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Global Tax Alert

Swedish SAC rules that foreign investment funds can be considered comparable to Swedish investment funds regardless of legal form

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Executive summary

The Swedish Supreme Administrative Court (SAC) ruled on 11 February 2020 that the fact that a foreign investment fund is set up as a legal entity does not preclude that the fund, in a comparability test under European Union (EU) law, is considered to be in a situation comparable to that of a Swedish contractual investment fund with respect to the taxation of dividends.

The ruling was issued in connection with a withholding tax reclaim filed by a United States (US) investment fund based on the principle of the free movement of capital as stipulated by EU law. The difference in legal form between the US fund and Swedish investment funds had been the main argument by the Swedish Tax Agency for denying the reclaim and it was also a seemingly decisive factor for the decisions by the lower courts.

Following the ruling, the SAC referred the case back to the Administrative Court of Appeal to assess whether the US investment fund was comparable to a Swedish investment fund in other aspects than legal form and if a potential difference in treatment could be justified.

The SAC's ruling substantially increases the possibilities for foreign investment funds structured as legal entities to claim an exemption from Swedish withholding tax on dividends.

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Detailed discussion

Background

According to Swedish domestic law, withholding tax is levied on dividends from Swedish limited companies paid to foreign legal entities.

The instant case concerns a US investment fund (RIC) which had claimed a refund of Swedish withholding tax paid in 2006-2008 on the basis that the US fund, unlike Swedish investment funds at the time, was not allowed to make a deduction for re-distributed dividends when calculating its taxable income and therefore was subject to discriminatory treatment.

According to Article 63 of the Treaty on the Functioning of the European Union (TFEU), all restrictions on the movement of capital between EU Member States, and EU Member States and third countries, shall be prohibited.

The Swedish lower courts ruled that the US fund was not comparable to a Swedish investment fund because the US fund was set up as a legal entity while Swedish investment funds are set up as contractual funds which lack a separate legal personality.

The US fund appealed to the SAC which granted a partial leave of appeal and accepted to consider the principal question of whether the fact that a foreign fund is set up as a legal entity excludes it from potentially being in a comparable situation to a Swedish investment fund when taking receipt of dividends.

The US fund requested that the SAC request a ruling from the Court of Justice of the European Union (CJEU). The SAC did, however, not find reason to do this.

The SAC's decision

First, the SAC found that the US fund, being resident in the US, was liable to pay withholding tax on dividends from investments in Swedish limited companies, and that those investments were cross-border investments that should be considered capital movements under Article 63 of the TFEU.

Second, the SAC found that the US fund under the Swedish withholding tax legislation was not allowed to deduct the dividends paid out by the fund to its investors, unlike Swedish investment funds which, at that time, could deduct dividends distributed to its investors from the tax base.

The SAC therefore found that the applied tax treatment could constitute a discrimination which would be a breach of article 63 TFEU if the fund should be considered to be in a situation comparable to that of a Swedish investment fund upon taking receipt of the dividends and if there would not be a valid justification for this restriction.

The SAC thereafter stated that the legal form of a subject may have significance under a comparability analysis but only if the legal form is relevant with regards to the purpose and design of the tax rules in question. The SAC referenced, inter alia, the CJEU's rulings in *Santander* (C-338/11), *Emerging Markets* (C-190/12) and *Pensioenfonds Metaal en Techniek* (C-252/14).

The SAC held that the reason for why Swedish funds are allowed to deduct distributed dividends is to avoid multi-level taxation (i.e., to avoid material taxation at both the investment vehicle level and at the investor level). Further, the SAC noted that the tax rules applying to Swedish investment funds also applied to Swedish Investment Companies, despite the latter being legal entities. According to the SAC, this suggested that the legal form of the foreign fund should not be relevant in the comparability analysis as it was not decisive considering the purpose of the tax rules applicable to Swedish investment vehicles.

In conclusion, the SAC held that the fact that a foreign fund has a legal personality does not, in the light of EU law, exclude it from being in a situation comparable to that of a Swedish investment fund with respect to taxation of dividends.

The SAC thereafter referred the case back to the Sundsvall Administrative Court of Appeal to continue to try the case, including assessment of whether the US fund was comparable in other aspects to Swedish investment funds and if this were determined to be the case, if the difference in treatment could be justified.

Implications

A decision from the Administrative Court of Appeal, to which the case was referred back to, is expected before year-end 2020.

It can, however, be noted that the Administrative Court of Appeal in several court cases issued in 2014 and 2015 already has held that US funds were comparable to Swedish investment funds and that the difference in treatment could

not be justified. The legal form of the US funds, however, was not discussed in these court cases, likely because the Swedish Tax Agency's position at that time was that the legal form was largely irrelevant for the comparability analysis.

However, the Swedish Tax Agency changed its position following a ruling from the SAC in 2016 concerning the interpretation of Swedish domestic tax law in relation to taxation of Swedish tax residents' investments in foreign non-UCITS funds. In this 2016 case, the SAC gave importance to the legal form of the foreign fund.

The SAC has now explicitly stated that the ruling from 2016 should be understood in the context of the domestic tax rules that were interpreted in that case and cannot be applied to EU law and withholding tax on dividends.

Given that the Administrative Court of Appeal earlier has found US investment funds to be comparable to Swedish investment funds and that a difference in treatment cannot be justified, it is likely that this again should be the outcome of the case referred back to the Administrative Court of Appeal by the SAC. The final outcome of the case should, however, be awaited.

The SAC's ruling should be relevant not only to US funds but also to other non-UCITS investment fund set up as legal entities. It can be noted that with respect to foreign UCITS-compliant funds, it has already been clarified that these as a main rule should be exempt from Swedish withholding tax on dividends regardless of the legal form they have been set up as.

An interesting note is that one of the SAC's judges made a separate written comment after the ruling itself, stating that the exemption that was introduced in 2012 in Swedish domestic withholding tax legislation for certain foreign investment funds should be interpreted in light of EU law and therefore, contrary to the position of the Swedish Tax Agency, could potentially include also non-UCITS funds set up as legal entities. Further, the judge made remarks which seems to corroborate the position taken by lower courts and the Swedish Tax Agency that foreign contractual funds which do not have a legal personality should not be liable to Swedish withholding tax.

In summary, the SAC's ruling entails that foreign investment funds that are structured as legal entities can potentially claim an exemption from Swedish withholding tax on dividends. Accordingly, foreign investment funds that have paid Swedish withholding tax should assess whether to file a reclaim.

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