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Comparability of Investment Funds – CJEU decision on case C-545/19

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Recently, a decision was issued by the Court of Justice of the European Union ("**CJEU**") setting a precedent for foreign funds investing in Portugal and potentially also in other jurisdictions.

The decision follows a controversial opinion of Advocate General Juliane Kokott ("**AG**") issued a few months ago in the case. Fortunately, the judges did not follow the AG's reasoning in full. Overall, this decision sends yet another positive signal to the investment fund industry.

Background

Portuguese Law provides for a specific tax regime related to Collective Investment Vehicles ("**CIV**"s).

This regime is applicable to securities investment funds (Fundo de Investimento Mobiliário or "**FIM**"), securities investment companies (Sociedade de Investimento Mobiliário or "**SIM**"), real estate property funds (Fundo de Investimento Imobiliário or "**FII**") and real estate property investment companies (Sociedades de Investimentos Imobiliário or "**SIIMO**"), incorporated and operating in accordance with Portuguese Law.

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Accordingly, CIVs are considered taxable entities for corporate income tax purposes with any qualifying investment income, rental income or capital gains being excluded from the taxable income (along with any expenses connected with obtaining said income and management fee expenses). Qualifying income does not include any income derived from blacklisted territory, however. CIVs are exempt from both municipal and state surtaxes. The beneficial income tax treatment at the CIV level (on qualifying income) is combined with a stamp tax levy on the net asset value of the CIV.

Since the new CIV tax regime is only applicable to Portuguese CIVs established under Portuguese law, there is a difference in the treatment of Portuguese-sourced income depending on the residence of the beneficiary fund. Accordingly, Portuguese-sourced income distributed to a Portuguese CIV will be exempt from withholding tax ("**WHT**"), whereas a 25% domestic WHT rate would apply, should the same income be paid to a US fund, for example. While treaties for avoidance of double taxation ("**DTTs**") concluded by Portugal might reduce this WHT, a difference in rate is likely to remain.

This difference in treatment constitutes discrimination and, therefore, grounds for a foreign mutual fund requesting a full refund of the tax withheld.

The appellant in the case at hand – AllianzGI-Fonds AEVN ("**AEVN**") – is a regulated, fund - type CIV established under German Law. In the years under dispute, AEVN received dividends from Portuguese companies. The fund did not benefit from the exemption provided by the Portuguese CIV regime as it was not operating under Portuguese Law, and was subject to general corporate income tax regime (i.e. 25% WHT at source, reduced to 15% under the Germany – Portugal DTT. AEVN applied for a refund of the WHT suffered, but its application was denied. Following an appeal filed with the Portuguese Arbitration Tax Court, a referral was made to the CJEU.

Five questions concerning the compatibility of Portuguese tax law with the fundamental freedoms were referred to the CJEU. With these questions, the referring Court ultimately sought to ascertain whether the taxation of a CIV formed under foreign law is compatible with the EU law and if the stamp duty applied to Portuguese resident investment funds and the WHT levied on income received by non-resident investment funds is comparable. An important question related to the taxation of the ultimate investors was raised, i.e. if the taxation of the natural or legal persons investing in the CIVs is comparable depending on the residence of the CIV itself and the shareholders.

The question on the taxation of the shareholders was also raised in previous CJEU cases (especially in the context of non-European CIVs) but, up until now, had not been fully analysed by the Court.

AG opinion

AG Kokott investigated the questions in depth. In her opinion, she concluded that, if Germany (the country of residence of the appellant) does indeed offset the Portuguese WHT (15%) against the investor's income tax liability, *"…it would be possible to assume, at the most, formal unequal treatment of the UCITS in that case, but not material unequal treatment of the investors. Since the raison d'être of a UCITS consists solely in providing investors with access to investments in the securities market, it is only their perspective that is relevant"*.

Although such conclusion might seem logical, it should be taken with a pinch of salt, as it might be difficult (if not impossible) to gather sufficient evidence on the actual offset available to the investors and such information might be misleading. Also, more importantly, possible offset available to the investors cannot be a justification of a discrimination at the level of the CIV, if the situation of the investors is not a decisive factor in the law granting the exemption. This position was also confirmed by the CJEU in the C-338/11 to C-347/11 joint cases decision[1].

On the question relating to the comparison between the stamp duty and the WHT, to which the foreign CIVs are subject, the AG concluded that the difference between stamp duty and WHT is purely dogmatic and that the fact that the entire capital stock of the Portuguese CIV is subject to stamp duty justifies the much lower rate to which the Portuguese CIVs are subject. The AG opinion was subject to widespread comments, most of them critical, and the decision of the CJEU was greatly anticipated.

[1] Paragraph 28 and the following of C-338/11 to C-347/11 joint cases decision.

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CJEU decision

The decision was issued on 17 March 2022.

The Court combined the 5 questions of the referring National Court into 2 key questions.

1. did the stamp duty on local CIVs achieve a similar result to the WHT on foreign CIVs?
2. should the shareholder taxation be taken into account?

Question 1: The Court concluded that dividend income received by foreign CIVs is clearly subject to WHT in all cases and the stamp duty applied to Portuguese CIVs cannot be considered a different technique for the collecting of the same tax. As the stamp duty is based on the net book value of the Portuguese CIV, it should be considered a property tax and not a corporate tax[2]. Further, a Portuguese CIV can avoid the taxation of the dividend income under the stamp duty, by an immediate distribution of the dividend income to its shareholders, a possibility which is not open to a foreign CIV[3].

Question 2: The Court emphasised that the key criteria for distinction are those set out in the local regulation concerned. As the local regulation only used the criteria of residence of the CIV, the taxation at the level of the CIV shareholders is irrelevant.

Although the details of each case need to be examined closely, this decision answers a few important questions that have been raised by local European tax administrations and courts (especially with regards to the importance of the taxation of the investors in the foreign CIVs). Furthermore, the Court repeated again that Article 63 TFEU must be interpreted as precluding legislation of a Member State under which dividends distributed by resident companies to a non-resident CIV are subject to WHT, whereas dividends distributed to a resident CIV are exempt from such WHT.

Do you have further questions?

KEITH O'DONNELL
Managing Partner,
International & Corporate Tax
keith.odonnell@atoz.lu
T + 352 26 940 257

DESISLAVA DIMITROVA
Director,
International & Corporate Tax
desislava.dimitrova@atoz.lu
T +352 26 940 236

[2] Paragraph 53 of C-545/19 CJEU decision

[3] Paragraph 55 of C-545/19 CJEU decision

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