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Flash News

Withholding tax refunds for Luxembourg funds – Recent developments in France

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Within the framework of the Fokus / Aberdeen cases, the European Commission ("EU Commission") has decided to refer France to the European Court of Justice ("ECJ") and to address the French discriminatory taxation of dividends paid to foreign pension and investment funds, which is considered to restrict free movement of capital. Indeed, French pension institutions and investment funds do not pay tax on their French dividend income, while their foreign equivalents are taxed.

On 23 May 2011, the French Conseil d'Etat, France's highest court for issues involving public administration, rendered its opinion on specific questions relating to the discriminatory tax treatment of dividends paid to foreign investment funds. Those questions were raised by Montreuil's Administrative Tribunal.

Reasoned Opinion of the EU Commission

According to French tax law, domestic pension and investment funds do not suffer withholding tax on their French-sourced dividend income. However, foreign pension and investment funds suffer withholding tax at a rate of 25 % or less (depending on the applicable double tax treaty) on their French-sourced dividend income and cannot obtain a refund.

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In February 2009, the Conseil d'Etat ruled that the French withholding tax regime on dividends paid to EU **pension funds** was incompatible with EU law.

In this context, in December 2009, France introduced a new piece of legislation aimed at ending discrimination against foreign non-profit organizations (including pension funds). This new legislation provides for a 15% withholding tax on dividend income paid to such beneficiaries regardless of whether they are located in France or elsewhere in the EU or EEA. The legislation was followed by some administrative guidelines - published on 15 January 2010 - which described the requirements to obtain the refund of the undue withholding tax.

However, the EU Commission considered the new rules mentioned above unsatisfactory, as the guidelines issued by the French tax authorities are not precise and do not enable the law to be applied fully and effectively. On 18 March 2010, the EU Commission issued its Reasoned Opinion ("avis motivé") against France, formally requesting France to change the tax treatment of dividends paid to **foreign pension and investment funds**, considering that such treatment is discriminatory.

On 19 May 2011, the EU Commission decided to refer France to the ECJ on the grounds that the French tax provisions restrict free movement of capital in breach of Article 63 of the Treaty on the Functioning of the European Union ("TFEU") and Article 40 of the European Economic Agreement. The EU Commission considers that France taxes dividends paid to foreign pension and investment funds discriminatorily. Indeed, French pension institutions and investment funds do not pay tax on their French dividend income, while their foreign equivalents are taxed.

"Fokus claims" cases for investment funds

In November 2010, "Fokus" claims cases for investment funds were brought before Montreuil's Administrative Tribunal. The cases relate to 10 situations involving Belgian, US, German and Spanish vehicles in forms corresponding to FCPs or SICAVs. In all instances, the Tribunal decided to submit the cases to the Conseil d'Etat and seek its opinion.

The Conseil d'Etat was requested to comment on the questions listed below:

- Shall the non resident collective investment vehicle who disputes the withholding tax justify that the income effectively paid has been reduced by this withholding tax or [shall] justify that the withholding tax has been effectively paid, notably by producing a detailed certificate of the paying agent?

- Can a decision by the ECJ dealing with the non-compliance of a French provision with a higher provision of law be taken into account even if a French jurisdiction has not yet referred the matter to the ECJ for a preliminary ruling or even if no action has been brought against France?
- To assess the difference in treatment which may constitute an infringement of free movement of capital, should the situations be compared at the level of the investment vehicle, of the units/shareholder or globally?
- Can a collective investment vehicle, taxed at a very low rate in its country of residence, be regarded as being in a situation which is objectively comparable to the situation of a French collective investment vehicle?
- A question arises as to the existence of an infringement to free movement of capital which would result from a tax levy applied on distributions made by French companies to non-resident collective investment vehicles while distributions of the same nature are exempt from any tax when they are made to the benefit of collective investment vehicles established in France;
- If this difference in treatment constitutes an infringement within the meaning of article 56 of the TFEU, the question will be whether the latter is justified by an overriding requirement of general interest;
- Under which conditions an investment fund established in the territory of a State which is a third party to the European Union can argue about the non-compliance of withholding tax on the basis of free movement of capital as provided for by article 56 of the TFEU, given that article 57 of the same treaty maintains restrictions which exist on 31 December 1993 when they relate to movements of capital to or from third countries involving direct investment.

In this context, on 4 April 2011, the “rapporteur public” (special magistrate) issued his report to the Conseil d’Etat. The outcome was as follows:

(i) A question, relating to the level of comparison required to assess the discrimination, shall be referred to the ECJ for a preliminary ruling. If the ECJ confirms that the positions of both the investors and the funds need to be taken into account, a second question would have to be referred to the ECJ for a preliminary ruling. This would be undertaken with a view to clarifying how the scale of discrimination at the level of the investors ought to be determined.

(ii) Based on the recent ECJ decision in the Haribo case, the special magistrate concluded that the approach shall be the same for both EU and non-EU (mainly US) funds. Assuming that discrimination is confirmed following completion of step (i) above then, in both cases, this would not be justifiable on any grounds.

(iii) From a practical standpoint, the request by the tax authorities for vouchers to be provided (in addition to references for the 2777 returns filed by the French paying agent) is valid. However, the special magistrate also stated that "any other means to evidence that the withholding tax has been effectively paid" should be allowed.

(iv) As regards timing, the special magistrate considers that the provisions of Article L.190 of the French Procedural Tax Code only apply if an ECJ case relates to French provisions or EU provisions transposed into national law. Therefore, he concluded that the Amurta or Aberdeen cases could not be considered events which further delay the refund of the withholding tax which is being claimed.

The Conseil d'Etat delivered its opinion on Monday, 23 May 2011. It stated that, in order to assess whether the application of French withholding tax complies with the EU principle of free movement of capital, it was necessary to understand whether the situation of unitholders ought to be taken into account, alongside the situation of the fund.

To support its decision, the Conseil d'Etat highlighted that, by taking into account the unitholders, the various situations might not be considered to be objectively comparable. Further, it indicated that there could be valid reasons (e.g. relating to efficiency of the tax audits) which could justify a difference in the tax treatment. According to the Conseil d'Etat, these considerations make it necessary to refer the matter to the European Court of Justice for a preliminary ruling.

The opinion relates to European investment funds as well as investment funds located outside the EU. With regard to the latter, the Conseil d'Etat highlighted that the discrimination could be justified by reference to the efficiency of any tax audits to be carried out. However, this argument would not be relevant if the third country and France have entered into a double tax treaty including an administrative assistance clause (e.g. United States).

It is worth noting that the Conseil d'Etat considers that a decision rendered by the ECJ and relating to the legislation of another Member State shall not be considered to be a new event which would cause special statute of limitations rules to apply. The Conseil d'Etat also ruled that there was no French legal provision describing the nature of evidence to be provided in order to justify the requested withholding tax refund amount, giving some flexibility on the means of proof which may be required.

The Administrative Tribunal of Montreuil shall examine the case and decide on the prejudicial question to be asked to the ECJ on June 17th, 2011.

PwC strongly recommend that Luxembourg funds file refund claims for any withholding tax suffered on their French-sourced dividend income. Our dedicated teams are here to assist our clients in this respect.

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