RICs by the KPMG International member firm in Finland working together with KPMG LLP and the KPMG International member firm in the United Kingdom. In these decisions, the Supreme Administrative Court granted the U.S. RICs repayment of Finnish withholding tax, as requested. The U.S. RIC claimants were structured as a closed-end fund and an open-end fund, respectively. These are final decisions from the highest court in Finland.

The claimant U.S. RICs initially applied for an advance ruling from the Finnish Central Board of Taxes (“CBT”) that Finnish withholding tax would not apply to dividends when paid by Finnish resident companies to the U.S. RICs (withholding tax relief at source). The advance rulings issued by the CBT denied the withholding tax relief requested. As a result, the U.S. RICs appealed the CBT advance rulings to the Supreme Administrative Court. The Supreme Administrative Court overturned the CBT advance

rulings, and held that the U.S. RICs should receive repayments of Finnish withholding taxes that were withheld in breach of EU law.<sup>26</sup>

In the case of the closed-end fund that had common shares listed on the New York Stock Exchange, the Supreme Administrative Court determined that the fund was comparable to a listed Finnish limited liability company (“LLC”), which is exempt from tax on dividends paid by Finnish resident companies under the Business Income Tax Act of 1968, as amended. Accordingly, the Supreme Administrative Court held that dividends paid by Finnish resident companies to the closed-end fund should be exempt from Finnish withholding tax.

In the case of the open-end fund, the Supreme Administrative Court determined that the fund was most closely comparable to a Finnish investment fund, which is wholly tax exempt on all income under Section 20 of the Finnish Income Tax Act of 1992, as amended. Accordingly, the Supreme Administrative Court held that dividends paid by Finnish resident companies to the open-end fund also should be exempt from Finnish withholding tax.

The Supreme Administrative Court ruled that the application of Finnish withholding tax to dividends paid by Finnish resident companies to U.S. RICs (whether structured as a closed-end fund or open-end fund), as compared to the exemption from such withholding tax applicable to Finnish LLCs and Finnish investment funds, respectively, constituted a restriction on the free movement of capital. Similar to the Swedish cases discussed above, the Supreme Administrative Court referred to the *Emerging Markets Series* case in rejecting the CBT’s argument that the restriction was justified by the need to guarantee the effectiveness of fiscal supervision given that the U.S.-Finland Income Tax Treaty includes an Exchange of Information Article (Article 26). As such, the Finnish tax authorities can verify the information provided by the U.S. RICs.

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<sup>26</sup> While U.S. RICs that satisfy the required criteria should be entitled to withholding tax relief at source on dividends when paid by companies resident in Finland, receiving such relief is extremely difficult in practice as a Finnish withholding agent may not have sufficient information about a U.S. RIC at the time a dividend is paid. As a result, U.S. RICs are likely to continue to suffer withholding tax on dividends paid by companies resident in Finland and to need to seek refunds of such taxes from the Finnish Tax Administration.

Similar to the Swedish cases, U.S. RICs, as well as investment funds resident in other third countries or in the EU/EEA, must demonstrate that they are objectively comparable to Finnish LLCs or Finnish investment funds to successfully assert Fokus Bank claims for dividends paid by Finnish resident companies. Non-resident investment funds also may be able to apply for an advance ruling in Finland for future years to ascertain the withholding tax treatment for dividends from Finnish resident companies prior to payment.

More recently and in addition to the positive rulings received, KPMG LLP working together with KPMG International member firms in the United Kingdom and Finland has received refund decisions from the Finnish Tax Authorities for another U.S. RIC with respect to claims filed in December 2012, without the need to litigate. The refund decisions follow the provision of certain background documentation and comparability analysis to the Finnish Tax Authorities. The amounts to be refunded are in line with the amounts originally claimed and include interest.

### Implications of the Decisions

These decisions, particularly the *Emerging Markets Series* case, add to the growing body of CJEU and EU Member State court decisions finding in favor of U.S. RICs and other third country investment funds filing Fokus Bank claims to recover withholding tax paid on dividends received from companies resident in EU Member States.

These decisions demonstrate that U.S. RICs can make successful Fokus Bank claims provided that sufficient comparability with a relevant EU investment fund (or in the case of Finland, also a Finnish limited liability company) can be shown. The local tax authority must be able to verify the comparability under an exchange of information procedure provided by an income tax treaty entered into between the United States and the local jurisdiction or by the Convention of the OECD and the Council of Europe. As noted above, it is expected that the Swedish and Finnish tax authorities will continue to assess on a case-by-case basis whether a U.S. RIC is objectively comparable to a resident investment fund. However, the Swedish and Finnish tax authorities are expected to issue procedural guidance regarding Fokus Bank claims in due course, which hopefully will clarify and streamline these assessments going forward.

In deciding whether to pursue Fokus Bank claims, a U.S. RIC should weigh (among other things) the costs of pursuing the reclaim against the

potential benefits based on the amount of the EU withholding tax eligible for recovery within the relevant country's statute of limitations,<sup>27</sup> and the likelihood of success in the jurisdiction in question. For example, the statutes of limitations in Poland, Sweden, and Finland are five calendar years. Therefore, U.S. RICs wishing to file Fokus Bank claims in any of the above territories could seek refunds back to January 1, 2010, provided that the claims are filed by December 31, 2015.

Finally, a U.S. RIC should assess the U.S. implications of pursuing Fokus Bank claims, including when to record and disclose pending Fokus Bank claims for financial statement purposes under U.S. Generally Accepted Accounting Principles. A U.S. RIC also should consider potential U.S. foreign tax credit implications of filing (or not filing) a Fokus Bank claim for any foreign taxes passed through as credits to shareholders in prior years and the extent to which EU withholding taxes on dividends should continue to be treated as "compulsory taxes" eligible for foreign tax credits as EU law continues to evolve.<sup>28</sup>



The information contained in this article is of a general nature and based on authorities that are subject to change. Applicability of the information to specific situations should be determined through consultation with your tax adviser.

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<sup>27</sup> Statutes of limitations vary from country to country and normally run on a calendar year basis (although some countries may follow a rolling limitation basis (e.g., Italy) or period counted as from a dividend distribution (e.g., the Netherlands and Denmark)). Typically the statutes of limitations vary between two and five calendar years. For example, France follows a two calendar year statute of limitations, while Germany follows a four calendar year statute of limitations. This means that a U.S. RIC can file a Fokus Bank claim in France in respect of withholding tax suffered on French sourced dividend income from January 1, 2013, forward, and in Germany from January 1, 2011, forward, provided that they are filed by December 31, 2015.

<sup>28</sup> See section 905(c) of the U.S. Internal Revenue Code of 1986 and section 1.901-2(e)(5)(i) of the U.S. Treasury regulations. For more information, see Deanna Flores, Caren Shein, and Daniel Dzenkowski, "European Union Tax Refund Developments and Potential Foreign Tax Credit Implications for U.S. Mutual Funds," *What's News in Tax* (Aug. 14, 2009).