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Austrian Withholding Tax Refunds on Dividends in the EU

by Niklas Koutny and Christian Wimpissinger

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In a decision published in July 2011 by the Beilage zur Österreichischen Steuerzeitung, the highest tax court of Austria, the Administrative Court (Verwaltungsgerichtshof, or VwGH), ruled that withholding tax on dividends paid to a 100 percent corporate shareholder in the EU must be refunded to the extent that no tax credit is granted in the resident state of the shareholder.[1] Two things should be noted:

- generally no withholding tax is imposed on Austrian dividend payments made to corporate shareholders resident in the EU if those shareholders hold an interest of 10 percent or more for at least one year; and
- under current law, Austrian withholding tax is refunded exactly in the way decided by the court if an EU corporate shareholder holds an interest of less than 10 percent in an Austrian corporation.[2]

The events in the case decided by the Administrative Court, however, took place before the law explicitly provided for a refund of Austrian withholding tax. Under the facts of the case, the one-year holding period for applying the exemption of a holding of 10 percent or more was not fulfilled.[3]

The taxpayer made two arguments. First, he claimed that a refund of the Austrian withholding tax was required; otherwise, an Austrian dividend paid cross-border would be treated less favorably than a dividend paid domestically — a clear violation of the freedom of establishment. Second, the taxpayer argued that a dividend payment from Austria to France or Finland would be treated more favorably than a domestic payment because the double tax treaties with those countries do not allow Austria to impose withholding tax if at least 10 percent interest were held in the dividend-paying Austrian corporation (irrespective of whether a particular holding period was fulfilled).

The taxpayer's second argument was dismissed by the Administrative Court: According to the European Court of Justice's judgment in *D*, the most favored nation principle, which holds that the most beneficial provision of all double tax treaties concluded within the EU should apply in any cross-border context, would not apply.[4]

The taxpayer's first argument was accepted with a slight, but important, limitation. The Administrative Court concluded that the Austrian withholding tax violated the freedom of establishment but that the violation would only occur to the extent the Austrian withholding would not be credited in the resident country of the shareholder.[5]

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[1] VwGH (2008/15/0086), Sept. 23, 2010. Like all Austrian court cases, this case is unnamed.

[2] Austrian Corporate Income Tax Act (Körperschaftsteuergesetz), section 21(1)(1a).

[3] The EU parent-subsidiary directive (90/435/EEC, July 23, 1990) allows for a maximum holding period threshold of two years (article 3(2)).

[4] VwGH, *supra* note 1.

[5] *Id.*, with reference to *Denkavit Internationaal* (C-170/05), Dec. 14, 2006, paras. 46 et seq., and *Commission v. Spain* (C-487/08) June 3, 2010, paras. 60 et seq.

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For purposes of testing whether the Austrian withholding tax is credited abroad, some questions arise:

- What if a credit would generally be granted but no credit is allowed when a refund of the source taxation is possible?
- Which country applies its rules first? Does Austria impose withholding first because it is credited, or does the other country disallow the credit first because Austria would refund the withholding tax anyway?

Reading between the lines of the Administrative Court's ruling, it appears as if the final result in the shareholder's country is decisive: If a credit is granted, there is no refund of the withholding to the extent of the credit; if no credit is granted at all, the total amount of taxes withheld in Austria is refunded. This is in line with ECJ case law, according to which the restriction of the freedom of establishment is not overcome if the withholding tax in the dividend-paying company's state is not credited in light of an exemption granted in the parent's state.[6]

The current law allows a refund of Austrian withholding tax as decided by the Administrative Court.[7] The refund must be made if domestic law exempts the Austrian dividend from taxation or to the extent no tax credit is granted abroad.[8] Evidence for the exemption or insufficient tax crediting must be provided by the taxpayer, a requirement criticized in the literature as an administrative burden that could be considered a harmful restriction. In light of recent ECJ judgments, however, this burden probably is not contrary to EU law.[9]

It should be noted that the effect of a violation of primary EU law (for example, a violation of the freedom of establishment) sets aside the domestic law causing the violation. What the Administrative Court did, however, went beyond that: It created law in order to bring Austrian tax law in line with the fundamental freedom at stake, and it invented a rule requiring that the withholding tax imposed had to be refunded — a rule that is today explicitly contained in the law.

One interesting question arising from the Administrative Court's decision is whether a refund of Austrian withholding tax concerns only dividend payments made to EU member states or also to dividend payments made to corporate shareholders resident in third countries (for example, the U.S., Canada, China, Brazil, Switzerland, or elsewhere). The law currently implements the rationale of the Administrative Court's ruling regarding participations that represent an interest of less than 10 percent, but it explicitly limits the refund to withholding tax imposed on Austrian dividend payments made to corporate shareholders in the EU.

The Administrative Court's ruling is based on the freedom of establishment, because the participation concerned represented a 100 percent interest. The freedom of establishment is a tool against discriminatory taxation within the EU; it does not protect shareholders in third countries from such taxation. The free movement of capital, however, also sanctions restrictions vis-à-vis third countries. Therefore, two questions arise following the Administrative Court's ruling:

- Would the application of the free movement of capital also lead to the result that Austria must allow a refund of withholding tax imposed on dividends paid to corporate shareholders abroad, because no withholding tax is imposed in the purely domestic situation?
- What are the criteria for a participation to fall within the scope of either the freedom of establishment or the free movement of capital (knowing that the application of the freedom of establishment supplants the application of the free movement of capital to the same situation in parallel[10])?

Regarding the second point, one criterion to apply the freedom of establishment to corporate participations is whether they give the relevant shareholders ''definite influence on the company's decisions and [allow] them to determine its activities.''[11] An aspect that is decisive could be to have the majority of the voting power.[12] Another criterion for determining which fundamental freedom must be applied is the type of investment; that is, if it is a merely passive investment to complement the portfolio of other investment assets, the free movement of capital is likely to apply.[13]

Finally, it should be noted that in the past, a parallel application of the two freedoms to the same situation was considered possible.[14] In short, the free movement of capital would apply only to participations that represent an interest in an Austrian corporation not giving

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[6] *Denkavit Internationaal* (C-170/05), Dec. 14, 2006, para. 47.

[7] Austrian Corporate Income Tax Act, section 21(1)(1a).

[8] Kofler and Tumpel, in: Achatz and Kirchmayr (eds.), *KStG-Komm. Section 21 Ann. 163.*

[9] *Id.*

[10] *Fidium Finanz* (ECJ, C-452/04), Oct. 3, 2006; *Stahlwerk Ergste Westig* (ECJ, C-415/06), Nov. 6, 2007; for details on that question, see Karolina Spies, ''The Free Movement of Capital and Shareholdings in ECJ Case Law,'' *SWI* 2011, 350.

[11] *Cadbury Schweppes* (ECJ, C-196/04), Sept. 12, 2006, para. 31, with reference to *Baars* (ECJ, C-251/98), Apr. 13, 2000, para. 22, and *X and Y* (ECJ, C-436/00), Nov. 21, 2002, para. 37.

[12] Cordewener, Kofler, and Schindler, ''Free Movement of Capital and Third Countries,'' *ET* 2007, p. 371.

[13] Spies, *supra* note 10, at 350, 352.

[14] Kristina Stahl, ''Free Movement of Capital Between Member States and Third Countries,'' *EC Tax Review* 2004, 47; Wolfgang Schön, ''Der Kapitalverkehr mit Drittstaaten und das internationale Steuerrecht,'' in: Gocke, Gosch, and Lang (eds.), *FS Wassermeyer*, 498.

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definite influence over the corporation. In economic terms, that would generally be passive participations, a broader term than portfolio participations as defined by Austrian tax law — that is, participations of less than 10 percent.[15]

Regarding the first point — whether the free movement of capital would provide the same benefit as decided on by the Administrative Court — it seems as if the ECJ (and, therefore, EU law) allows broader justifications to restrict the free movement of capital than are allowed for restrictions of the freedom of establishment.[16] This is a new development that was not always true; in the past, determining whether a fundamental freedom was violated followed the same principles no matter which of the freedoms were concerned.[17] However, the possibly different approach toward a justification depending on whether the freedom of establishment or the free movement of capital is applicable should not matter, since no justification was taken into account by the Administrative Court. Therefore, it can be concluded from the Administrative Court's decision that Austrian withholding tax imposed on Austrian dividends and paid to corporate shareholders in third countries whose participation does not give definite influence over the corporation must be refunded to the extent no tax credit is allowed regarding the withholding abroad.

As a result, that refund obligation is only interesting regarding countries that do not (or do not fully) credit the Austrian withholding tax onto a tax imposed on the dividend. ◆

[15]Regarding the definition of portfolio participations, see Corporate Income Tax Regulations Ann. 586.

[16]Ben J.M. Terra and Peter J. Wattel, *European Tax Law*, 5th ed. (2008), 61.

[17]Christian Wimpissinger, *Steuerrechtliche Verlustverrechnung nach EG Recht, Peter Lang* (2006), 24.

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