Euro Tax Flash from KPMG's EU Tax Centre

Background

The CJEU decision

EU Tax Centre comment

CJEU decides that Portuguese taxation of dividends received by foreign UCITS is contrary to EU law

CJEU – Portugal – Free movement of capital – Withholding tax on dividends – UCITS – Comparability

On March 17, 2021, the Court of Justice of the European Union ('CJEU' or 'Court') rendered its decision in case C-545/19. The case concerns the compatibility with EU law of the Portuguese withholding tax levied on dividends paid by Portuguese companies to foreign undertakings for collective investment in transferable securities ('UCITS'). In contrast to the opinion of the Advocate General ('AG'), the Court concluded that the Portuguese legislation under dispute is contrary to the free movement of capital.

Background

The plaintiff is a tax-exempt UCITS established in Germany that received dividend income from investments in Portuguese companies. The taxpayer disputed the Portuguese regime on grounds of discrimination prohibited under EU law.

In Portugal, dividends distributed by Portuguese entities to UCITS set up under Portuguese law are exempt from corporate income tax (CIT) and are taxed in the hands of the investors, at the time of the distribution. However, since 2015, domestic UCITS are subject to a quarterly 'stamp duty' of 0.0125 percent, that is levied on the total net asset value of the UCITS (including, inter alia, unpaid dividends). On the other hand, foreign UCITS are subject to a final withholding tax of 25 percent to the extent that they are subject in their country of establishment to a CIT rate lower than 60 percent of that applied in Portugal. The withholding tax can be reduced under double tax treaties in force.

On May 6, 2021, AG Kokott of the CJEU suggested that the Court finds that the legislative provisions under dispute are compliant with EU law. In short, in the AG's view, the case under dispute was different from previous case law such as Fidelity Funds (C-480/16) since it did not involve a full tax

exemption for domestic UCITS. Instead, the AG considered that the case concerns a mere difference in taxation techniques, and a restriction could only exist if foreign UCITS are subject to a less favorable tax treatment compared to domestic UCITS.

For the purpose of this analysis, the AG notes that one should also consider whether the Portuguese dividend withholding tax is creditable when the income is taxed in the hands of the foreign UCITS's investors. Moreover, in the AG's view, foreign UCITS are not in a comparable situation to domestic UCITS because Portugal does not have the authority to tax foreign entities in the same way as it taxes Portuguese UCITS (i.e. by applying a stamp duty on the global net asset value of the UCITS). Furthermore, the AG noted that even if the CJEU proceeds based on the assumption that the domestic and foreign UCITS are in a comparable situation, the difference in treatment would be justified by the need to preserve the balanced allocation of the power to impose taxes between the Member State, to avoid 'double non-taxation' in the context of efficient tax collection and to safeguard the coherence of the Portuguese tax system.

The CJEU decision

The CJEU concluded that the case needs to be analyzed in light of the free movement of capital. In this regard, the Court observed that, based on settled case law, measures that are likely to dissuade non-residents from making investments in a Member State or to dissuade residents from making investments in other States, restrict the free movement of capital. The CJEU also noted that this is also the case of the legislation under dispute. Contrary to the AG's opinion, the Court therefore held that the difference in treatment between domestic and foreign UCITS represents a restriction of the free movement of capital prohibited by Article 63(1) TFEU.

The Court then addressed the issue of whether such a restriction is justified and first observed that the situation of a German UCITS is comparable to that of a domestic UCITS. In particular and contrary to the AG's opinion, the CJEU noted that the stamp duty levied on domestic UCITS is a tax on assets which is not comparable to a tax on the income derived by legal entities. Furthermore, even if one would assimilate the stamp duty to a tax on dividends, domestic UCITS could avoid the payment by distributing the income immediately to investors. Additionally, the Court noted that the stamp duty applies only in cases where a minimum holding period is not met with respect to shares held in the companies distributing the dividends. In practice, it therefore impacts a limited number of cases.

Consequently, in the Court's view, the fact that foreign UCITS are not subject to stamp duty does not place them in an objectively different situation compared to domestic UCITS.

The Court also recalled that the comparability analysis should be based on an overall assessment having regard to the aim, purpose and content of the Portuguese legislation. The reported aim of the measures under dispute, which needs to be verified by the referring court, is to prevent economic double taxation, by transferring the tax burden from the domestic UCITS to the level of the investors. In this context, the Court noted that because Portugal chose to levy tax on the income received by foreign UCITS, the latter are in a situation comparable to that of UCITS established in Portugal.

Finally, the Court successively considered and rejected the justifications brought forward by the Portuguese government, i.e. the need to safeguard the coherence of the Portuguese tax system and the need to ensure a balanced allocation of taxing rights. With regard to the latter, the Court referred to its previous case-law based on which this justification cannot be invoked in cases where a Member State chose not to tax domestic UCITS on the domestic dividend income received. As a

consequence, the Court found that the Portuguese withholding tax on dividends paid to foreign UCITS constitute an unjustified breach of EU law.

EU Tax Centre comment

The CJEU decision is broadly in line with its previous case law on the taxation of dividends paid to foreign UCITS, and notably takes a different approach than the one suggested by the AG.

In particular the Court rejected the AG's analogy with the judgement in the Pensioenfonds Metaal en Techniek case (C-252/14) and argued that a tax levied on net assets is not comparable to an income tax for the purpose of assessing the existence of a restriction on the free movement of capital. Another key point is that the CJEU's decision doesn't follow the AG's controversial reasoning on the comparability of domestic and foreign UCITS. As noted above, the AG took the view that the situations are not comparable because the latter cannot be subjected to the stamp duty on their entire assets. Such approach might have led to the arguable interpretation that Member States are allowed to differentiate between resident and non-resident taxpayers on the grounds that only resident taxpayers can be subject to worldwide taxation.

Finally, we would like to comment on the argument put forward by the Portuguese government that the restriction is neutralized by a tax credit in Germany for the Portuguese dividend withholding tax. Although in theory this is correct, it assumes that the shareholders in the German fund are all tax resident in Germany. That is extremely unlikely. Secondly, not all German tax residents are de facto able to benefit from such a tax credit (for example if they have a very low income).

Should you have any queries, please do not hesitate to contact KPMG's EU Tax Centre, or, as appropriate, your local KPMG tax advisor.

Robert van der Jagt
Chairman, KPMG's EU
Tax Centre and
Partner, Meijburg & Co

Ana Puscas
Manager
KPMG's EU Tax Centre

kpmg.com/socialmedia

Privacy | Legal

You have received this message from KPMG’s EU Tax Centre. If you wish to unsubscribe, please send an Email to eutax@kpmg.com.

If you have any questions, please send an email to eutax@kpmg.com

You have received this message from KPMG International Limited in collaboration with the EU Tax Centre. Its content should be viewed only as a general guide and should not be relied on without consulting your local KPMG tax adviser for the specific application of a country's tax rules to your own situation. The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavor to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

To unsubscribe from the Euro Tax Flash mailing list, please e-mail KPMG's EU Tax Centre mailbox (eutax@kpmg.com) with "Unsubscribe Euro Tax Flash" as the subject line. For non-KPMG parties – please indicate in the message field your name, company and country, as well as the name of your local KPMG contact.

KPMG's EU Tax Centre, Laan van Langerhuize 9, 1186 DS Amstelveen, Netherlands

© 2022 Copyright owned by one or more of the KPMG International entities. KPMG International entities provide no services to clients. All rights reserved.

KPMG refers to the global organization or to one or more of the member firms of KPMG International Limited (“KPMG International”), each of which is a separate legal entity. KPMG International Limited is a private English company limited by guarantee and does not provide services to clients. For more detail about our structure please visit home.kpmg/governance.