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**Developing Issues on Withholding Tax on Outgoing
Dividends in the European Union**

by

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Summary

The European Court of Justice has repeatedly held that it is contrary to EU-law to charge withholding tax on cross-border dividend payments when comparable, domestic transactions are not taxed at the corresponding burden. Therefore, the question of withholding taxes compatibility with EU-law has been the topic of extensive legal literature over many years. However it seems that this is a non-stopping issue without a solution.

The field of direct taxation is only partially harmonized to the extent of the implementation of the internal market. In order to achieve an internal market the EU has implemented limitations on the Member States, such as the Fundamental Freedoms. Therefore, the Member States have the right to charge withholding tax on dividends as long as they do not treat non-resident taxpayers less favourably than resident taxpayers. Here the question of comparability on dividend payments between resident and non-resident taxpayers becomes important. However, this is an uncertain matter, even though the assessment of comparable situations on dividend payments has been up for questioning several times.

First, this thesis presents an overview of the relationship between withholding taxes and the internal market and correspondingly the Fundamental Freedoms.

Second, it analyses previous and upcoming case-law from the European Court of Justice on dividend payments, showing how important and uncertain the question of comparable situation is.

Third, the thesis presents what factors must be analysed in order to make a correct assessment in the terms of whether comparable situations exist or not. Thereafter, possible restrictions in the aspects of dividend payments will be presented. This leads to the conclusions that the situation of how to determine a comparable situation and how to calculate a restriction are unpredictable and uncertain matters.

Finally, the thesis analyses future aspects of withholding tax on dividend payments, suggesting abolishment of the rules and harmonization of the system, as the situation is uncertain and must be resolved on a case-by-case basis. This can be solved by replacing the withholding tax system with an effective information exchange between the Member States, as this would lead to a more effective internal market.

Abbreviation list

AG	Advocate General
Commission	European Commission
ECJ	European Court of Justice
EU	European Union
P.	Page
Para.	Paragraph
SICAV	Société d'investissement à capital variable
TFEU	Treaty on the Functioning of the European Union
WHT	Withholding tax
PSD	Parent-Subsidiary Directive

1. Introduction

1.1. Background

As activities and markets has become more unstable and unclear in the globalized economy, governments has had to undergo remarkable changes in order to protect their tax revenues. The change of a tax rate or a extension of the tax base no longer have the same effect as it did before, as taxpayers today are more mobile and can more easily relocate their income in order to pay less tax. Therefore countries has started to waive their right to tax income on cross-border situations that they would normally not tax in purely internal situation, this is for example fully shown in the case of withholding tax (WHT) on dividend payments.¹

One of the main aims of the European Union (EU) is to provide an internal market, in which goods, capital and natural and legal persons can move freely. In order to attain this internal market, tax obstacles, for natural and legal persons have to be removed.² The Treaty on the Functioning of the European Union (TFEU) ³ explicitly prohibits any sort of discrimination under Article 18. The problem of the prohibition of discrimination in the TFEU is that the discrimination in most cases is based on the situation of residency. However, in direct taxation this is the factor that distributes and defines the Member States taxing competences and since direct taxation is not a harmonized field this remains as an exclusive competence for the Member States. Therefore Member States have the right to charge withholding tax on cross-border dividend payments which may constitute an infringement of the free movement of capital. This in turn, may result in

¹ W. Schön, International Tax Coordination for a Second-Best World (Part I), 1 World Tax J. (2009), Journals IBFD, p. 70.

² Christoph Spengel, Lisa Evers, 'The Cross-border Taxation of Dividends in the Case of Individual Portfolio Investors: Issues and Possible Solutions' (2012) 21 EC Tax Review, Issue 1, p. 17.

³ Consolidated Versions of the Treaty on the Functioning of the European Union, Official Journal of the European Communities, C 83, 30 March 2010, pp. 1 - 403. Official Publications

double-taxation of non-resident investors creating obstacles to the development of the internal market.⁴

Keeping this in mind, it becomes important to question what impact the status of residency has on the determination of discrimination. The European Court of Justice (ECJ or the “Court”) has in several cases stated that it is against EU-law to levy WHT on dividends in cross-border situations when comparable taxation on domestic situations does not exist.⁵ After those judgments the European Commission (Commission) has started several proceedings against Member States regarding their WHT legislations. The Swedish legislation on pension funds is one of them. The Commission argues that foreign pension funds, are treated worse than Swedish pension funds which has resulted in a long discussion between the Commission and Sweden.⁶ Sweden considers the Swedish legislation not to be in breach of EU-law based on the fact that resident and non-resident pension funds are not in a comparable situation. However several taxpayers have now started questioning the Swedish system as well, which has led to a pending case before the ECJ⁷. This is also the current situation in the Netherlands where three pending cases are awaiting judgement from the ECJ regarding the Dutch WHT rules on dividend payments.⁸ Even though WHT compatibility with EU-law has been up for question several times, it is still uncertain to what extent a source state can exercise its taxing rights in the situation of outgoing dividend payments.

1.2. Aim and Purpose

With the influence from the Swedish situation, the aim and purpose of this thesis is to show how the law stands today and how the current case-law

⁴ TFEU Articles 63-66.

⁵ See for example Cases: C-170/05 *Denkavit* and C-303/07 *Aberdeen*.

⁶ See the commissions pressreleases: IP/07/616, IP/10/1406 and IP/12/284

⁷ Swedish Supreme Administrative Court referred Case No. 2868/12. Not yet numbered at the ECJ.

⁸ See pending cases C-10/14 *Miljoen*, C-14/14 *X*, and C-17/14 *Société Générale*.

should be interpreted in situations regarding WHT on dividend payments in the EU. The study seeks to evaluate the compatibility of withholding taxes with the internal market and the Fundamental Freedoms in order to determine if source taxation of dividend payment in a cross-border situation is in compliance with EU-law when the same dividend is not taxed at source in a purely internal situation.

If this can be answered successfully this will lead to the answer whether WHT on dividend payments is compatible with EU-law and if so, how such compatibility is achieved. As WHT is a constantly evolving area, some concluding remarks on future aspects and difficulties are presented.

The questions analysed in the thesis are as follows:

- To what extent can a source state exercise its taxing rights in the situation of outgoing dividends?
 - When are resident and non-resident recipients of dividends in a comparable situation? What factors must be analysed?
 - When different taxing techniques are used between residents and non-residents, how is a possible restriction calculated? What factors must be taken into consideration?

1.3. Method

This thesis is based on the traditional legal method and the traditional legal sources of law as it aims to show how the law stands today.⁹

The materials used, have mainly been primary law such as the TFEU and the case law of the European Court of Justice, and secondary law, such as directives and other sources such as doctrinal articles and literature (mainly in English). The doctrine used in the thesis is mainly collected from tax journals, such as IBFD, European Taxation and EC Tax Review. This

⁹ S. Douma, *Legal Research in International and EU Tax Law*, p. 18.

doctrine must be considered to have high authority because it has undergone quality controls.¹⁰

Considering the ECJ's importance to the EU-law, the judgements from the ECJ are a cornerstone for this thesis. This is shown as the ECJ's case law gives the reader a good overview of the subject and will also be of importance in the major analytic parts, either strengthening or weakening different lines of argumentation. The case-law that is examined concerns WHT and its relationship to the Fundamental Freedoms and focus will lie on the determination of how a comparable situation and restriction should be determined from the source states perspective.

Since the thesis takes the starting point from the Swedish situation reference will be made to the communication between Sweden and the Commission and Swedish legal doctrine that have commented on the situation. In the communication Sweden uses the *Truck Center*¹¹ case as an argument to show that no comparability exists when two different taxing techniques are used. Therefore a thorough analysis of this case will be made, in order to determine how applicable that judgement is to other situations. However, in order to present a full cover of how the law stands today other relevant aspects are discussed and analysed.

1.4. Delimitations

In order to present the thesis some delimitations are made. Marking the core of the problem opens up the possibility to offer a more interesting and deep discussion. Due to the purpose of the thesis and the broad scope of WHT, this thesis will be limited in its coverage to the aspects of WHT on dividend payments from the source state's perspective.

Further, the discussion of proportionality and possible justification grounds will only be briefly discussed as the study does not aim to investigate if a specific rule is compatible with EU-law.

¹⁰ S. Douma, *Legal Research in International and EU Tax Law*, p. 18.

¹¹ Case C-282/07 *Truck Center*.

The Parent-Subsidiary Directive (PSD)¹² will also be discussed. However as dividends that fall within the scope of the directive are not subject to WHT the study will only focus on dividend payments that fall outside the scope of the directive.

Finally, since the free movement of capital is of significance in this thesis it must be noted that the free movement of capital has developed to also cover third countries, however as this thesis focuses on the relationship with the internal market, the discussions will only deal with internal matters within the EU.

1.5. Outline

This thesis has been divided into sections that will approach different aspects of the compatibility of WHT with the internal market and the Fundamental Freedoms. In order to give the reader some guidance this sub-chapter provides a short introduction to the thesis' outline.

After the first chapter, where the background purpose and aim are presented, the second chapter will serve the purpose of introducing the reader to the relationship between withholding taxes, the Fundamental Freedoms and the internal market. Chapter three then goes on and analyses the previous case-law from the ECJ with respect to dividend payments in order to give the reader a good overview of the issue of WHT on dividend payments. The last part of chapter three then focuses on the Swedish situation and presents new issues that have not been dealt with before. Chapter two and three are of importance, to be able to fully understand the later parts of the thesis.

The fourth chapter is the starting point of the thesis more analytic part presenting the concept of comparable situation in cases of WHT. The first part presents what factors need to be analyzed and how they should be interpreted and then goes on to see if two different tax treatments can affect the comparability analysis. Depending on the outcome of chapter four, if

¹² Council Directive 90/435/EEC of 23 July 1990 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States, amended by Council Directive 2011/96/EU of 30 November 2011

comparable situations exist, chapter five presents what factors must be analyzed when determining if a restriction exists.

The sixth chapter then goes on to give some future issues surrounding the WHT system within the EU.

Finally, in chapter seven, an honest attempt is provided to summarize and highlight the findings of the study. The intention is to give answers to the initial questions of the thesis.

2. Withholding Taxes and Their Relationship with the Fundamental Freedoms and the Internal Market

As stated before the area of direct taxation is not harmonized as EU tax law provisions only direct Member States to the extent of the realization and the functioning of the internal market.¹³ Therefore in direct taxes EU-law only takes precedence over domestic law when EU law leads to more lenient tax consequences for the taxpayer.¹⁴

The founding of the TFEU economic integration of the Member States and the creation of an internal market are the most important objectives of the EU. These objectives are achieved by establishing an internal market and a monetary union. Therefore, obstacles on the free movement of goods¹⁵, persons¹⁶, services¹⁷ and capital¹⁸ preventing this development must be abolished. The non-discrimination principle stated in Article 18 of TFEU explicitly prohibits discrimination. Therefore, taxes may not prevent or restrict any of the Fundamental Freedoms in order for the functioning of the internal market. Even though the harmonization in the field of direct taxes has been rather limited, Member State's tax systems constantly harmonizes and therefore also are being harmonized. The tax legislation of the Member States constantly develops in order to be in accordance with the provisions and the objectives of the founding treaties, which results in better coordination between the tax systems and the abolishment of tax obstacles.¹⁹

¹³ TFEU Article 4.

¹⁴ M. Helminen, Chapter 1: Concepts and Basic Principles of EU Tax Law in *EU Tax Law – Direct Taxation* – 2013 (IBFD 2013), Online Books IBFD.

¹⁵ TFEU Article 26.

¹⁶ TFEU Article 21.

¹⁷ TFEU Article 56.

¹⁸ TFEU Article 63.

¹⁹ M. Helminen, Chapter 1: Concepts and Basic Principles of EU Tax Law in *EU Tax Law – Direct Taxation* – 2013 (IBFD 2013), Online Books IBFD.

WHT on dividend payments has only partially been harmonized through the PSD²⁰. The PSD provides for dividends flowing freely between companies treated as opaque in their respective Member State of establishment, provided that the companies are subject to corporate tax and that the parent company has a minimum shareholding of 10 % in the distributing company. Due to this limited scope of application dividends paid to recipients that are outside the scope of the PSD will be taxed according to the source states rules, as they are free to exercise their taxing rights. Here a potential obstacle for the functioning of the internal market is at risk as Member States are free to treat residents and non-residents differently, which might end up in discrimination and economic or juridical double taxation of non-resident shareholders.²¹

²⁰ Council Directive 90/435/EEC of 23 July 1990 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States, amended by Council Directive 2011/96/EU of 30 November 2011

²¹ Joachim Englisch, 'Taxation of Cross-Border Dividends and EC Fundamental Freedoms' (2010) 38 Intertax, Issue 4, p. 197-198.

3. The Fundamental Freedoms and Withholding Taxes

3.1. Free Movement of Capital

Article 63 of the TFEU states that restrictions regarding capital movements between Member States and Member States and third countries are forbidden. Among other things, the free movement of capital applies to cross-border financial placements. In order to constitute a forbidden restriction of the free movement of capital there must be a comparable domestic situation that is treated more favorably than the cross-border activity. In other words, in order for tax rules to breach the free movement of capital there must be a comparable domestic situation that is treated better than the foreign situation.²²

According to Article 65 (1) of the TFEU the prohibition of restriction of free movement of capital in Article 63 shall not affect the Member State's right to apply different tax treatment of taxpayers who reside in different states or who have invested in different states. This is an exception to the principle of free movement of capital and shall therefore be interpreted restrictively.²³

Keeping this in mind, Member States can treat resident and non-residents differently as long as their situations in fact are not the same. The question therefore is when are residents and non-residents in a comparable situation regarding dividend payments? For that reason, the following chapter provides an overview of the ECJ's case-law dealing with this question.

3.2. ECJ Case-Law on Withholding Tax

3.2.1. Introduction

The treatment of WTH on dividends to non-resident taxpayers has been discussed on several occasions as the ECJ has presented several rulings on the question of whether or not WTH is in breach of the Fundamental Freedoms. This chapter will provide a brief background on the most relevant cases

²² C-251/98 *Baars*, C-524/04, *Thin Cap Group Litigation*.

²³ Case C-338/11 *Santander*; para. 23.

regarding the question of the compatibility of WHT on dividend payments with EU-law.

3.2.2. C-170/05 *Denkavit*

This case regarded dividends flowing from a French subsidiary to its parent company in the Netherlands. While French parent companies almost did not pay any taxes on dividends from French subsidiaries, France withheld a tax of 25 % on dividends distributed to foreign companies. Even though the bilateral treaty between France and Netherlands decreased the WTH to 5 % and held that the Dutch company could credit the tax held in France, the legislation still constituted a restriction of the Freedom of Establishment. This is because Dutch companies could not credit this WTH since foreign dividends were not taxable in the Netherlands. The credit-method therefore did not bring any neutralization of the taxation and constituted a worse treatment of the Dutch company in comparison to domestic French companies.²⁴ This case showed that a restriction in the source-state cannot be compensated for in the state of residence.²⁵

3.2.3. C-379/05 *Amurta*

In this case the ECJ once again tested whether national legislation regarding rules on WTH on dividends was a breach of EU-law. A Dutch subsidiary distributed dividends to its Portuguese parent company with a WTH of 5 % held at source when at the same time dividends distributed to a Dutch company (which owns more than 5 % in the subsidiary) were exempt from taxation. The Court found that this was a breach of the free movement of capital and made clear that domestic rules in the resident state never can eliminate a discrimination in the source state. In other words a Member State that discriminates in a cross-border situation can never rely on the other contracting state's domestic rules in order to eliminate the discrimination.²⁶ However the Court stated that it is fully possible to use bilateral treaties in order to eliminate the discrimination, but in these cases the bilateral treaty must fully eliminate the discrimination.²⁷

²⁴ Case C-170/05 *Denkavit*, paras. 54-55.

²⁵ F.J. Nocete Correa & J.S. Pastoriza Vázquez, *EU Law and Tax Treaties: The Non-EU UCITS Dividends Case*, 52 Eur. Taxn. 11 (2012), Journals IBFD. P 536.

²⁶ Case C-379/05 *Amurta*, para. 77-78.

²⁷ Case C-379/05 *Amurta*, para. 79-83.

3.2.4. C-303/07 *Aberdeen*

In this case a fully owned Finnish subsidiary was charged with WTH at source when distributing dividends to its foreign parent company, a Luxembourg situated Société d'investissement à capital variable (SICAV²⁸), which was not covered in the PSD. The SICAV was not taxed in Luxembourg and the question was whether this entity and the Finnish company were in a comparable situation. The Court found that even though the Finnish legislation did not acknowledge a SICAV this constituted a breach of the freedom of establishment.²⁹ The fact that the Luxembourg company in question had a shareholding in the Finnish company and therefore had definite influence over that company's decisions and activities made it comparable to the Finnish company. The fact that such comparable Finnish companies were exempt from tax on dividend payments made it clear that this was a breach of the freedom of establishment.³⁰ The Court found it irrelevant that Luxembourg did not tax the income of the SICAV which leads to double non-taxation of the dividends. This did not change the fact that the SICAV was in a comparable situation with a Finnish company.³¹ The reasoning from the Court is very interesting as they are stating that the source state can not extend its tax rights in cross-border situations with the argument of avoiding double non-taxation.

3.2.5. C-540/07 *Commission vs Italy*

In this case the Commission started an infringement proceeding against Italy's WHT rules, which according to the Commission lacked compliance with the Fundamental Freedoms. The Italian rules resulted in foreign companies being taxed at a higher tax rate than if the dividends were distributed between two Italian companies. Such discrimination could not be neutralized by the fact that Italian bilateral treaties in some circumstances offered possibilities to credit the tax for the non-resident receiver. Decisive in this case was that Italy could not guarantee that no discrimination could occur and had to rely on the receiving state's internal rules in order to ensure that the credit was possible.³²

²⁸ Société d'investissement à capital variable – an investment form in Luxembourg with the character of both an Investment Fund and a company.

²⁹ Case C-303/07 *Aberdeen*, paras. 50 and 55.

³⁰ Case C-303/07 *Aberdeen*, paras. 62 and 76.

³¹ Case C-303/07 *Aberdeen*, para. 51.

³² Case C540/07 *Commission vs Italy*, paras. 38-40.

3.2.6. C-493/09 *Commission vs Portugal*

This case regarded whether the Portuguese rules for taxation of foreign Investment Funds were in breach of EU-law or not. Foreign Investment Funds had to pay 20 % in tax on dividends received from Portuguese companies whereas Portuguese Investment Funds that received dividends were exempt from taxation if the fund had owned shares in the distributing company for more than a year. The Court found that this restriction would stop Portuguese investors from investing in foreign Investment Funds as they are taxed more burdensome than Portuguese Investment Funds.³³ This was a clear breach of the free movement of capital which could not be justified, according to the Court.³⁴

3.3. Conclusion of the ECJ Case-Law

After the judgements of the mentioned cases it is clear that the ECJ does not accept WHT that puts foreign companies in a worse situation than comparable domestic ones. The Court places importance on the fact that the non-resident taxpayer and the resident one are in a comparable situation.³⁵

It is also clear that a Member State cannot neutralize or eliminate a discrimination by reference to the other Member States domestic rules. The source state must be able to guarantee that there is no possibility of discrimination and can therefore not reference to the other Member State's rules. However the Member State can neutralize a discrimination by a bilateral treaty, but still they must be able to guarantee there is no possibility of discrimination. This guarantee can be tough to reach as the bilateral treaty always is in coordination with domestic legislation and therefore it can be argued that neutralization of a discrimination is difficult to reach.³⁶

In all of these cases the Member States have tried to justify their restrictions by any of the justification grounds. One frequently argued and consistently denied justification ground is the need to maintain the coherence of a tax system. The Court's view of this justification ground is still is very restrict.³⁷ Not any of the

³³ Case C-540/07 *Commission vs Portugal*, para. 28-30.

³⁴ Case C-540/07 *Commission vs Portugal*, para. 51-52.

³⁵ See for example; Cases *Amurta*, para. 32-33 and *Aberdeen*, para. 42-44.

³⁶ See Hilling, Maria, Aktuellt om EG-domstolens praxis – direkt beskattning, Skattenytt nr 1-2, 2010, p. 44.

³⁷ See; C-3798/05 *Amurta*, Case C-303/07 *Aberdeen*, C540/07 *Commission vs Italy* and C-540/07 *Commission vs Portugal*.

other justification grounds were accepted either.³⁸ Therefore in the author's opinion, it can be argued that there are almost no possibilities to justify a restriction when Member States treat foreign and domestic companies differently which are in a comparable situation.

3.4. The Swedish Situation on Pension Funds

It is quite clear from the previous case-law that Member States cannot treat non-resident taxpayers less favorably than resident taxpayers in the case of dividend payments. However, how to determine what is a less favorable treatment is not always easy, as new issues constantly arise.

On May 21 2014, the Swedish Supreme Administrative Court asked the ECJ for a preliminary ruling on whether the differential tax treatment of dividends received through non-resident pension funds compared to dividends received through Swedish pension funds constituted a restriction on the free movement of capital.

According to Swedish legislation, non-resident pension funds are subject to domestic WHT on dividends received from Swedish companies. The tax rate amounts to 30 % and can be reduced to 15 % if there is a double tax convention. These funds are seen as non-transparent entities for Swedish tax purposes and are therefore liable to WHT.³⁹ Resident pension funds however are not taxed on dividends received from Swedish companies. Instead they are subject to a 15 % tax on their yield, which is called the yield tax. The tax base is not calculated on the actual profits but on a notional basis, in other words assets minus liabilities, to which the interest rate for government bonds is applied, which varies each year. The tax is not linked to the profit of the fund as it is for companies, the fund is instead subject to the tax irrespective of whether they receive any dividends or not as the tax is due on an annual basis and is based on the increase in value of the fund's assets (capital gains, plus dividends, minus costs).⁴⁰

This difference in tax treatment raises questions. Since there are two different tax treatments, this will lead to two different tax billings depending on the computation of the tax. The outcome of the tax on Swedish pension funds is impossible to predict as the determination depends on whether Swedish pension funds are in an advantageous situation or not. Sweden argues that the two

³⁸ See for example: Case C-540/07 *Commission vs Portugal* para. 55-57.

³⁹ Sec. 4 of the Withholding Tax Act No. 624 of 1970.

⁴⁰ Law on Yield Tax on Pensions No. 661 of 1990.

situations are not comparable since the yield tax is not a tax on income and is charged even if no dividends are distributed. In other words, there are two different techniques of taxation that fulfills two different purposes. Further Sweden argues that the goal of the system is to achieve a similar result in the long-run, therefore the fact that the effective tax paid is not always the same each year is not discrimination as the treatment will be equal over time. The Commission on the other hand argues that Swedish pension funds always are better off than foreign ones, as their tax is computed on a lower basis than the one applicable to foreign pension funds. According to the Commission non-resident funds should be able to deduct portfolio management costs and other costs related to the holding of Swedish shares, just as the Swedish pension funds are in relation to their yield tax.⁴¹

In parallel with the Commission's infringement proceeding against Sweden, a number of taxpayers have challenged the Swedish system as well. The taxpayers are non-resident pension funds and non-resident Collective Investment Vehicles (both type of investment structures are treated in the same way for tax purposes⁴²) claiming refund of the tax withheld in Sweden. The case⁴³ has reached highest instance, the Supreme Administrative Court, which have referred the case for a preliminary ruling to the ECJ. The Swedish Court asks, whether a law, such as the Swedish one which might occasionally treat investors in a resident fund more favorably than non-resident funds, constitutes a breach on the free movement of capital. Sweden reasons that this is not a breach since the goal is to find neutralization in the long run and refers to the *Truck Center*⁴⁴ case where different methods of taxation between resident and non-residents were seen as compatible with EU-law. This is because the taxpayers were not seen to be in a comparable situation.⁴⁵

The questions that need to be dealt with are, first, are resident and non-resident investment funds in a comparable situation? If yes, how should a restriction be calculated? Is there a restriction just because the non-resident investment fund is treated worse in one year but at the same time treated better in the long run? Sweden argues that this needs to be viewed on a long-term basis to ensure

⁴¹ C. Brokelind, *Three New Swedish Direct Taxation Cases on Their Way to the ECJ*, 54 Eur. Taxn. 9 (2014), Journals IBFD. p. 390.

⁴² Sec. 4(4) Withholding Tax Act No. 624 of 1970.

⁴³ Swedish Supreme Administrative Court Case No. 2868/12.

⁴⁴ Case C-2082/07 *Truck Center*.

⁴⁵ Swedish Supreme Administrative Court Case No. 2868/12.

neutrality (not equality) between the investment forms. In order to determine who is better off, the computation should be done on the accumulated holding period of the shares. Brokelind argues that the ECJ has no competence to determine this, it is instead the government that needs to explain how the system in detail was designed in order to provide the right way to determine if there is discrimination or not.⁴⁶

This Swedish situation shows how complex and difficult it can be to determine the question of comparability and possible restrictions in the case of WHT on dividend payments. Therefore the following chapters will analyze these questions in order to answer how they should be interpreted in accordance with EU-law.

⁴⁶ C. Brokelind, *Three New Swedish Direct Taxation Cases on Their Way to the ECJ*, 54 *Eur. Taxn.* 9 (2014), *Journals IBFD*, p. 391.

4. Comparable Situation

4.1. Introduction

As seen above, the tiebreaker is whether there is a comparable situation or not. This chapter will therefore highlight some of the most important aspect that need to be analyzed in order to determine if a comparable situation exists in the case of dividend payments.

Situations that limited and unlimited taxpayers find themselves in are generally not objectively comparable, according to the ECJ.⁴⁷ However, this is rather the exception than the rule. What is an objectively comparable situation is normally based on the formation of the tax rules and not on the tax subject's actual situation.⁴⁸ In the decisions the purpose of the domestic rules is also considered.⁴⁹ If similar rules are applied on limited and unlimited taxpayers can their situation lack of objective differences and therefore be in an objectively comparable situation.⁵⁰

4.2. Comparable Situation in the Aspect of Dividend Payments

4.2.1. Formal or Substantive Approach

In cases regarding WHT on dividends the ECJ has examined what the purpose of the domestic legislation aims to achieve. If non-resident taxpayers with the same aim and purpose as resident taxpayers are treated less favorably there is a risk that a restriction exists. Genta argues that in order to determine if comparability exists, two solutions may be envisaged. Either the “*Formal approach*” or the “*Substantive approach*”. The formal approach examines the foreign entity's legal form. If the foreign entity is considered a legal person where it is established it can be argued that the comparison should be with a domestic company. On the other side the substantive approach looks at the activities carried out by the foreign entity and its features. Therefore the comparison should be done with a domestic entity with the same function and

⁴⁷ See for example; Case C-279/93 *Schumacker*, para. 31.

⁴⁸ G. Genta, *Dividends Received by Investment Funds: An EU Law Perspective – Part 2*, 53 *Eur. Taxn.* 4 (2013), *Journals IBFD*. P. 142.

⁴⁹ Cases C-337/08 *X Holding*, para. 22. and C-18/11 *Philips Electronics*, para. 17.

⁵⁰ See Cases C-279/93 *Schumacker*, para. 36-38 and C-107/94 *Asscher*, para. 42.

purpose. The legal form adopted in the country of establishment is in this approach not important.⁵¹

A formal approach was taken in the earlier mentioned *Aberdeen*⁵² case when the Court stated that the fact that the non-resident company had a shareholding and therefore definite influence over the distributing company made it comparable to a resident company and should be treated alike. The Court based its decision on the fact that the SICAV was considered a legal person in Luxembourg and had similar characteristics to a legal person in Finland even though the SICAV had the function of an investment fund.

In the case C-342/10 *Commission vs. Finland* the ECJ tested whether the Finnish rules on taxation on dividends distributed from Finland to foreign pension funds was in breach of EU-law. Under Finnish legislation, dividends distributed to both domestic and foreign pension funds are, in principle, taxed at a rate of 19,5 %. However Finnish pension funds had the possibility to deduct the tax, which was not possible for foreign pension funds. Consequently, the effective tax rate for Finnish pension funds became lower than 19,5 %. Regarding the question of comparability the Court stated, as follows:

*Furthermore, it is settled case-law that, in relation to expenses, such as business expenses which are directly linked to an activity which has generated taxable income in a Member State, residents and nonresidents of that State are in a comparable situation(...)*⁵³

The ECJ did not look into if foreign pension funds in fact had such expenses but instead took the view that since the Finnish legislations deductions were directly linked to the special purpose of pension funds, as follows;

Thus, the direct link between expenses and taxable income results from the technique of assimilation chosen by the Finnish legislature, among other possible techniques, such as a pure and simple tax exemption, in order to take account of the specific purpose of the pension funds which is to accumulate capital, by way of investments producing,

⁵¹ G. Genta, *Dividends Received by Investment Funds: An EU Law Perspective – Part 2*, 53 Eur. Taxn. 4 (2013), Journals IBFD p. 143.

⁵² Case C-303/07 *Aberdeen*.

⁵³ Case C-342/10 *Commission vs. Finland*, para. 37. With reference to Case C-450/09 *Scröder*, para. 40.

*in particular, an income in the form of dividends in order to meet their future obligations under insurance contracts.*⁵⁴

The specific aim of the Finnish pension funds can also be an aim for foreign pension funds, which puts them in a comparable situation according to the Court.⁵⁵ The Court took a clear substantive approach in this case and in the author's opinion it is clear that Member States must evaluate the characteristics of the non-resident taxpayer and compare them to the purpose of the legislation in question in order to determine how it should be treated. It is clear that they cannot base such decision on mere fact of residency.⁵⁶

As the Court has used both approaches in its previous case-law, is it uncertain which approach should apply. In the author's opinion it seems reasonable that the Member States should apply both methods of comparison, if both methods are applicable, the Member State should apply the treatment that is the most favorable for the non-resident.

4.2.2. The Scope of Who is Comparable

In the case of different types investment vehicles the question regarding who should be included in the comparison analysis is important. The outcome of the comparability test and a potential restriction can shift depending if the comparison analysis is made at the investment fund level or at the level of the investment fund and the investor.

In the *Santander*⁵⁷ case the ECJ took the approach, looking at the purpose of the legislation at hand. The case regarded tax withheld on dividends distributed to non-resident investment funds when dividends distributed to domestic (French) investments funds were exempt from taxation. The referring Court asked how the comparison should be made. France argued that since intermediaries do not necessarily have a legal personality, therefore the sole purpose of the intermediary is to arrange investments on behalf of its investors. That being stated, the referring Court asked, when determining if there is a restriction, whether reference should only be made

⁵⁴ Case C-342/10 *Commission vs. Finland*, para. 42.

⁵⁵ Case C-342/10 *Commission vs. Finland*, para. 43.

⁵⁶ Case C-190/12 *Emerging Markets*, para. 61-63.

⁵⁷ Case C-338/11 *Santander*.

to the investment funds or whether the situation of the shareholder should also be taken into account. The Court made it clear that the situations must only be compared at the level of the investment fund. This is because reference should only be made with the conditions for exemption from tax in the French legislation. In the French legislation no reference was made to the investor's situation, the exemption was only dependent on where the investment fund was resident.⁵⁸ Therefore the Court came to the conclusion that the French rules constituted a discrimination against the Fundamental Freedoms.⁵⁹ The *Santander* judgement is in accordance with the previous ruling in *Orange European Smallcap Fund*.⁶⁰ In the *Orange European Smallcap Fund* case, the Court came to the conclusion that the perspective of the investor had to be taken into account because the domestic legislation demanded it.⁶¹ In these cases the Court places importance on the purpose of the legislation, what the legislation aims to achieve. A conclusion from this is that the Court seems to move more and more from the formal approach to apply the substantive approach more consistently. However there is no guarantee that the Court will not apply the formal approach again.

4.3. Different Taxing Techniques

4.3.1. Introduction

In the pending Swedish case Sweden argues, with reference to *Truck Center*⁶² that domestic and foreign pension funds are not in a comparable situation based on the fact that they are taxed with two different taxing techniques. It is therefore relevant to analyze this case in order to determine how it should be interpreted in other situations.

⁵⁸ Case C-338/11 *Santander*, para. 35.

⁵⁹ Case C-338/11 *Santander*, para. 55.

⁶⁰ Case C-194/06 *Orange European Smallcap Fund*.

⁶¹ Case C-338/11 *Santander*, para. 40.

⁶² Case C-282/07 *Truck Center*.

4.3.2. *Truck Center*

Under Belgian law, payment or allocation of interest income was liable to WHT if the receiver was a non-resident. However if the recipient company was a resident the income was exempt from WHT, but only if the company was subject to corporate tax. The different techniques of taxation depended on where the receiver was resident which resulted in different tax treatment of domestic and foreign taxpayers and the question was whether they were in a comparable situation or not.⁶³ The Court came to the conclusion that this did not constitute a comparable situation since the different techniques of taxation were based on where the recipient has its residence.⁶⁴ To support its decision the Court gave three circumstances. First, the state of Belgium was in different positions depending on where the receiver of the income was resident. Second, the different tax treatment of foreign and domestic recipients is based on different legal grounds (the difference between corporate tax and withholding tax). As a final argument, the Court stated that non-residents are not directly subject to the supervision of the Belgian tax authorities like residents. The recovery of taxes from non-residents required the assistance of the other Member State and therefore could not be in a comparable situation.⁶⁵ Even though the Court did not find a comparable situation they stated that these rules did not necessarily constitute a worse situation for the non-residents taxpayer because the WHT was significantly lower than the corporate tax which also had to be pre-paid by the domestic taxpayer.⁶⁶ In the author's opinion, one might wonder why the Court analyses if there is a discrimination when there is no comparable situation. The fact that the Court is vague in saying that the rule "does not necessarily"⁶⁷ constitute an advantage for the domestic taxpayers is unfortunate and misleading. In the case *FII Group Litigation*⁶⁸ a similar question was dealt with⁶⁹. The case regarded the difference in tax treatment of UK companies receiving dividends from UK resident and non-resident companies. Dividends received by UK resident companies from UK resident companies were not subject to corporate tax on that income. However

⁶³ Case C-282/07 *Truck Center*; para. 35-36.

⁶⁴ Case C-282/07 *Truck Center*; para. 41.

⁶⁵ Case C-282/07 *Truck Center*; para. 42, 43 and 47.

⁶⁶ Case C-282/07 *Truck Center*; para. 49.

⁶⁷ Case C-282/07 *Truck Center*; para. 49.

⁶⁸ Case C-446/04 *FII Group Litigation*.

⁶⁹ In this case it was clear that a comparable situation existed.

dividends received from a non-resident UK company to a resident UK company was subject to corporate tax on that income, with the possibility to offset the tax paid by the distributing company. The Court stated that using two types of taxing techniques was not a breach of EU-law, as long as the foreign taxpayer was not treated worse than the domestic one.⁷⁰ In the following case *Test Claimants in the FII Group Litigation*⁷¹ the Court once again made clear that these two methods are in fact equivalent, as long as the foreign taxpayer is not treated worse than the domestic one. However, because the imputation method, unlike the exemption method, did not grant the possibility of passing over the benefit of corporate tax deductions from the paying company to its corporate shareholder, these two methods might end up being not equivalent. Therefore since these rules could not guarantee that foreign investments were not treated worse than domestic investments the rules constituted a restriction on the freedoms of establishment and capital movements.⁷² Even though the latter judgement came after *Truck Center* this have been a settled requirement for before *Truck Center*.⁷³ In the author's opinion it is unclear why the Court makes this statement as it only creates uncertainty and unpredictability for both Member States and their taxpayers.

The judgement is also easy to criticize for its lack of substance. The first argument from the Court, that Belgium's position is different depending on the residency of the receiver, is only a statement from the main rule that limited and unlimited taxpayers generally are not in a comparable situation.⁷⁴ However, the Court has repeatedly confirmed that situations between unlimited and limited taxpayers lack objective differences and are therefore comparable.⁷⁵ The second argument from the Court is only, from the point of view of the lender, a precise description of the differences in treatment which is the subject to the alleged discrimination.⁷⁶ The last argument from the Court with regard

⁷⁰ Case C-446/04 *FII Group Litigation* para. 73.

⁷¹ Case C-35/11 *Test Claimants in the FII Group Litigation*.

⁷² Case C-35/11 *Test Claimants in the FII Group Litigation*, para. 64-65.

⁷³ See for example Case C-330/91 *Commerzbank*.

⁷⁴ See for example Case C-279/93 *Schumacker*, para. 31.

⁷⁵ See for example Cases C-170/05 *Denkavit*, C-379/05 *Amurta*, C-284/09 *Commission vs Germany*.

⁷⁶ Confédération Fiscale Européenne, Comment by the CFE Task Force on ECJ Cases on the Judgment in *Belgium SPF Finance v. Truck Center SA*, Case C-282/07, Judgment of 22 December 2008: Paper submitted by the Confédération Fiscale Européenne to the Council of the European Union, the European Commission and the European Parliament in 2009, 49 *Eur. Taxn.* 10 (2009), *Journals IBFD*. Point 17.

to the difference in recovery of the tax, once again, only refers back to the fact residents and non-residents are different because residents and non-resident are different. This goes directly against prior case-law and actually states that a resident and a non-resident never can be in a comparable situation.⁷⁷

The Court also stated that the rules required the assistance from the other Member State and therefore could not be in a comparable situation, this could be a justification ground, however not a reason not to be comparable. In the *Scorpio*⁷⁸ case the Court expressed that case preceded the scope of The Mutual Assistance Directive⁷⁹ and therefore was no option but to withhold tax since the request of assistance was not possible.⁸⁰ This could have been the case in *Truck Center*. However, at the time of the case there existed a convention between the Benelux countries on Mutual assistance on tax claims which made it possible for Belgium to request assistance from Luxembourg.⁸¹ In the *Emerging Markets of DFA Investment Trust Company* case, the ECJ confirmed that the lack of exchange of relevant information may in principle justify a restriction to a Fundamental Freedom but also made it clear that this justification is not possible if there exists a double tax convention providing the possibility for the source state to collect and verify the relevant information.⁸² Broe and Bammens argues that it is unfortunate that the Court transposes a justification ground into the comparability analysis. A theoretically sound approach requires a comparability analysis without interference from justification arguments. It is also troubling that the Court from its previous judgements has shifted its reasoning and included the perspective of the tax administrations in the comparability analysis.⁸³ In earlier case-law the analysis has always been from the taxpayer's perspective⁸⁴. From the tax administrations perspective a

⁷⁷ Confédération Fiscale Européenne, Comment by the CFE Task Force on ECJ Cases on the Judgment in Belgium SPF Finance v. Truck Center SA, Case C-282/07, Judgment of 22 December 2008: Paper submitted by the Confédération Fiscale Européenne to the Council of the European Union, the European Commission and the European Parliament in 2009, 49 Eur. Taxn. 10 (2009), Journals IBFD. Point 18-20.

⁷⁸ Case C-290/04 *Scorpio*.

⁷⁹ Council Directive 76/308/EEC Mutual Assistance Directive.

⁸⁰ Case C-290/04 *Scorpio* para. 38.

⁸¹ AG Opinion, Case C-282/07 *Truck Center*, para. 42.

⁸² Case C-190/12 *Emerging Markets of DFA Investment Trust Company* para. 81-88

⁸³ Luc De Broe, Niels Bammens, 'Truck Center Belgian Withholding Tax on Interest Payments to Non-resident Companies Does Not Violate EC Law: A Critical Look at the ECJ's Judgment in Truck Center' (2009) 18, p. 133.

⁸⁴ See for example: Cases C-319/02 *Manninen* and C-307/97 *Saint Gobain*

resident and a non-resident will always be in a non-comparable situation since they are in different degrees of administrative tax burdens. Therefore including the tax administrations perspective severely limits the scope of the Fundamental Freedoms in the area of direct taxation which results in a major setback in the realization of the internal market. Therefore the tax administrations perspective should never be included in the comparability analysis, however it is an important aspect when examining justifications linked to administrative burdens and the issue of proportionality.⁸⁵

Considering this, it is the author's opinion that this case should be not taken as a precedent in future cases on dividend payments. Especially as *Truck Center* deals with payments of interest and not dividends, which according to Advocate General Kokott cannot be compared.⁸⁶

4.3.3. The Character of the Tax

A further question that should be answered is the character of the domestic tax. In the Swedish case it can be questioned whether the yield tax in fact can be considered as a tax on dividends since it is not only based on dividends received. Våljemark argues that the yield tax should be compared with a wealth tax rather than a tax on dividends, since the tax is not solely based on dividends. This would constitute the fact that dividends distributed to resident taxpayers are tax exempt, or at least the yield tax should be compared to the WHT on the part that is based on the dividends received.⁸⁷

In *Truck Center* the Court focuses on the final tax burden and not on how the tax was calculated. In the author's opinion this was the right assessment in that case since the tax was based on the same income. However the situation is clearly different in the Swedish situation where not only two different tax treatments are used but also two significantly different tax bases.

It will be interesting to see if the Court lays any weight on this matter. But a clarification is needed whether the character of the tax (what the tax is based on and how it is levied) has any importance to the determination of comparability and a potential restriction.

⁸⁵ Luc De Broe, Niels Bammens, 'Truck Center Belgian Withholding Tax on Interest Payments to Non-resident Companies Does Not Violate EC Law: A Critical Look at the ECJ's Judgment in *Truck Center*' (2009) 18, p. 133.

⁸⁶ AG Opinion, Case C-282/07 *Truck Center*, para. 60-63.

⁸⁷ C. Våljemark, Har Sverige rätt att ta ut källskatt på utdelning? *Skattenytt* 2010, p. 31.

4.4. Concluding Remarks on Comparable Situation

It is still uncertain how the comparability analysis should be done in situations of dividend payments. But what is clear from the case-law is that the analysis should be made against the aim and purpose of the legislation at hand. Either the formal or the substantive approach, if both methods are applicable, the Member State should apply the treatment that is the most favorable for the non-resident taxpayer.

In the author's opinion the judgement from *Truck Center* is unfortunate as it has created uncertainty on what factors affect the comparability analysis. Therefore the situation right now is hard to predict. If the Court confirms the judgement from *Truck Center* in future cases it would severely damage the internal market and the possibility for taxpayers to claim their Fundamental Freedoms rights would be severely limited.

The question that still remains is whether the difference in tax treatment can affect the character of a resident taxpayer so much that it cannot be compared to a non-resident taxpayer. In the author's opinion a Member State cannot justify such reasoning with reference to the judgement in *Truck Center*. However, if a Member State can prove that tax legislation applied to resident taxpayers makes them so fundamentally unique from other taxpayers, there might be a possibility that no comparison can be made.

5. Restriction of the Free Movement of Capital

5.1. Introduction

When determining if a restriction exists the ECJ focuses on whether a comparable non-resident taxpayer is taxed more heavily than a resident taxpayer. If the final outcome shows that a resident taxpayer is in a more advantageous situation than a non-resident taxpayer, a restriction exists.⁸⁸

5.2. The Calculation of the Restriction

The question of whether a restriction could be equalized by the argument that the outcome of the tax will be equal over time, has never been up for question until the current Swedish pending case. The issue is, what period of time the comparison between non-residents and residents should be based on in order to find a restriction in the free movement of capital.⁸⁹ Sweden argues, that since this is a pension fund, the final outcome of the pension income is the income received during the entire working life of the retiree. In other words it would be misleading to argue that a non-resident pension fund is treated worse based on a single tax year. Brokelind agrees with the fact that there are a lot of factors that can affect the situation from year to year and that foreign pension funds could both be treated better and worse. For example, have any dividends been distributed? If no, then the non-resident funds are clearly in a better position. If yes, you need to know the actual rate of the government bond that determines the yield tax of Swedish pension funds. If it is low, it is a big risk that non-residents are taxed more heavily than resident pension funds.⁹⁰

Even though the Swedish argument is in fact based on solid grounds with reference to the purpose of Swedish pension funds it is impossible to guarantee that non-resident pension funds are not treated worse than resident pension funds. This is because the Swedish legislation has no possibility to predict the development of the government bond that will affect yield tax. Therefore there will always be a risk, even in the long run, that non-resident pension funds will be taxed more heavily than resident funds. In the author's opinion, the fact that

⁸⁸ See for example Cases; C-170/05 *Denkavit*, para. 41, C-105/08 *Commission v. Portugal* paras. 26-32, C-282/07 *Truck Center* para, 49 and C-35/11 *Test Claimants in the FII Group Litigation*, para. 64-65.

⁸⁹ C. Brokelind, *Three New Swedish Direct Taxation Cases on Their Way to the ECJ*, 54 *Eur. Taxn.* 9 (2014), *Journals IBFD*, p. 390-391.

⁹⁰ C. Brokelind, *Three New Swedish Direct Taxation Cases on Their Way to the ECJ*, 54 *Eur. Taxn.* 9 (2014), *Journals IBFD*, p. 390-391.

ECJ has stated that the mere risk of a restriction is enough to constitute a restriction⁹¹ leads us to the conclusion that it is unlikely that Sweden will have any success with this argument.

5.3. The Calculation of the Tax Base – Deduction of Costs

Just like in the *Commission vs Finland*⁹² case the ECJ has in the *Centro Equestre*⁹³ case stated that costs that should be deductible for non-residents are those costs that have a direct economic connection to the income linked to the source state. However in the case *Commission v. Portugal*⁹⁴ the ECJ denied the Commission's claim for right to deduct for non-resident taxpayers since the Commission, which bore the burden of proof failed to prove higher taxation of non-residents. In the case resident taxpayers were taxed with a corporate tax of 25 % on their net income when non-residents were taxed with 20 % on their gross income. The outcome of this case may result in the “*Bouanich problem*”, as it is necessary to balance the differences of tax rates and cost deduction rules.⁹⁵ The *Bouanich*⁹⁶ case addressed the question of calculation of WHT on gross dividends instead of the net income and stated that this might be a potential discrimination. However the Court stated that the denial of deductions is not a breach of EU-law as long as non-resident taxpayers are not treated less favorably than residents.⁹⁷

In the author's opinion, the conclusion of this case-law must be that, in accordance with the territorial principle the source state is obliged to grant deductions of costs to non-residents which have a direct economic link with the income derived there. However if the source state can prove that non-residents are not treated less favorably than residents this obligation does not exist. Problems that arise here are how companies/Member States should calculate and attribute costs to certain foreign-sourced dividends and how to decide if these costs are direct or indirect costs. The most ambitious method may be to attribute cost on an individual basis. The exact cost that the non-resident

⁹¹ See for example Cases C-270/83 *Avoir Fiscal*, para. 21. And C-524/04 *Thin cap group litigation*, para. 62.

⁹² Case C-342/10 *Commission vs. Finland*, para. 42.

⁹³ Case C-345/04 *Centro Equestre da Lezíria Grande* para. 21-27.

⁹⁴ Case C-105/08 *Commission v. Portugal*.

⁹⁵ G. Maisto among others, *Taxation of Intercompany Dividends under Tax Treaties and EU Law*, p. 30.

⁹⁶ Case C-265/04 *Bouanich*.

⁹⁷ Case C-265/04 *Bouanich* para. 56.

taxpayer has paid for the management of his equity investments in the source state. This is probably the most efficient way to do it but also the most demanding and difficult.⁹⁸ Another method could be to proportion the global costs incurred by the non-resident. This is a far less precise method but more practical to apply.⁹⁹ A third method could be to attribute costs based on a comparison with the cost structure of comparable domestic taxpayers in the source state.¹⁰⁰ However as the methods might provide solutions for the attribution of the cost, it is only the first method that guarantees that the costs are direct and not indirect, in the author's opinion.

With regard to the Swedish case, foreign pension funds should have the right to deduct costs incurred in the source state if they are treated less favorably than Swedish pension funds. How these costs should be calculated and characterized can be debated and must probably be solved on case-by-case basis, in the author's opinion.

5.4. Concluding Remarks on Possible Restrictions

As stated above, the Court has been consistent in its judgements that it is the final outcome that determines if a restriction exists. However new guidance is needed as the Swedish case raises a new aspect to the calculation of the final outcome. In the author's opinion with reference to previous case-law a calculation of a possible restriction in the long-run is not compatible with EU-law, as it will be impossible for a Member State to guarantee that non-residents are not treated less favorably than residents. The fact that the ECJ has several times stated that a Member State must be able to guarantee that no restriction is possible and that the mere risk of a restriction constitutes a restriction makes it hard to come to another conclusion.

In respect of the deduction of costs, the Court has also failed to give guidance as to what a direct cost is and how it should be calculated. The fact that the Court states that the denial of deductions is not a breach of EU-law as long as non-residents are not treated less favorably, is troubling. The fact that cost sometimes must be included and sometimes not, creates situations that only can be solved on a case-by-case basis. Hopefully the Court will provide helpful

⁹⁸ G. Maisto among others, *Taxation of Intercompany Dividends under Tax Treaties and EU Law*, p. 31.

⁹⁹ G. Maisto among others, *Taxation of Intercompany Dividends under Tax Treaties and EU Law*, p. 31.

¹⁰⁰ Case C-105/08 *Commission v. Portugal* para. 18.

guidance on this matter in the pending Dutch cases *Société Générale*¹⁰¹, *X*¹⁰² and *Miljoen*¹⁰³.

The question of how a potential restriction should be calculated is also an uncertain matter. Even though it is in principle acceptable to apply different tax treatments of resident and non-resident taxpayers, this is only possible when non-residents are not treated less favorably than residents. The Court have been consistent in its judgements, that it is the final outcome of the tax due that determines whether there is a restriction or not. However, how to calculate a restriction is not an easy matter when the two tax treatments may lack fundamental similarities. This problem will grow in the future as Member States will try to develop new ways to tax capital, like the Swedish yield tax system where an assessment of year-to-year final tax outcome may be hard to determine. Therefore the potential risk of discrimination will always be present. The fact that the ECJ has stated that the mere risk of a restriction is enough to constitute a discrimination makes it hard to believe that there is a future for withholding taxes.

¹⁰¹ Case C-10/14 *Miljoen*, (pending).

¹⁰² Case C-14/14 *X*, (pending).

¹⁰³ Case C-17/14 *Société Générale*, (pending).

6. Future Aspects of Withholding Tax

When evaluating the ECJ's case-law it has developed a method of balancing the EU interest and the Member State's interests. Therefore the Court must always weigh pros and cons between the Member States revenue raising concerns and the development of the internal market.¹⁰⁴ However in the case of WHT tax the Court has failed to be consistent and clear in this balancing. Even though there is a considerable body of case law on cross-border dividend taxation, the Court has failed to give helpful jurisprudence in the area, especially regarding the assessment of comparability. Therefore, there is a need to revise the ECJ's case law on direct taxes and develop new and more convincing and consisting concepts.¹⁰⁵

Englisch argues that the disparities between Member States tax systems cannot be invoked by any of the Fundamental Freedoms. Therefore the parallel use of two Member States tax systems that create obstacles in the internal market cannot be overcome by negative integration through the Fundamental Freedoms.¹⁰⁶ Schön means (in his article based on Klaus Vogel's lecture 24 October 2014 at the Vienna University) that the ECJ should avoid the thought of, that within the EU, income derived by a taxpayer should only be taxed or deducted once. The problem is that the Fundamental Freedoms do not provide a framework for such one-off taxation. Such framework would not only require the prohibition of juridical taxation in the first place but also would require a common set of rules to calculate the income, and a common set of rules to the allocation of the taxing rights between the Member States. Such framework does not exist in the EU

¹⁰⁴ M. Isenbaert, *The Contemporary Meaning of "Sovereignty" in the Supranational Context of the EC as Applied to the Income Tax Case Law of the ECJ*, EC Tax-review 2009-6, p. 105.

¹⁰⁵ Joachim Englisch, 'Taxation of Cross-Border Dividends and EC Fundamental Freedoms' (2010) 38 Intertax, Issue 4, p. 221.

¹⁰⁶ Joachim Englisch, 'Taxation of Cross-Border Dividends and EC Fundamental Freedoms' (2010) 38 Intertax, Issue 4, p. 205.

treaties today.¹⁰⁷ Spengel and Evers mean that the problem may only be overcome by way of harmonizing direct taxation. The need for efficiency within the EU (which is inherent in the TFEU Article 120) requires that taxation does not distort the efficient allocation of capital throughout the internal market. The negative effects, such as cash-flow effects and compliance costs, are all arguments to abolish the WHT in favor of an effective internal market.¹⁰⁸ Magliocco and Sanelli also question if there is a possibility for withholding taxes on dividend payments in the future considering the growing market integration, the increasing correlation of international markets and the reduction of transaction costs. From a pure economic point of view the elimination of withholding taxes would boost the internal market as it would attract more foreign capital and at the same time the administrative burden would be significantly be reduced. But in order to abolish withholding taxes without it resulting in an advantage for investors using tax havens and aggressive tax planning this exemption from withholding taxes should only be allowed to countries that allow for an effective information exchange.¹⁰⁹ Helminen also argues that WHT levied by the Member States is in conflict with the TFEU and that the Member States should go over to a system without WHT and instead use a harmonized tax treatment of dividend payments.¹¹⁰

With regard to the allocation of taxing rights, a system without WHT would create a more clear-cut allocation of taxing rights between the Member States. The business profits created in the source state will be taxed in the source state and the distributed profits would be taxed in the hands of the

¹⁰⁷ W. Schön, *Neutrality and Territoriality – Competing or Converging Concepts in European Tax Law?*, 69 *Bull. Intl. Taxn.* 4/5 (2015), *Journals IBFD*, pp. 278-279.

¹⁰⁸ Christoph Spengel, Lisa Evers, 'The Cross-border Taxation of Dividends in the Case of Individual Portfolio Investors: Issues and Possible Solutions' (2012) 21*EC Tax Review*, Issue 1, pp. 25-26.

¹⁰⁹ A. Magliocco & A. Sanelli, *Should Outbound Dividends Remain Taxed at Source in the European Union? Some Hints from the Italian Example*, 49 *Eur. Taxn.* 4 (2009), *Journals IBFD*. P 214.

¹¹⁰ Helminen M, *The future of source state dividend withholding taxes in Finland and the European Union*, p. 357 and 360.

shareholder, in his state of residency.¹¹¹ Even though there are a lot of upsides to the abolishment of withholding taxes there are a lot of negative effects that need to be considered. The abolition would create negative effects on the source state's tax revenue as the tax income would be shifted from the source state to the resident state. However this is not necessarily a problem as the source state already had the possibility to tax the business profits. A bigger downside is the increased risk of tax avoidance and aggressive tax planning opportunities. Therefore the need to introduce an automatic information exchange between the Member States is a must. Spengel and Evers considers this to be a more effective tool than withholding taxes in order to prevent tax evasion. Additionally they suggest an introduction of an EU identification tax number to provide an even more effective information exchange. However, this would impose major administrative and compliance cost for the tax administrations and might encourage investors to relocate their capital to countries that do not take part of the information exchange. Therefore the introduction of automatic information exchange is only effective to some extent.¹¹²

The doctrine seems very united in the argument to abolish WHT on dividend payments within the EU. The development of the case-law on withholding taxes, where the Member State in several cases have had to change their legislation's, lead us to the fact that the space to levy WHT is getting more and more restrictive.¹¹³ Schön argues that the fact that even when two Member States use the exact same tax rules in parallel to raise revenues double taxation can occur, which creates a big wedge between

¹¹¹ Christoph Spengel, Lisa Evers, 'The Cross-border Taxation of Dividends in the Case of Individual Portfolio Investors: Issues and Possible Solutions' (2012) 21EC Tax Review, Issue 1, p. 27.

¹¹² Christoph Spengel, Lisa Evers, 'The Cross-border Taxation of Dividends in the Case of Individual Portfolio Investors: Issues and Possible Solutions' (2012) 21EC Tax Review, Issue 1, p. 28.

¹¹³ A. Magliocco & A. Sanelli, Should Outbound Dividends Remain Taxed at Source in the European Union? Some Hints from the Italian Example, 49 Eur. Taxn. 4 (2009), Journals IBFD, p. 201.

purely internal and cross-border situations.¹¹⁴ In the author's opinion the conclusion of this statement together with the previous case-law seems to be that even though the ECJ tries to harmonize the Member States rules on WHT obstacles to the development of the internal market, such obstacles will always be present. Therefore it is reasonable to argue that even though the area of direct taxation still is not harmonized a future without withholding taxes may soon be a reality. When and how this will happen is still uncertain but in the author's opinion there is a future without withholding taxes and when this happens it will be a great step in the right direction for the development of the internal market.

¹¹⁴ W. Schön, *Neutrality and Territoriality – Competing or Converging Concepts in European Tax Law?* 69 *Bull. Intl. Taxn.* 4/5 (2015), *Journals IBFD*, p. 274.

7. Conclusion

The purpose of this thesis is to evaluate the compatibility of withholding taxes on dividend payments with the internal market and the Fundamental Freedoms. As the aspects of the internal market and the Fundamental Freedoms go hand in hand this thesis has focused on the determination of a potential discrimination.

Since only rules that treat non-resident taxpayers less favorably than resident taxpayers can be a potential restriction of the Fundamental Freedoms the question of comparability is of importance. Even though the subject of WHT compatibility with EU law has been dealt with several times, the ECJ has failed to provide helpful jurisprudence regarding the assessment of comparability. What can be drawn as a conclusion from the case law is that the assessment should be taken out from the purpose of the legislation at hand. Either the formal or the substantive approach can be taken in this matter as the Court is inconsistent in its rulings. Even more troubling is the judgment from *Truck Center* where the Court includes justification grounds and the perspective of the tax administration in the assessment of comparability. From the perspective of legal certainty the situation is very unpredictable as it can only be solved on a case-by-case basis.

The question of how a potential restriction should be calculated is also an uncertain matter. Even though it is in principle acceptable to apply different tax treatments of resident and non-resident taxpayers, this is only possible when non-residents are not treated less favorably than residents. The Court have been consistent in its judgements, that is the final outcome of the tax due that determines whether there is a restriction or not. However, how to calculate a restriction is not an easy matter when the two tax treatments may lack fundamental similarities. This problem will grow in the future as Member States will try to develop new ways to tax capital, like the Swedish yield tax system where an assessment of year-to-year final tax outcome may

be hard to determine. Therefore the potential risk of discrimination will always be present. The fact that the ECJ has stated that the mere risk of a restriction is enough to constitute discrimination makes it hard to believe that there is a future for WHT on dividend payments.

Considering the amount of case law on this particular matter it seems that the problem cannot be solved through the ECJ. Therefore WHT on dividend payments will always be an uncertain matter. In the author's opinion there is, for this reason, no future for WHT within in the EU. The need for harmonization in this particular area is of essence for reasons of legal certainty and for the development of the internal market.

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Advocate General's Opinion

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the case Case C-282/07 *Truck Center*.