

Morgan Lewis

WTAX

FOREIGN WITHHOLDING TAX RECOVERY ECJ CLAIMS AND US TAX CONSEQUENCES

June 30, 2021

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AGENDA

- 01.** | Morgan Lewis and WTax Introduction
- 02.** | Withholding Tax Landscape
- 03.** | Additional ECJ Information
- 04.** | US Tax Considerations – US RIC and Withholding Tax Refunds
- 05.** | How WTax and Morgan Lewis Can Help

01. | Morgan Lewis and WTax

Introduction

BREADTH AND DEPTH OF OUR MORGAN LEWIS TAX PRACTICE



WE WORK IN COLLABORATION AROUND THE WORLD

**31 OFFICES
ACROSS 17
TIME ZONES**

700+
PARTNERS

180+
SENIOR
LAWYERS

1100+
ASSOCIATES

450+
LEGAL
PROFESSIONALS

WTax

1 000+ Clients

4 500+ Funds serviced globally

150+ Custodian Relationships

30+ Foreign Reclaim Jurisdictions

Fee – Success-based

VAT IT GROUP



VAT
Recovery



VAT
Compliance



Withholding
Tax Recovery



Importer
of Records



Meridian
VAT Reclaim



Largest indirect tax recovery firm globally



1 300+ employees located in 40 wholly owned offices



Servicing over 15 000 clients in 107 countries

02. | Withholding Tax Landscape

What is withholding tax and how can it be reclaimed?

Withholding tax is a tax deducted at source by a local government on dividends and interest paid to a non-resident domiciled outside that country.

How can you get relief from and reclaim withholding tax?



Relief at Source



Double Tax Treaties



Domestic Tax
Legislation Exemptions



European Court
of Justice (ECJ)



European Court of Justice (ECJ) / Case Law Precedent Claims

Also referred to as Santander, Aberdeen,
Fokus Bank or EU claims

Basis:

Legal precedent in favor of anti-discrimination and the free flow of capital within the European Union

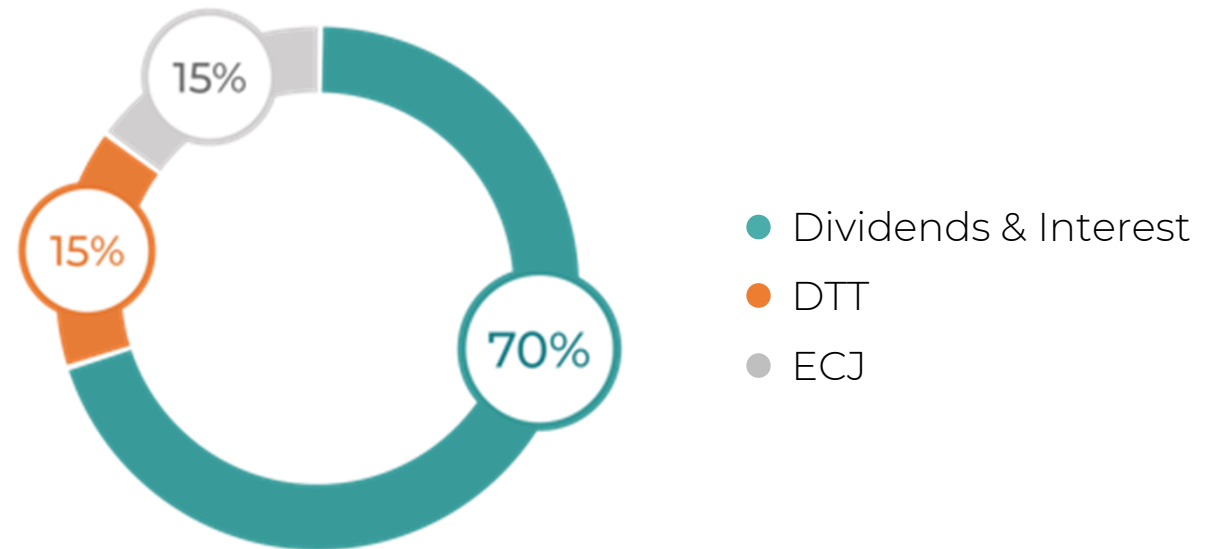
Availability

Specific investors in limited EU countries

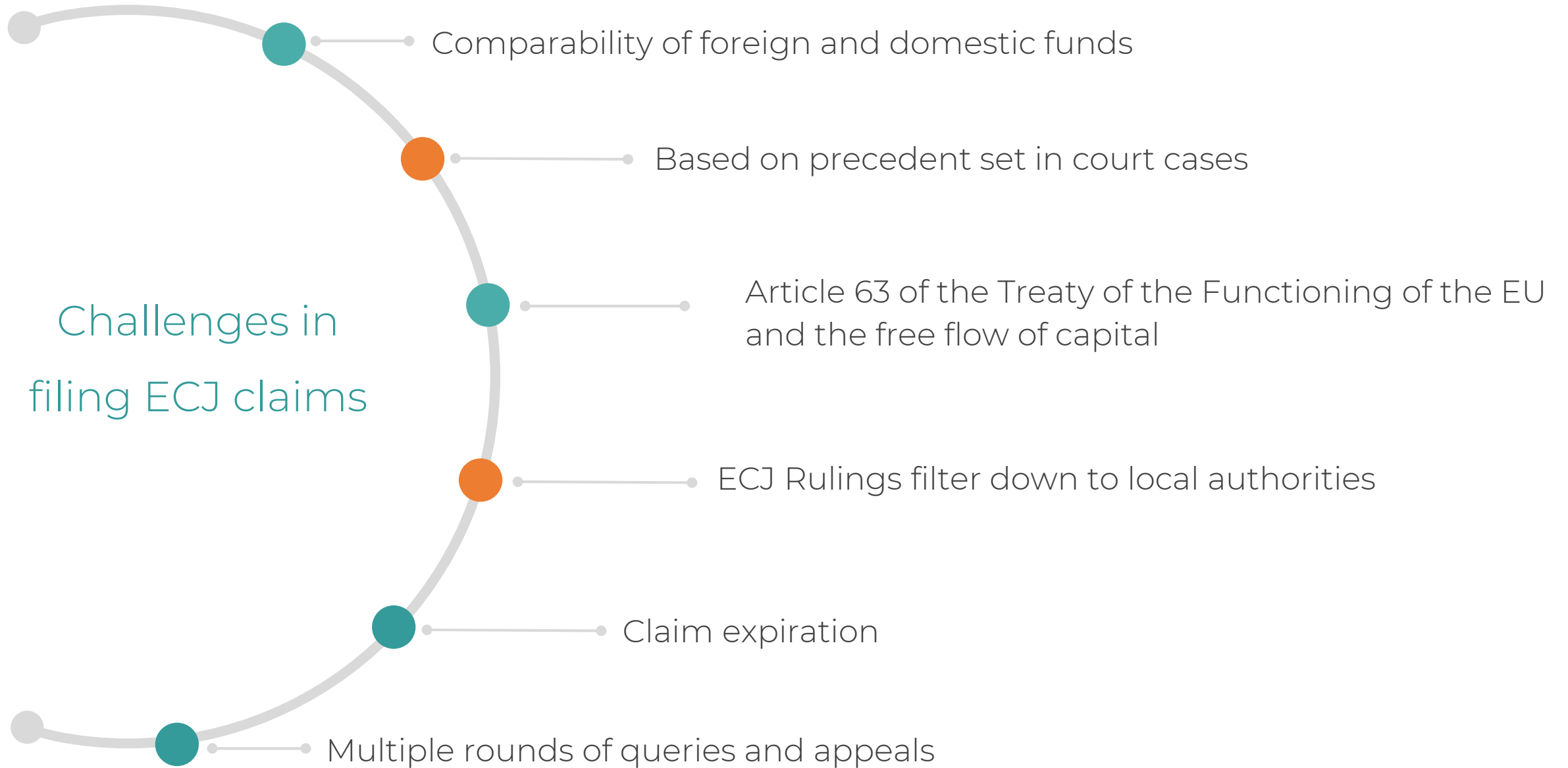
Opportunity

Specific investment funds (EU and Non-EU)

WHT incurred and generally fully recovered through ECJ mechanism



Challenges in filing ECJ claims



03. | Additional ECJ Information

ECJ territories for US RICs

Actively
refunding

Finland
Poland

Partly refunding
/ refunds
expected

France
Sweden
Spain

Refunds under
consideration

Denmark
Germany
Netherlands
Italy

* Please note there are additional territories where refunds were previously available and are now passed statute as well as some additional territories where we do not believe claims are viable.



Finland

- The tax authorities are **actively granting refunds** to US RIC's where comparability is evidenced.
- Finland only considers **contractual investment funds** comparable to Finnish investment funds. Historically, both US RIC's established as Delaware Trust and Massachusetts trust have been considered comparable.
- The Finnish Administrative court has also issued positive rulings regarding US RIC's organized as **Maryland corporations** finding that these corporate funds are comparable with Finnish contractual-based funds under EU law.

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Poland

- Following **the Emerging Market case** US RIC's have been **receiving successful refunds** from Poland for EU based claims. Albeit the success the reclaims are **administratively burdensome and complex**.
- Starting from **1 January 2021**, all claims for WHT refunds in Poland are reviewed by one entity – **Lubelski Tax Office** in Lublin (before 2021, depending on circumstances, other tax offices - e.g. in Warsaw - were responsible for such proceedings).
- While the requirements for these claims are now **unified** they are also unfortunately **stricter** than before.



France

- — During 2021 the French Tax Authorities (FTA) issued the first set of [favorable decisions and refunds](#) on reclaims filed by US RIC's on the basis of the free movement of capital.
- — On [August 12, 2020](#) the FTA published draft updated guidelines concerning the documentation and application process for non-EU CIV's seeking domestic exemption on French equities
- — As a reminder - Article 119 bis 2 of the French tax code (FTC) provides for an exemption from withholding tax on French dividends paid to certain nonresident regulated CIV's. This exemption was introduced following the positive ruling by the CJEU in the [Santander case in May 2012](#)
- — The updated guidelines provide clarity on the criteria that must be met by a non-EU CIV to confirm its comparability to a French CIV to qualify for the domestic exemption on French sourced dividend payments.
- — Currently, non-EU CIVs are required to submit a contentious litigation request with supporting documentation to the FTA to obtain approval to qualify for domestic exemption. If a positive decision is reached, the FTA issue an approval for exemption which is valid until December 31 of the second year following the approval date.



Sweden

- In 2015 the Swedish Administrative Court of Appeal ruled that several US funds were entitled to a refund based on EU law.
- However, during 2016 the Swedish Tax Agency stated that it is of the opinion that contractual funds and trust funds that are not considered as legal entities, may be equivalent to a Swedish special fund but that legal entities are not considered comparable. As a result US RIC's started receiving rejections.
- On 11 February 2020 a ruling was given in case no. 3725—3727-18 concerning a US RIC. The Court held that the fact that the foreign fund is a legal entity does not prevent it from being in a situation that is comparable to a Swedish investment fund, according to EU law. Thus it was found that a US RIC is comparable to a Swedish investment fund.
- Since this ruling US RIC's have again seen refunds being paid on their Swedish EU claims. Notably these positive refund decisions have only been made to open-ended US RIC's established as Delaware Trusts.
- The Swedish Tax authorities are currently contending that US RIC's established as Massachusetts Trust are not equivalent to Swedish Special Funds given that the liability of investors is not limited.



Spain

- No repayments to date. Claims are assessed by tax office but mostly rejected. Need to file Economic Administrative appeals.
- On 13 November 2019 the Spanish Supreme Court (RJ 2019, 4791) (Rec. 3023/2018)) ruled that the current provisions of the Spanish legislation with regards to the effective 1% final tax on dividends represents a violation of the free movement of capital by denying the same treatment afforded to Spanish CIUs to Non-EU funds.
- Comparability analysis must be carried out in accordance with Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 (“UCITS Directive”) as opposed to Spanish internal source legislation on undertakings for collective investment.
- Exchange of information provision between the US and Spain is sufficient for the Spanish tax authorities to gather the relevant information required to prove the framework comparability between a US RIC and UCITS funds.
- The Spanish National Court (Audiencia Nacional) has also issued two favourable rulings regarding withholding refund claims on behalf of US RIC’s, dated July 9th and July 12th , 2020



Denmark

- No repayments to date. Claims are not assessed by tax office or rejected based on High Court decision.
- In June 2018 the CJEU ruled, in the [Fidelity Funds case](#), that the Danish tax regime for foreign investment funds is contrary to EU Law.

However, in April 2019 the Danish High Court found that the foreign investment fund was not entitled to the exemption as the fund did not fulfil the requirements for being qualified as an investment fund with minimum taxation according to Danish Legislation ([SKM.2019.383](#)).
- The decision of the Danish High Court was appealed to the [Supreme Court](#) on 7 May 2019. A Decision was issued by the Supreme Court on 24 June 2021.
- Foreign investment institutions were not entitled to a refund of withheld dividend tax. No basis for re-referral to the European Court of Justice ([Case 59/2019](#)).



Germany

- No repayments to date. Claims are not assessed by tax office.
- Following the change in the WHT regime from [1 January 2018](#), both German and foreign investment funds are subject to a 15% withholding tax.
- Litigation has commenced for both European and US Investment funds.

During [2019](#) German Regional Tax Courts rejected test cases involving EU investment funds, arguing that a different treatment of German and foreign investment funds is justified by the coherence considering the taxation of holders of fund units and by the need to allocate taxing rights to the member states ([Finanzgericht Hessen, decision dated August 21, 2019 – 4 K 999/17, 4 K 2079/16](#)). The need to preserve the balance in the distribution of taxing powers between Member States has also been noted as reason for justification.
- The decisions of the Regional Tax Court are currently under review at the Federal Tax Court. It is expected that the Federal Tax Court will forward questions to the CJEU to clarify whether section 11 German Investment Tax Act (“InvStG”) (old version) conforms with EU law.



Netherlands

- Dutch Supreme court issued two key rulings – its ruling on the Köln Aktienfonds Deka (KA DEKA) case on [October 23, 2020](#) (dividends paid between 2002 and 2008) and on [9 April 2021](#) its ruling in [ECLI:NL:HR:2021:506](#) on the post-2008 scheme (involving a US RIC).
- Dutch Supreme Court denies the claim for a refund of Dutch dividend withholding tax for the years as from 2008.
- No payments to date. Claims not currently viable.



Italy

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- No payments to date. Italian tax authorities has not been active with reclaims
 - In several judgements, [Italian tax courts](#) found the withholding tax framework applicable towards non- Italian recipients of dividends paid by Italian-resident companies as [discriminatory, thus in violation of the principle of free movement of capital as depicted by the CJEU case-law](#). This line of reasoning has been recently upheld by the [Italian Supreme Court \(Corte di cassazione\)](#).
 - Reclaims are expected to be subject to litigation

04. | US Tax Considerations – US RIC and Withholding Tax Refunds

Legal Framework

- Foreign tax credit
 - US taxpayers may take a credit (a “foreign tax credit” or “FTC”) or deduction for creditable foreign taxes paid or accrued to a foreign country or US possession
- What about US RICs, which are typically unable to use the full value of an FTC?
 - IRC Section 853 provides a solution to preserve, at the shareholder level, the tax benefits associated with FTCs attributable to foreign taxes paid by US RICs

Legal Framework

- IRC Section 853
 - If more than 50% of the value of a US RIC's asset at the close of its taxable year is stock or securities of foreign corporations, the US RIC may elect to treat creditable foreign taxes (including creditable ECJ withholding taxes) paid by the US RIC as paid by its shareholders
- Effect of election
 - The US RIC
 - Forgoes an entity-level deduction or credit for the foreign taxes
 - Increases its dividends-paid deduction by the amount of the foreign taxes
 - Each shareholder
 - Includes its share of the foreign taxes in income and can claim an FTC or take a deduction (subject to generally applicable limitations)

Treatment of Refunded Foreign Taxes

- IRC Section 905(c)
 - A taxpayer that receives a refund of all or a portion of foreign taxes for which an FTC was previously allowed is required to notify the IRS and the IRS re-determines the taxpayer's US federal income tax liability for the affected years
- How would a US RIC and its shareholders comply with this obligation?
 - Amended tax information returns (e.g., Forms 1099)
 - Shareholders would then determine their own Section 905(c) obligations (if any)
 - Failure to comply?
- Notice 2016-10 issued to provide workable methods to comply with Section 905(c) for US RICs and their shareholders

Notice 2016-10

- Notice 2016-10 provides two alternative methods a US RIC can use to satisfy its own Section 905(c) obligations and its shareholders' obligations
 - the "Netting Method" and
 - the "Closing Agreement Method"
- If a US RIC does not, or is not eligible, to use either the Netting Method or the Closing Agreement Method, the general rules of Section 905(c) apply

Notice 2016-10: The Netting Method

- Allows the foreign tax refund to be taken into account in the refund year
 - The US RIC nets its “foreign tax adjustment” (or “FTA”) against the foreign taxes paid by the US RIC and reported to its *refund year* shareholders
 - FTA = the foreign tax refund + an interest component
- Simplified Example
 - In Year 5, US RIC receives (a) \$2,000,000 of foreign dividends from which \$250,000 is withheld and (b) \$230,000 refund of ECJ withholding taxes paid in Year 1, plus \$20,000 of interest on the ECJ refund
 - Assume US RIC has no other income or expenses and distributes all available amounts to its shareholders
 - What are the results under the Netting Method?

Notice 2016-10: The Netting Method

FTA: \$250,000 (\$230,000 ECJ refund + \$20,000 of interest)

Distributable amount: \$2,000,000 (\$2,000,000 of foreign dividends + \$230,000 ECJ refund + \$20,000 of interest - \$250,000 foreign withholding tax)

Foreign taxes passed through: \$0

Amount included in Year 5 shareholder's income: \$2,020,000 (\$2,000,000 distribution plus the \$20,000 of interest)

Notice 2016-10: The Netting Method

- A US RIC can only use the Netting Method if all of the following requirements are satisfied in the refund year
 1. The US RIC made a Section 853 election
 2. The creditable foreign taxes paid by the US RIC is equal to or greater than the US RIC's FTA
 3. The US RIC is not an insurance-dedicated RIC
 4. The economic benefit of the refund primarily inures to the refund year shareholders
- A US RIC that utilizes the Netting Method must notify the IRS on a statement attached to its tax return for the refund year

Notice 2016-10: The Netting Method

- Pros
 - Eliminates need to identify and locate shareholders from prior years
 - No need to determine extent of FTCs taken by shareholders with respect to tax amounts refunded
 - Easy and does not require IRS consent
- Cons
 - Can impose additional tax burden on shareholders who purchased shares in years after the tax amount refunded was initially paid
 - Strict eligibility requirements
 - No carry forward of excess FTAs
 - No guidance on “post-refund” interest

Notice 2016-10: The Closing Agreement Method

- The US RIC seeks a closing agreement from the IRS to address the treatment of foreign tax refunds
- Can be used only if:
 1. The Netting Method is unavailable; and
 2. The US RIC is able to provide information sufficient to establish a reasonable estimate of the adjustments that would be due under IRC Section 905(c) with respect to the foreign tax credits claimed by its shareholders (including former shareholders) who were treated as paying the refunded tax

Notice 2016-10: The Closing Agreement Method

- Process
 - Legal counsel engages attorneys at the IRS to discuss a potential closing agreement
 - \$38,000 filing fee (at least for initial fund in a fund complex)
 - Current status of requested closing agreements?
- IRS will take a universal approach in the closing agreements
 - The US RIC pays a compliance fee plus a post-refund interest amount
 - The compliance fee equals 85%* of the US RIC's FTA multiplied by its "taxable shareholder percentage"

*Anticipated percentage

Notice 2016-10: The Closing Agreement Method

- Simplified Example
 - In Year 5, US RIC receives (a) \$2,000,000 of foreign dividends from which \$250,000 is withheld and (b) \$230,000.01 refund of ECJ withholding taxes paid in Year 1, plus \$20,000 of interest on the refunded amount
 - During the relevant period, US RIC's taxable shareholder percentage was 46%
 - Assume US RIC has no other income or expenses and distributes all available amounts to its shareholders
- What are the results under the Closing Agreement Method?

Notice 2016-10: The Closing Agreement Method

FTA: \$250,000 (\$230,000 ECJ refund + \$20,000 of interest)

Compliance Fee: \$98,000 (85% of the FTA multiplied by 46%)

Distributable amount: \$1,852,000 (\$2,000,000 of foreign dividends + \$230,000 ECJ refund + \$20,000 of interest - \$250,000 foreign withholding tax - \$98,000 compliance fee - \$38,000 filing fee - \$12,000 of estimated attorney fees)

Foreign taxes passed through: \$250,000

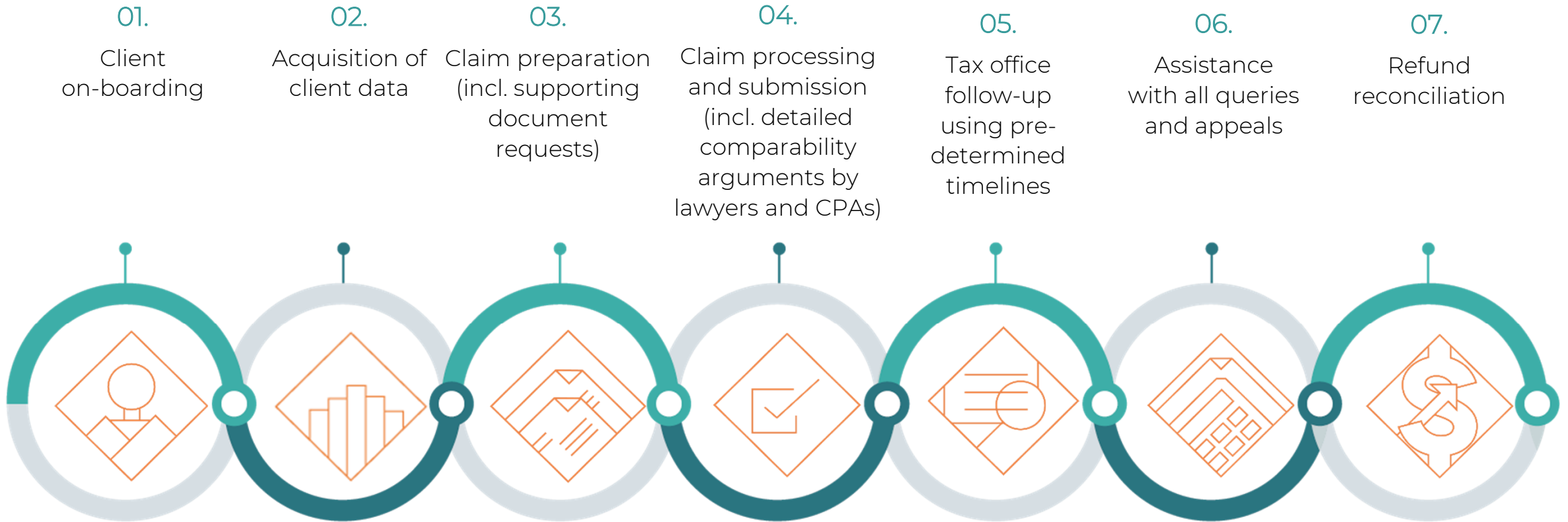
Amount included in Year 5 shareholders' income: \$2,102,000 (\$1,852,000 distribution + \$250,000 foreign taxes passed through)

Considerations

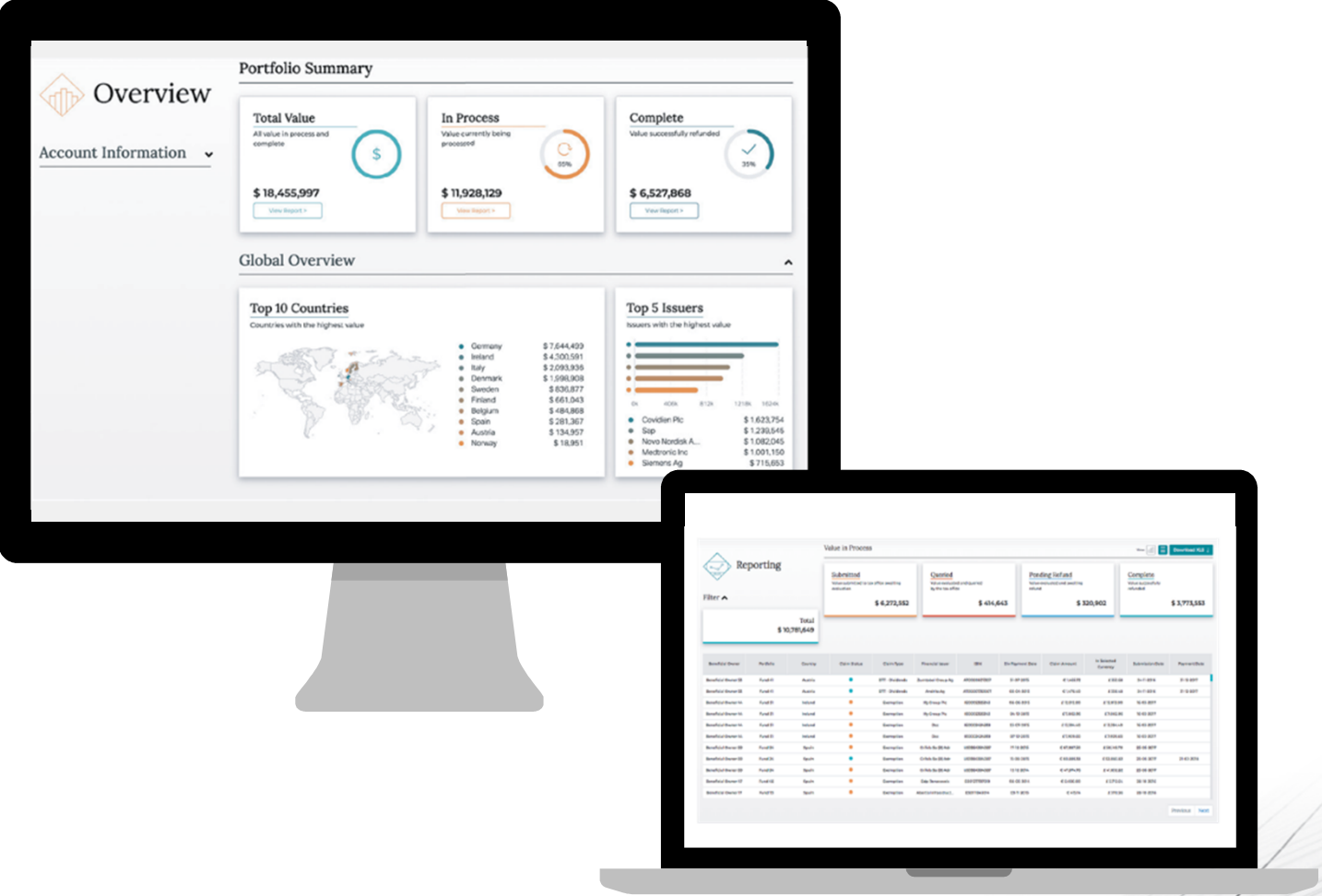
- The Netting Method provides an administrable method and does not require a significant outlay of capital
 - Strict eligibility criteria limits availability
 - Industry calls for carryforwards
- The Closing Agreement Method can cause non-taxable shareholders to economically bear the cost of compliance and can push compliance to a taxable year after year the tax refund is received
 - No mechanism to allow a US RIC to deposit funds to cut off running of interest






05. | How WTax and Morgan Lewis Can Help

WTax Recovery Process Flow



Withholding Tax Reporting



-  TRANSPARENT
-  ACCURATE
-  LIVE
-  DETAILED
-  USABLE

How Morgan Lewis Can Help

Assist US RICs determine their eligibility for the Netting Method or the Closing Method

Calculations for US RICs in terms of the Netting Method

Representation of US RICs before the IRS to pursue closing agreements

Q & A



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**THANK
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