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By PwC Deutschland | 22 March 2022

Portuguese dividend withholding tax for foreign UCITS in breach of EU law

Does the free movement of capital require a Member State to tax non-resident and resident investment vehicles according to the same tax system? This is the question raised in the request for a preliminary ruling submitted to the European Court of Justice (ECJ) by the Portuguese tax court (Tax Arbitration Tribunal). Contrary to the Opinion of the Advocate General the ECJ decided that the withholding tax on dividends paid to non-resident Undertakings for Collective Investments in Transferable Securities (UCITS) is in violation with current EU Law.

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Background

In the case at issue, a Portuguese legislation was tested before the ECJ which – in the case of non-resident investment vehicles - levies a withholding tax on capital investment income if, in their State of residence, those entities are not subject to corporation tax or if their corporation tax liability is low. In contrast, resident investment vehicles are taxed according to a different approach: The dividend income is neither subject to corporation tax nor is there a tax withholding tax at source. It is only when dividends are distributed to the investor that the latter becomes subject to Portuguese income tax.

The plaintiff, *AllianzGI-Fonds AEVN*, is **a collective investment undertaking** (Undertaking for Collective Investments in Transferable Securities - UCIT) **with its seat in Germany** and which receives investment income in the form of dividends paid by corporations resident in Portugal. Portugal treats dividends distributed to a UCITS formed under Portuguese law as exempt from corporate income tax.

According to the **Advocate General in her Opinion of 6 May 2021**, the provisions on the free movement of capital would not preclude the Portuguese tax regime under which withholding tax is levied on dividends distributed by a resident company to a non-resident UCITS which is not subject to corporation tax in the State of residence. In her opinion, the justifications (inter alia, preservation of the balanced allocation of taxing powers and preservation of the coherence of the Portuguese tax system) outweigh the interest of the plaintiff to be exempted from corporate income tax like a resident UCITS.

ECJ decision

In general terms the court agrees with the GA that Portugal treats dividends paid to non-resident corporations less favorably than dividends paid to resident corporations. This is a clear disadvantage compared to resident funds and thus likely to discourage foreign companies from pursuing investments in Portugal and, consequently, is per se a restriction of the free movement of capital, prohibited under Article 63 TFEU. - However, such **restriction can be justified** if the difference in treatment concerns situations which are **not objectively comparable** or **by an overriding reason in the public interest (**either to *preserve the balanced allocation of the power to impose taxes* or *maintaining the cohesion of the tax system***)**. Contrary to the Opinion of the GA both alternatives were dismissed by the court as reasons for justification.

Comparability of domestic and foreign situations:

Based on the distinction made in the Portuguese tax provision, which is based solely on the place where the UCITS are domiciled, no difference can be objectively established between the situation of resident and the situation of non-resident UCITS. The different treatment of resident and non-resident UCITS thus concerns situations which are objectively comparable. Since Portugal has decided to exercise its taxation powers on income received by non-resident UCITS, the latter are in a situation comparable to that of resident UCITS insofar as the risk of economic double taxation of dividends paid by Portuguese resident companies is concerned.

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Preserving the balanced allocation of the power to impose taxes:

Preserving the balanced allocation of taxation could only be accepted as ground for justification if the purpose of the provision in question was to interfere with the right of a Member State to exercise its power of taxation in respect of activities carried on within its territory. However, if a Member State chooses - as in the present case - not to tax resident UCITS which receive dividends of domestic origin, the need for a balanced allocation of tax sovereignty between Member States cannot be relied upon to justify the taxation of non-resident UCITS receiving income of the same nature.

Maintaining the coherence of the tax system:

In the opinion of the ECJ, the preservation of coherence can only be accepted as justification if a direct connection between the tax advantage in question and the compensation of this advantage by a certain tax burden is demonstrated. The exemption from withholding tax on dividends paid to resident UCITS in the present case, however, is not subject on the condition that the UCITS pass on the dividends received and that taxation of the dividends in the hands of the unit holders makes it possible for them to offset the exemption from withholding tax. Thus, the court sees no direct connection between the exemption from withholding tax of dividends of domestic origin paid to a resident UCIT and the taxation of these dividends as income of the unit holders of the UCIT.

Source:

The ECJ case reference is C?545/19 *AllianzGI-Fonds AEVN* judgment of 17 March 2022.

(An english version of this decision was not available at the time this article was posted)

Keywords

UCITS / OGAW, investment vehicle, portuguese dividend withholding tax