EUDTG Newsalert
7 November 2024

CJEU Clarifies Equal Tax Treatment for Dividends of Resident and Non-Resident Insurance Companies Regarding Costs Arising from the Increase in Future Payment Obligations

According to the Court of Justice of the EU (CJEU) in *XX* (C-782/22), the EU freedom of capital prevents national legislation where:

i) Dividends paid by a resident company to a non-resident company that has invested in shares to cover future payment obligations are subject to dividend tax withheld at source on the gross amount, whereas,

ii) Dividends paid to a resident company are subject to dividend tax withheld at source, which can be fully offset against the corporation tax payable, potentially resulting in a zero tax burden. This is because the costs arising from the increase in future payment obligations are taken into account when calculating the corporate tax base.

Background and facts

The case involved a UK insurance company offering "unit-linked policies" to UK-based institutional pension insurers and employers. XX invests insurance premiums received from clients to generate returns, with the investment risk borne by these clients. These premiums are placed into unit-linked baskets of securities, and clients receive units representing their investment. XX's compensation is based on a percentage of the assets managed and the investment results. During the relevant period, the baskets included shares in Dutch companies, and dividends from these were taxed at a withholding rate of 15% on the gross amount. Unable to receive a credit for the Dutch withholding tax () in the UK, XX applied for a refund in the Netherlands, which was rejected.

Before the Zeeland-West-Brabant District Court and later the Court of Appeal DenBosch, XX argued that the 15% WHT imposed resulted in different treatment compared to a resident taxpayer. If XX were established in the Netherlands, corporate income tax would only be levied on the remuneration for its services, with a net corporate income tax base of nil for the dividends, as costs from increased obligations to clients would be deductible. The court noted this difference in treatment between residents and non-residents regarding dividends but questioned whether XX is comparable to a resident taxpayer, considering the costs arising from its increased obligations to clients.

CJEU's judgment

Difference in treatment: The CJEU ruled that resident companies are not taxed on the (gross) dividends received, as costs related to increased liabilities under the unit-linked policies are considered when calculating the taxable profit. This results in a net corporate income tax base of zero for those dividends. According to the CJEU, dividends paid to non-resident companies are treated less favourably, being subject to a final 15% tax on gross dividends, whereas dividends paid to resident companies are effectively exempt from tax due to being taxed on a net basis. This constitutes a restriction on the free movement of capital. Such a restriction is allowed only if it does not involve objectively comparable situations or is justified by an overriding reason in the public interest.

Objectively comparable situations: The CJEU determined that XX is objectively comparable to resident taxpayers regarding costs from increased liabilities to clients under unit-linked policies. This conclusion was largely based on the *College Pension Plan of British* Columbia (C-641/17, EUDTG newsalert) case, applied by analogy, where dividends received by a Candian pension fund were used to fund future pension obligations. The CJEU stated that if national legislation recognizes a direct link between dividends received by resident companies and their obligations to clients, then non-resident companies receiving Dutch dividends are in a comparable situation to resident companies. This is because their activities and the impact of dividends on client obligations are similar. However, the referring court must determine the existence of such a direct link.

Justifications: The CJEU rejected all presented justifications. More specifically:

- Balanced allocation of taxing powers: The CJEU observed that the Netherlands taxes all dividends, whether received by resident or non-resident companies, but neutralizes the withholding tax burden only for residents. Therefore, it cannot justify taxing non-resident companies differently.

- Avoidance of double deduction of costs: Responding to Germany's argument about the risk of double deduction of charges (in the Netherlands and elsewhere), the CJEU ruled that an EU Member State can verify if these charges are not deducted from other income in another Member State. Germany did not demonstrate that the EU Directive on Administrative Cooperation (DAC) would be insufficient to prevent this risk.

- Coherence of the tax system: The CJEU stated that the argument for preserving the coherence of the Dutch tax system is based on the premise that costs related to increased liabilities towards clients are linked to client remuneration, which is not taxable in the Netherlands. However, the Court ruled that if the Dutch tax system recognizes a direct link between dividends and costs, then non-resident companies are comparable to resident companies in terms of these costs and as a result the coherence justification cannot be accepted.

Takeaway

In *XX*, the CJEU distanced itself from applying the findings from *Miljoen and Others* (C-10/14, C-14/14 and C-17/14) regarding the deductibility of costs to the case at hand. In *Miljoen*, the CJEU ruled that only costs directly linked to the collection of dividends are deductible from the Dutch withholding tax base. However, according to the CJEU in *XX*, the mere fact that the increase in obligations towards clients does not appear to be directly related to the collection of dividends is not sufficient to conclude that the situations of residents and non-residents receiving dividends are not comparable under Dutch legislation.

For unit-linked insurance companies with pending Dutch dividend WHT reclaims, this judgment can be considered a positive development. Though the case specifically concerned unit-linked insurance, the judgment is broadly worded and may also have implications for other investors in similar economic positions, such as pension funds or regular life insurance companies, or for other sources of investment income, other than dividends (e.g., real estate investment by a non-resident insurance company or pension fund). Furthermore, since the judgment specifically refers to the potential refund of Dutch dividend WHT for Dutch entities not in a corporate income tax paying position in its conclusion, the question remains whether the legislative changes following the *Sofina* case law have successfully remedied the discrimination for foreign unit-linked insurance companies or if discrimination continues under the current system.

Let's talk

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