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TaxNewsFlash

Europe

U.S. based partnership RIC exempt from tax-at-source in Finland

Tax practice development regarding the application of Art 63 TFEU

A recent decision of the Finnish Tax Administration (FTA) deals with withholding taxation of dividends paid to an open-ended Massachusetts Business Trust based partnership regulated investment company (RIC) (claimant).

Background

The claimant was a U.S. based open-ended investment fund, established as a Massachusetts Business Trust and registered as a RIC and regulated by the U.S. Securities and Exchange Commission (SEC). Since the fund was open-ended, it had the obligation to obtain units from a unitholder upon request. The units were traded at the New York Stock Exchange (NYSE). A separate custodian held the assets of the fund whose value was determined in accordance with the net asset value at the end of the trade day in NYSE.

The claimant's legal form was a partnership. It was a separate legal person whose liabilities were carried by unitholder, subject to the worth of the held unit in the fund. According to U.S. tax laws, the claimant must distribute its profits annually to the unitholders. The distribution was deductible in the claimant's taxation and thus the claimant was in practice tax exempt. Consequently, the claimant could not credit in the United States the withholding taxes deducted in Finland. In its withholding tax reclaim, the claimant submitted that it should be treated tax exempt in Finland since it was comparable to Finnish investment funds, which are exempted from tax.

Decision

The FTA accepted the claim and refunded the withholding taxes deducted in Finland with interest. In its reasoning, the FTA stated that although U.S. based investment funds are not fully similar to any Finnish entities, they can nevertheless be comparable to domestic investment funds on basis of the investment activities they are conducting. Therefore, on basis of the claimant's characteristics and general

assessment, the claimant was comparable to a Finnish investment fund. Moreover, there was an effective exchange of information in place between the Finnish and U.S. tax authorities under the Finland-United States income tax treaty. The withholding taxes deducted in Finland were thus refunded.

KPMG observation

The decision represents a significant development since it expands the application of Article 63 TFEU (EU treaty) to third country investment funds whose legal form is a partnership. Although this structure means in practice that the fund itself is a flow-through entity whose profits are taxed at the unitholder level, it nevertheless differs from the structures dealt thus far with other U.S. RICs, because the fund was a separate legal person whose unitholders were liable for the fund's liabilities, similarly as in private equity funds. Usually, the liabilities are carried by the investment management company and the fund itself is not a legal person. As a result, investment funds built on structures alike should be in a good position to receive withholding tax refunds from Finland.

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