**INFOLETTER**

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# Europe - Recent developments affecting the international fund industry (Germany, UK, Poland, Belgium, Italy & Portugal)

Dear Madam / Dear Sir,

This WTS Global Info Letter contains a brief review of 2020 and an outlook on 2021 with regard to certain fund tax law related developments, which you may find interesting.

## Germany

### DAC6 in the Asset Management industry

With the beginning of 2020, the DAC6 rules entered into force in Germany. Unlike most other member states, Germany did not extend the reporting deadline for the back book period, and has thus become one of the test sites for the actual reporting in the asset management industry.

The wording of the German legislation deviates from the directive. The German legislation employs the term “user” to define the person characterized in the directive as the “relevant taxpayer”. The intention of this deviation is not fully clear, e.g. can a participant qualify as a user without being a taxpayer? From a German DAC6 perspective, the answer is Yes. Based on draft administrative guidance issued by the German Ministry of Finance, a partnership is - in general - considered the "user", even though it is not a taxpayer for German income tax purposes. The partners then qualify as “other participants” only. Exceptionally, the members of a partnership may also be "users" within the meaning of the law, if the tax effects of the arrangement are intended to have a direct impact on the partner level, too.

For investment funds, there is comparable draft administrative guidance: usually the fund is the "user", at least in the case of a standard mutual (UCITS) fund. Depending on the fund type, e.g. special fund, and whether the tax structure has a direct impact on investor level, exceptions apply.

The German implementation of DAC6 does not only differ in terms of personal scope (see above), but also fails to clearly define which structures are in material scope of a "cross-border tax arrangement", and therefore in scope of the reporting obligation. Especially, the term "arrangement" is open for interpretation. Traditionally, the German tax authorities will have a broad understanding of this term, to cover as many structures as possible. The authors are of the opinion that such understanding is too wide and questionable. The application of the German term for arrangement (*Gestaltung*) should also consider the intention of further international tax projects, such as the OECD's BEPS project "Tax challenges arising from digitalization". According to the recently published Blueprint Report on Pillar Two, investment funds which fulfil certain criteria, are specific and structurally exempted from taxation globally and, thus, shall not be subject to measures imposed on internationally operating industries. This reasoning of the OECD applied to the field of DAC6 leads to the argument that investment funds shall not be regarded as an "arrangement". The mitigating effect of the OECD reasoning would be thwarted, if the term "arrangement" would be understood broadly in the German DAC6 context.

### Private Equity funds and ATAD implementation

This new development is especially important for international private equity funds with German investors.

On 17th of November 2020, the German Ministry of Finance published a further draft bill for the implementation of the ATAD Directive (Council Directive (EU) 2016/1164 dated 12 July 2016). The draft bill aims to maintain the exclusive applicability of German investment tax law to foreign funds that are comparable to German mutual funds, like UCITS, and to German special funds, like AIFs. This is generally good news for the international fund industry, as the current approach prevents foreign funds from being disadvantaged compared to German domiciled funds via adverse taxation under the German controlled foreign company (CFC) regime.

However, an exception might affect international private equity funds with German investors. According to the draft bill, the German investment tax act (GITA) and CFC rules shall apply simultaneously, where more than one third of the income of the fund was generated through transactions with the investor or parties related to the investor. Funds with numerous investors are unlikely to be covered by this exemption. However, special fund vehicles, e.g. non-German cash pooling vehicles used by German companies, family offices or HNWI, might be in scope of the disadvantage resulting from the applicability of both tax regimes mentioned above (GITA and CFC rules).

Even though the ATAD implementation has yet to be tabled before the German parliament, investors in international special fund vehicles should revisit whether they are exceeding the aforementioned limit or not, to prevent the application of inimical CFC rules.

### Further legislative proposals

The German Ministry of Finance has taken advantage of the transposition of EU directive 2019/1160/EU regarding the cross-border distribution of collective investment undertakings, to introduce additional measures that are likely to enhance Germany's attractiveness as a location for the establishment of collective investment schemes. On 3rd December, the Ministry published a respective draft bill containing tax and regulatory measures aimed at reducing bureaucracy and streamlining the regulatory framework for the launch of funds in Germany.
In line with the EU directive, Germany introduces the possibility of the pre-marketing of AIFs to professional and semi-professional investors.

One of the highlights of the draft bill is the introduction of closed-end master-feeder structures. The rules applicable to such master-feeder structures shall predominantly be equivalent to the rules applicable to other master-feeder structures. However, unlike open-ended funds, which can be converted into a feeder fund after their initial set up, closed-end feeder funds have to be created as such from their initialization. The proposed changes include streamlining measures such as replacement of the current paper-based form with one in digital format, enabling the agreement for a special AIF to be concluded in digital format.

Venture capital funds will gain a level playing field with other fund types. The draft bill provides for the exemption from VAT of investment management services delivered to venture capital funds, thereby harmonizing the VAT treatment with that afforded to UCITS and AIFs.

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## Crediting of foreign WHT in Germany - Update

This development is important for international investment funds, that may have suffered discriminatory treatment through the incidence of local WHT in an EU member state, particularly if the fund has German investors.

The crediting of non-German WHT on German fund investor level has become more difficult than in the past. With effect from 1st of January 2020, the relevant income tax act provision was changed. The crediting of foreign WHT against German income or corporate tax might be denied not only for foreign WHT that was actually refunded, but also for foreign WHT for which a refund claim could exist. This exclusion from crediting is applied regardless of whether the refund claim results from national law or from ECJ case law.

In fact, the German tax authority might deny the crediting of foreign WHT, unless a negative decision on the refund application abroad can be presented. For the WHT suffered in foreign countries, there is thus the considerable risk of a significant WHT leakage, e.g. in the context of a tax audit.

Consequently, it is advisable for funds to file a WHT refund claim in the source state of the income, irrespective of the outcome of the refund claim i.e. whether it is refused or admitted in that jurisdiction.

## Refund of German WHT under ECJ case law

This development is important for international investment funds having suffered WHT in Germany after 1 January 2017.

Numerous investment funds have over the past years applied for a refund of German WHT, claiming a discrimination compared to German funds, based on ECJ case law (recently: C-480/16 - “*Fidelity Funds*” and C-156/17 - “*Koeln-Aktienfonds Deka*”). Though these applications have been accumulating, the German tax authority up to now refused to process them. This break might now be about to be released due to a recently published request for a preliminary ruling placed with the European Court of Justice by the highest German tax court (*Bundesfinanzhof*).

The case presented to the ECJ concerns a Luxembourg FCP that had invested in German real estate. Notwithstanding the specificity of the fact pattern, the key consideration has an impact on refund claims of other fund types, too. The case hinges upon whether the exemption from German corporate tax and WHT is confined to German investment funds, thereby discriminating against comparable non-German investment funds. WTS is of the opinion that the ECJ, as in comparable cases concerning other member states, will rule in favor of the fund industry and declare the German rule as being discriminatory.

Since Germany revised its investment tax act in 2018 and abandoned the aforementioned rule, the upcoming ECJ case is relevant for German WHT suffered before 1 January 2018. As the general statute of limitations in Germany is 4 years, a refund claim for WHT suffered in 2017 can still be filed until the end of December 2021.

### WHT Reclaims in the light of ECJ case “College Pension Plan”

In November 2019, the ECJ ruled on the case C-641/17 - “College Pension Plan of British Columbia” (CPP).

The court held that a German tax rule, which prevented a Canadian pension fund from reclaiming / crediting WHT on German dividends, whilst a German pension fund is allowed to credit WHT suffered on German dividends, is contrary to the free movement of capital.

In the CPP case, the pension fund did not directly invest into German equity assets, but held them as an indirect investment via participating in pooled investment portfolios. Though the investment structure was indirect in this case, the ECJ in order to establish the comparability, focused on the Canadian pension fund as such. The ECJ held that the Canadian pension fund was in a comparable situation as a German pension fund investing directly into German equity assets.

This case affects not only WHT reclaims filed by pension funds in Germany, but also in other EU jurisdictions.

A reclaim of WHT on dividends suffered by a non-resident pension fund should be successful, where the pension fund filing the reclaim is comparable to a pension fund established according to the national rules of the source country of the dividend (resident pension fund). The CPP case is therefore mostly relevant for pension funds investing directly into equity assets.

In the case of a non-resident pension fund investing indirectly, i.e. via a fund vehicle, taking the argumentative step via the CPP case might be unnecessary in most EU jurisdictions. This is because according to current tax rules in many EU jurisdictions, non-resident investment funds, like resident investment funds, do not suffer final WHT on dividends or the reclaim of local WHT can be achieved based on rather well established ECJ case law related to the discrimination of foreign funds or even based on national legislation. Thus, in these cases, to invoke the new CPP case law of the ECJ does not seem to be of advantage.

Nevertheless, the CPP case might come back into focus, where national legislators intend to ignore the level of the fund vehicle, and apply a transparent look-through to the fund investor. This could be the case especially when the investment fund is a single investor vehicle. We see an emerging development, e.g. in the Netherlands, where tax benefits for investment funds can be declined, if the investment fund has only a single investor.

## United Kingdom

### Brexit

The first noteworthy item seems to be that the Trade and Cooperation Agreement, finalized shortly before the year-end 2020, contains in its “trade” section several articles on Financial Services that are rather vague, e.g. the parties agree to make their best endeavors to ensure that internationally agreed standards in the Financial Services sector for regulation and supervision are implemented and applied in their territories. The parties seem to know that these vague rules will not meet the needs of the Financial Services industry. The parties therefore agree on a future Memorandum of Understanding establishing the cooperative framework regarding Financial Services; this MoU is scheduled for March 2021.

However, the current Agreement already seems to set the spirit of what can be expected from the MoU insofar as the parties aim at maintaining the free movement of capital between the EU and UK. The agreement also outlines the intention that tax measures shall not be applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where like conditions prevail. It should in our view therefore be unlikely that the MoU will contain measures that impose lax legal barriers on the Financial Services industry, at least in the short term.

On the other hand: one day after the UK's acceptance of the named Trade and Cooperation Agreement, the UK abandoned important aspects of the DAC 6 reporting, i.e. the obligation to report arrangements that fulfil hallmarks A to C and E. Only hallmark D shall remain in force in the UK (automatic exchange of information and beneficial ownership). Thus, the UK level of reporting obligations is now in line with the OECD’s mandatory disclosure rules, which are of a lower standard.

Besides general differences between the regimes of DAC 6 and MDR, the first **important implication** of the recent UK development is a shift of the reporting obligation and the risk of consequences of non-compliance from the intermediary to the level of the relevant taxpayer (in Germany: user). The UK Intermediary of an arrangement fulfilling hallmarks A to C or E will no longer be obliged to report in the UK. Consequently, the non-UK taxpayer (or a further intermediary) should check whether the arrangement is reportable in an EU member state. In our analysis, this compliance obligation of the taxpayer has already come into effect on 1 January 2021.

### UK Reporting Fund Status

Most funds that are distributable to UK investors comply with UK's tax reporting regime for offshore funds, known as UK Reporting Fund Status (UK RFS). Under the regime, each qualifying share class must be registered with UK HMRC. The deadline to register any new share class is at the end of the accounting period, i.e. 31 December 2020 for funds that follow a calendar year end. The application is filed using HMRC Form CISC1.

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# Poland

## New WHT regulations postponed again

The Finance Ministry of Poland is working on legislation to again postpone the introduction of the WHT refund procedure. The WHT refund procedure requires tax to be withheld at 19%, or 20% where the total payments to one recipient exceed PLN 2 mill. within one tax year. The tax can be reclaimed in whole or in part, but only if proof is made that the reduced rate or exemption applies. This mechanism is to be deferred for the fifth time, this time until 30 June 2021.The postponement legislation is scheduled to take effect on 1 January 2021.

The Finance Ministry of Poland is also working to amend various statutory provisions relating to WHT (including the ultimate design of the WHT refund procedure). This work is scheduled to be completed in 2021.

## Changes in tax office jurisdiction

The Finance Ministry of Poland is working on changes to the jurisdiction of tax offices, which would come into force as of 1 January 2021 and include a centralization of tax authority. Jurisdiction over investment funds and pension funds will be centralized in Warsaw. The enforcement of WHT compliance will be centralized as well; WHT matters, including dealing with overpayments, will be within the competence of the Tax Office in Lublin.

The Finance Ministry of Poland claims that these changes will be beneficial for taxpayers because the same tax authority will deal with all comparable cases, thus contributing to a more professional customer service and a more effective prevention of tax abuse. In the opinion of the Ministry, issues related to WHT require an appropriate strategy as well as a high level of specialized practical and theoretical knowledge in this specific field of tax law.

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## Belgium

### Government works on new tax on securities accounts

A first “annual tax on securities accounts” (applicable to individuals only) was annulled by the Belgian Constitutional Court on 17 October 2019 because the Court ruled that the tax was unconstitutional and contrary to the principles of equality and non-discrimination.

The Belgian government is now working on a draft bill introducing a new “annual tax on securities accounts”. Both the taxpayers in scope (also legal entities) and the securities in scope are broader compared to the first attempt. The tax applies both to Belgian resident persons and legal entities (regardless where the intermediary is located), and to foreign residents (both individuals and entities) who hold the securities account with a Belgian intermediary. Furthermore, contrary to the annulled first version of the tax, all financial instruments held on a securities account are covered by the new tax, including derivatives and cash.

The rate of the (new) tax is 0.15% on an annual basis. The tax only applies to securities accounts with financial instruments with an average value of more than 1 million euro.

An exemption ratione personae is provided for securities accounts held by certain institutional entities such as banks, insurance companies, UCITS, alternative investment funds, etc. The exemption however does not apply if another person or entity (which does not qualify for exemption itself) holds a receivable on the institutional entity, which is linked to the value of the underlying securities account. Moreover, funds and fund compartments, which are exclusively held by related investors (“fonds dédié” compartments), are also excluded from the exemption.

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# Italy

### New rules on taxation of Italian-sourced dividends and capital gains derived by foreign UCIs

The draft of the 2021 Italian Budget Law provides a new set of rules applicable to foreign undertakings for collective investment ("UCIs") investing in Italian resident companies.

In more detail, foreign UCIs would not be subject to Italian WHT (26%) on either dividends or on capital gains derived from Italian shareholdings (or comparable instruments). This exemption shall apply to foreign UCIs established in accordance with the UCITS Directive and to non-UCITS established in an EU (EEA) Member State, which allows for an adequate exchange of (tax) information; further the UCI's manager must be subject to regulatory supervision pursuant to the AIFM Directive, in the country where the manager is established.

These new rules would repeal a tax system that should be considered as discriminatory in the context of EU law. However, discrimination is only abolished for EU funds, non-EU funds are still at a disadvantage. The new rules should be effective with respect to distributions of profits and capital gains realized as of the entry into force of the 2021 Budget Law (most likely, 1 January 2021).

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# Portugal

### ECJ pending case on WHT applicable to foreign investment funds

The taxation applicable to non-resident investment funds has been a very controversial topic in Portugal for several years. However, tax disputes – especially on the basis of EU Freedoms – have been growing significantly in Portugal in the recent past.

The case “*Fund AEVN*” (C-545/19) is one of the cases where a domestic litigation process quickly turned into a request for a preliminary ruling of the ECJ, regarding the (in)compatibility of the Portuguese tax system with EU Law. This case addresses the WHT that applies to dividends distributed by Portuguese companies to non-resident investment funds, which would not be triggered if said dividends would be paid to a Portuguese investment fund. A decision is expected shortly, as the parties have just filed their final written pleadings.

This will certainly be a leading case for the fund industry in Portugal. A considerable number of cases were already brought before Portuguese Tax Courts by foreign investment funds claiming a WHT refund. Whilst most of these proceedings are pending for ECJ’s position in case C-545/19, it is interesting to note that there were cases where Portuguese Courts did not find it necessary to wait for the ECJ ruling. Taking the view that there are already sufficient grounds for a decision, in light of previous case law dealing with WHT levied on dividends distributed by resident entities to non-resident investment funds, there is a growing number of decisions favorable to non-resident investment funds. These cases are a turning page in Portugal and already gave rise to several effective refunds.

Another new case has recently reached the ECJ, regarding the Portuguese regime that allows a 50% deduction in dividends paid pursuant to Portuguese stock exchanges, excluding dividends obtained on the stock exchanges of other EU countries (Real Vida Seguros, C-449/20).

The fact that the Portuguese litigation rules include an option for taxpayers to resort to tax arbitration (which is based, as a standard rule, on a single-tier decision procedure), allows for the Portuguese legal system to work as an expedite platform to access the ECJ and develop European case-law on innovative matters. Hence, we expect Portugal to leverage interesting discussions EU-wide, in particular on cases dealing with the breach of EU law whose significance goes beyond Portuguese borders.

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