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# ATOZ ALERT

## European Court of Justice rules on Tax Treatment of Non-Resident Investment Funds in Austria

13 May 2025

On 30 April 2025, the Court of Justice of the European Union ("**CJEU**") published its decision (the "**Decision**") regarding reclaims of withholding tax ("**WHT**") filed on behalf of Franklin Mutual Series Funds – Franklin Mutual European Fund (**the** "**Fund**"), a U.S. regulated investment company ("**US RIC**"). The case deals with the question of whether the denial of tax refunds to non-resident investment funds that are comparable to EU-regulated funds is compatible with the free movement of capital set out in Article 63 of the Treaty on the Functioning of the European Union ("**TFEU**").

In this article, we analyse this Decision and its consequences for pending WHT reclaims in Austria.

### Background

In 2013, the Fund received dividends from Austrian listed companies, which were subject to a 25% WHT rate. The Fund filed a refund request on behalf of its unitholders and received a partial refund up to 15% through the application of the corresponding Double Tax Treaty between Austria and the US. The Fund filed a second refund request, in its own name, for the refund of the remaining 15% WHT relying on Paragraph 21 (1) (1a) of the Austrian corporate income tax law of 1988.

This Paragraph provides that corporations subject to limited tax liability and resident in the EU or in a State that is part of the Agreement on the European Economic Area ("**EEA**") may apply for a refund of tax suffered on income from capital if this income cannot be offset in the State of residence.

The Fund argued that this provision should apply to funds residents in non-EU Member States, based on the non-discrimination rule embedded in Article 63 TFEU.

The Austian tax authorities ("**ATA**") rejected the WHT refund application on the grounds that the Fund was neither a resident in another EU Member State nor in a State party to the Agreement on the EEA. After initial dismissal by the Austrian Federal Finance Court (*Bundesfinanzgericht*), the Supreme Administrative Court (*Verwaltungsgerichtshof*) held that a "typological comparison" was necessary to assess (i) the Fund's comparability to an Austrian corporate entity and (ii) the proper attribution of income, and remitted the case to the Austrian Federal Finance Court for this analysis to be conducted.

In its decision, the Austrian Supreme Administrative Court ruled that a comparability analysis should be performed between the Fund and an Austrian corporate entity and that it must be determined who is the beneficiary of the income received. The case was sent back to the Austrian Federal Finance Court for the corresponding analysis to be performed. The court noted that if the only reason preventing the attribution of income to the foreign entity is Paragraph 188 of the Austrian law on investment funds 2011 (*Investmentfondsgesetz* or "**InvFG 2011**"), this could constitute a restriction on the free movement of capital, the justification of which must be assessed.

The Austrian Federal Finance Court ruled that the Fund (i) is comparable to an Austrian corporate entity, and (ii) is the beneficiary of the dividends distributed from Austria. The Federal Finance Court also held that Paragraph 188 InvFG 2011 constitutes an unjustified restriction on the free movement of capital.

The ATA appealed the decision to the Austrian Supreme Administrative Court on the basis that the Fund is an investment fund comparable to an Austrian investment fund and should therefore be treated similarly. Consequently, the shareholders are considered as the beneficiaries of the income and only the shareholders can apply for a refund of WHT.

Following the above, the Austrian Supreme Administrative Court referred the case to the CJEU.

## Analysis of the CJEU

The Austrian Supreme Administrative Court asked the CJEU whether Article 63 TFEU must be interpreted as meaning that national legislation which has the effect of precluding a refund of tax on income from capital to a non-resident entity which, on the one hand, has the same characteristics as a UCITS within the meaning of the UCITS Directive but, on the other hand, has legal personality and is, in that regard, comparable to a resident legal person, even though, under that national legislation, a resident UCITS is considered to be transparent for tax purposes and cannot operate as a legal person, constitutes a restriction on the free movement of capital. In other words, the CJEU examined whether applying the tax transparency regime to a non-resident entity like the Fund (UCITS-like, but with legal personality) constitutes a restriction on the free movement of capital.

With regard to the restriction on the free movement of capital, the CJEU reminded that such restriction is measured by the difference in treatment in a Member State between comparable domestic and cross-border transactions that could dissuade foreign investors to invest in foreign investment funds with exposure in the Member State as well as dissuade foreign investment funds from investing in that Member State. The CJEU also stated that national legislation that applies equally to domestic and foreign persons may still constitute a restriction on the free movement of capital. The CJEU notes that the comparability of situations must be assessed based on the objective of national law.

The CJEU highlighted that the objective of Paragraphs 186 and 188 InvFG 2011 is the transparent taxation of investment funds, ensuring income is taxed at the unit-holder level to prevent tax shielding at the fund level.

According to the CJEU, Paragraph 186 (1) InvFG 2011 applies to investment vehicles without legal personality which pool capital and provide investment opportunities to investors under certain authorization and supervision. According to the Federal Finance Court, Paragraph 186 aims at ensuring that income received by the Austrian investment funds is taxed in the hands of the shareholders. In parallel, Paragraph 188 InvFG 2011 applies to foreign investment funds, irrespective of their legal form, if they comply with the principles of risk spreading. For the Federal Finance Court, the objective of Paragraph 188 is to "*ensure equal tax treatment of resident and non-resident investment funds so that non-resident investment funds do not produce a shielding effect and taxation takes place at the level of the unitholders*".

The CJEU confirms that the Fund is objectively comparable to an Austrian Investment Fund as per Paragraph 186 (1) InvFG 2011 and a UCITS fund. However, the Fund has a legal personality similar to an Austrian corporation and considered the beneficiary of the dividend income received.

Following the above, the CJEU mentioned the necessity to analyze whether the Fund would be in a different situation than of the domestic and foreign investment funds falling in the scope of Paragraph 186 and Paragraph 188 of InvFG 2011, because of its legal form and legal personality.

With this regard, the Court concluded that for tax purposes, in particular the avoidance of double taxation of income from investment and to ensure equivalent treatment of indirect investments through investment vehicles similarly as direct investments, the legal form of the investment funds is irrelevant. In fact, the tax neutrality could also be achieved through specific tax exemptions from income tax in the country of residence.

In other words, while the Fund has legal personality, unlike Austrian UCITS, the CJEU stated that having legal personality does not necessarily mean a different situation compared to a resident investment fund without legal personality, *especially* if the dividends received by the non-resident entity are attributed to its unit-holders and taxed at the *unit-holder level* in its state of residence, rather than at the entity level.

Therefore, according to the CJEU, the provisions of Paragraph 188 InvFG 2011 do not constitute a restriction on the free movement of capital as per Article 63 of TFEU provided that the income received by the non-resident entity is attributed to its unitholders and is taxed at the level of its unitholders. The CJEU seems to suggest that the facts in this case (i.e., that the fund distributed all of its income in 2013 and therefore did not pay any US income tax that year) points to a taxation at unitholders level in the United States, even though this is not the case from a legal perspective.

Following the CJEU's ruling, the Austrian Supreme Administrative Court will now have to determine whether the national rules give rise to unlawful discrimination in the specific case. Given the clarity of the CJEU's reasoning, it is expected that the Court will align its decision with the position taken by the CJEU.

## Conclusion

The decision of the CJEU is important for the pending WHT reclaims in Austria for the years leading up to 2013. The analysis of the Austrian Supreme Administrative Court on the circumstances of the case, i.e. the specific tax regime applicable to the Fund in the US and the fact that the Fund initially recognized the unitholders as the beneficial owners of the income by filing the reclaims based on the Double Tax Treaty on their behalf remain to be seen.

Until May 2025 the tax office suspended the decision on similar proceedings and was not issuing decisions on the refund applications based on Article 63 TFEU. With the CJEU decision being issued now, we expect that the Austrian Supreme Administrative Court will decide on the question whether the investment fund in the pending case is comparable with an Austrian corporation or not. Upon the decision of the Austrian Supreme Administrative Court the Austrian tax authorities will assess the pending cases.

## Do you have any questions?

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