



## In Focus – European Union Protective Reclaims

In this edition of *In Focus*, we highlight the latest developments in European Union (EU) protective reclaims, answer key questions, and provide insight to investors who are considering filing.

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### What are EU protective reclaims?

Cases of tax discrimination arise where an EU member country taxes income paid to its resident investors differently than income paid to nonresident investors domiciled in EU and non-EU countries.

Where investors and their tax advisors take a position that a European country's withholding tax laws are discriminatory to nonresident investors, tax advisors can file reclaims to protect the investor's potential entitlements. These protective reclaims are usually filed pursuant to Article 63 of the Treaty on the Functioning of the European Union (TFEU), which prohibits restriction on the free movement of capital.

European courts, including the European Court of Justice of the European Union (CJEU), have ruled in many cases that EU member countries are not permitted to tax resident investors more favorably than nonresident investors, whether domiciled in another EU member country or in a non-EU country. When making a determination on discriminatory taxation, the CJEU often looks to whether the nonresident claimant is comparable to the favorably-treated resident investor, and whether there is justification for the unequal tax treatment. Comparability is generally analyzed by comparing local laws governing the resident investor to the laws of the country governing the nonresident investor.

EU protective claims are typically initiated with the competent authority of the country of investment. If the tax authority rejects the claim, then litigation is usually required.



## In which countries of investment can investors file EU protective reclaims?

Opportunities to file protective reclaims are constantly evolving based on case law and should be discussed with a tax advisor. Cases such as Fokus Bank (2004 -Norway), Denkavit (2006-France), Aberdeen (2009 -Finland), Amurta (2007-Netherlands), and Santander (2012-France) have paved the way for EU protective reclaims.

These were claims filed by EU and non-EU resident investors to recover tax withheld on dividend income paid by an EU member country. The European courts and the CJEU held favorably for the claimants, concluding that the countries' withholding tax regimes were discriminatory and in violation of the Article 63 of the TFEU.

BBH tracks European court cases to provide clients with an overview of the European courts' positions with respect to markets' withholding tax laws. Investors are encouraged to review the [European Union Withholding Tax Initiatives](#), a compilation of recent European court cases and local law developments toward harmonization.

## How does BBH assist with EU protective reclaims?

BBH does not file protective reclaims. BBH files reclaims based on local tax laws and tax treaties. Protective reclaims are filed by the investor's appointed tax advisor. However, BBH recognizes that our clients may require our support to provide information and documentation to accompany EU protective reclaims, and as a result, BBH provides administrative assistance upon client instruction.

BBH provides administrative assistance in the form of historical income reports and proof of taxes paid on custody income payments. Clients can review historical income reports with their tax advisor to determine whether and to what extent they can pursue protective reclaims. Clients then instruct BBH as to the events for which supporting documentation is necessary.

Clients must execute an EU Protective Claim Agreement and complete Exhibit A (Request for Historical Income Activity) and Exhibit B (Request for Tax Vouchers). The agreement provides clients with a consistent operating model, as well as timeframes for requesting reporting and tax vouchers. Please contact your client service Manager for additional information regarding the EU Protective Claim Agreement.

## Should I file for a protective reclaim?

Investors should decide with their tax advisor whether to file protective reclaims, taking the following into consideration:

- opportunities available in the market of investment based on favorable European court decisions
- factual analysis of the client's fact pattern as compared to previously decided favorable court cases (comparability analysis)
- cost benefit analysis of filing the reclaim based on amounts at stake and likelihood of prevailing

## Can I request that BBH take down unfiled pending reclaims if I decide to file EU protective reclaims through my tax advisor instead?

Yes, clients can instruct BBH to take down tax reclaims that have not yet been filed with the local market.

BBH pursues tax treaty benefits, local law withholding tax exemptions and reduction opportunities on behalf of its eligible clients. In some instances, a withholding tax exemption may be available pursuant to the laws of the country of investment. However, regulations have not been issued allowing custodians to request relief at source or to file a tax reclaim on behalf of eligible investors. In such instances, investors may choose to pursue the reclaim as a protective claim through their tax advisor.

## If BBH filed a tax reclaim on my behalf pursuant to a tax treaty, can I also file a protective reclaim pursuant to a local law of the same country of investment?

BBH pursues tax treaty benefits on behalf of its treaty-eligible clients, either at source or by filing a tax reclaim. Investors that determine with their tax advisor that they are eligible for a full withholding tax exemption or further reduction based on discriminatory taxation, can claim the balance of the tax withheld as an EU protective claim through their tax advisor.



If BBH has already filed a treaty-based tax reclaim in a market, investors can only pursue EU protective reclaims for the balance of the tax withheld, regardless of whether the treaty-based reclaim is still pending with the tax authorities.

### Are protective reclaims paid back to my BBH custody account?

Yes, protective reclaims are paid to the client’s BBH custody accounts.

### What is the statute of limitations for filing protective reclaims?

The statute of limitation for filing EU protective reclaims can be different from the statute of limitations for filing standard tax reclaims in the jurisdiction.

Market of Investment	Statute of Limitations <sup>1</sup>
Austria	5 years
Belgium	5 years
Denmark	3 years
Finland	5 years for payments prior to 2017, 3 years for payments after 2016
France	2 years
Germany	4 years
Italy	48 months
Netherlands	3 years
Poland	5 years
Portugal	2 years
Spain	4 years
Sweden	5 years

<sup>1</sup>Statute of limitations periods are based on information gathered from external advisory firms and are subject to statutory and case law changes at any time.

## US Tax Considerations

### Has the Internal Revenue Service (IRS) provided guidance on how US mutual funds are to treat refunds resulting from EU protective reclaims?

Pursuant to Section 853 of the Internal Revenue Code (IRC), regulated investment companies (RICs) may elect on an annual basis to pass through to its shareholders foreign withholding taxes that are paid during the year that are expected to be non-refundable by filing a tax reclaim. The RIC’s shareholders may then claim a foreign tax credit proportionate to the amount of foreign withholding tax passed through.

US mutual funds have been filing protective reclaims in various markets and in some cases are being repaid. These refunds take years to pay out, which creates an administrative burden in complying with Section 905(c) of the IRC. Section 905(c) requires taxpayers that claimed a foreign tax credit and then receive a refund for foreign taxes paid notify the IRS, usually by filing an amended return for the year to which the change relates and pay a re-determined tax amount plus interest. Where the RIC makes an annual election under Section 853, each shareholder that claimed a foreign tax credit would need to notify the IRS of the refund received. This creates an overly burdensome and oftentimes impossible requirement to satisfy.

On January 15, 2016, the IRS released Notice 2016-10, (*Guidance Relating to Refunds of Foreign Tax for Which an Election Was Made Under Section 853*). The Notice describes new regulations to be issued under Sections 853 and 905(c) of the IRC, that would allow eligible RICs to apply a netting method to satisfy obligations pursuant to Section 853 and 905(c) of the IRC. Pursuant to the netting method, the RIC may reduce the amount of foreign taxes it reports to its current shareholders by the refund amount received, plus accrued interest received on the refund, if any. In order to qualify to use the netting method, the following criteria must be met:



1. The economic benefit of the refund and any related interest payment received by the RIC primarily inures to the RIC's refund-year shareholders (as opposed to the shareholders in the year in which the RIC paid the refunded foreign taxes)
2. The RIC was not held predominantly by insurance companies in the year the foreign taxes were paid
3. The RIC made a valid election under Section 853(a) to pass through foreign taxes to its shareholders for the refund year
4. The RIC paid an amount of foreign taxes in the refund year that is equal to or greater than the amount of foreign tax adjustment for the year

RICs that choose to apply the netting method must attach a statement to its Form 1118 providing certain information.

Alternatively, RICs that have made a Section 853 election may request a Closing Agreement from the IRS, if they can demonstrate that it is precluded from applying or that it is not reasonably practical for it to apply the netting method. The RIC must also provide sufficient information to establish a reasonable estimate of adjustments that would be due with respect to foreign tax credit claimed by its shareholders who were treated as paying the foreign tax.

Taxpayers are permitted to rely on the netting method set forth in Notice 2016-10 for refund years ending before the proposed or temporary regulations are issued.

### **What happens if the refund amount is greater than the foreign tax credit taken?**

The IRS and US Department of the Treasury requested comments on Notice 2016-10 and the industry voiced its concerns with certain provisions of the Notice. In April 2016, the Investment Company Institute (ICI) wrote a letter to the IRS and the Department of the Treasury requesting additional guidance to implement Notice 2016-10.

Specifically, the Notice only permits netting if a RIC paid enough tax in the refund year to fully offset the amount of tax recovered in that year. If this requirement is not met, then the RIC may enter into a closing agreement with the IRS. As more EU countries start paying out tax reclaims and larger amounts are recovered, it is more likely a RIC will be precluded from using the netting method.

In its letter, the ICI proposes carryover of excess foreign tax credit reductions for a reasonable period (eight years) and with reasonable interest charged. Where there is an excess refund, the RIC would be permitted to use the netting method to offset the full amount of the current year foreign taxes.

The ICI set forth a few additional proposals concerning provisions of Notice 2016-10:

- RICs held primarily by insurance companies would be permitted to use netting.
- Simplification of how RICs calculate the post-refund interest amount that would be included in the netting adjustment. RICs should be permitted to use the applicable federal rate in effect on the date the netting adjustment is determined and be permitted to assume that the tax will be paid by March 1.
- Confirmation that the amount of refunded tax should have the same character as the income that gave rise to the original withholding.
- Standardization of the closing agreements: 1) The closing agreement payment would be calculated based on the character of the income that gave rise to the tax withheld, and 2) RICs would be permitted to rely on estimates they receive from their brokers and RIC managers in determining the ratio of taxable to tax exempt investors in the RIC.
- A process where RICs would not need to renegotiate a closing agreement every time a new country pays a refund or a refund is paid for a different year.



### Is there a process for obtaining a Securities and Exchange Commission (SEC) certificate to support an EU protective reclaim?

The Division of Investment Management provides US registered funds with letters addressed to foreign jurisdictions to support filing EU tax reclaims. In March of 2017, the Division of Investment Management issued an information update setting forth guidelines for requesting such certificates. The guidelines require that the fund draft a letter to the Division of Investment Management that includes the following information:

- The name of the registrant and registration statement file numbers
- The first date of the fund's fiscal year to which the claims relate
- A statement that the fund is an open-end registered investment company (The Division of Investment Management is considering issuing certificates to closed-end registered investment companies)
- The date and state of organization for the relevant fund

Funds must include supporting documentation confirming information provided in the letter.

Various factors should be taken into consideration in determining whether to file protective claims. While BBH cannot file protective claims on behalf of its clients, our goal is to provide coordinated, efficient and effective support to clients who decide to file such claims through their tax advisors.

**For more information please contact your relationship manager or the Global Tax Services Group.**

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