Updates from the Court of Justice of the European Union – DAC6 and withholding tax on foreign funds

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AG opinion on compatibility of EU MDR notification obligations with EU law

On April 5, 2022, Advocate General ('AG') Rantos opined in the case of Orde van Vlaamse Balies and Others, C-694/20. The AG concluded that the requirement for intermediaries, availing of legal professional privilege under the EU mandatory disclosure rules ('DAC6'), to notify other intermediaries (or the relevant taxpayer) of their reporting obligation, did not infringe on their rights under the Charter of Fundamental Rights of the EU insofar as the name of the intermediary claiming privilege is not disclosed to the tax authorities.

Background

On December 21, 2020, a request for a preliminary ruling was made to the Court of Justice of the European Union ('CJEU') by the Belgian Constitutional Court in a case regarding the mandatory disclosure requirements for intermediaries and relevant taxpayers under DAC6.

The question referred to the CJEU concerns the compatibility of Article 8ab of DAC6 with the right to a fair trial, as guaranteed by Article 47 of the Charter of Fundamental Rights of the European Union ('the Charter'), and the right to respect for private life, as guaranteed by Article 7 of the Charter.

Article 8ab(5) of DAC6 provides that Member States grant intermediaries "the right to a waiver from filing information on a reportable cross-border arrangement where the reporting obligation would breach the legal professional privilege under the national law of that Member State". However, Article 8ab(5) further provides that intermediaries claiming legal professional privilege are required "to notify, without delay, any other intermediary or, if there is no such intermediary, the relevant taxpayer of their reporting obligations".

The waiver for legal professional privilege was incorporated into Belgian domestic law in Article 11/6(1) of a Flemish decree on administrative cooperation in the field of taxation. While the decree does not specify the manner in which the notification must be made or the full content required, it does require that the intermediary notifies other intermediaries (or the taxpayer, if there is no other intermediary) that a reportable cross-border arrangement exists and that a notification obligation arises. In addition, the decree requires that the name of the intermediary is listed as part of the notification data.

The Flemish Bar Council argued that they are not able to fulfil their obligations under the decree without breaching professional secrecy rules. In this regard, the Flemish Bar Council argued that the notification obligation was an infringement of the right to a fair trial and the right to respect for private life under the Charter.

The AG opinion

In his opinion, Advocate General Rantos, noted that the core objective of DAC6 is the reporting of cross-border arrangements by intermediaries. As such, a restriction on reporting could potentially undermine the manner in which the Directive functions.

The AG found that professional privilege is one of the general principles of EU law and is guaranteed under Articles 6 and 8 of the European Convention on Human Rights. The AG also found that professional privilege is also guaranteed under Articles 7 and 47 of the Charter.

However, the AG noted that the right to a fair trial, as guaranteed by Article 47 of the Charter, was applicable to cases where an individual is involved in legal proceedings. While this right extends to an individual being properly informed, defended and represented, the reporting obligations imposed by DAC6 typically apply in circumstances unrelated to legal proceedings. The AG therefore concluded that, in a DAC6 context, a lawyer is not representing their client in a dispute with the tax authorities. In particular, the AG noted that DAC6 is preventative in nature and the notification obligation applies before disputes have arisen with the tax authorities. The AG therefore concluded that the notification obligation did not infringe on the right to a fair trial as it was outside the scope of that provision.

When considering the right to respect of private life, the AG also concluded that the notification obligation imposed on lawyers claiming professional privilege was compatible with Article 47 of the Charter. In forming this view, the AG noted that DAC6 requires all intermediaries to report certain cross-border arrangements to the tax authorities, unless intermediaries can rely on legal professional privilege as provided for under the laws of the relevant Member State. The AG noted that the scope of legal professional privilege is not harmonized across Member States and concluded that it should be for individual Member States to determine its scope as a result.

In the AG's opinion, the notification obligations provided for under the Belgian decree only required the disclosure of limited information including (i) notifying the other intermediary (or relevant taxpayer, if no other intermediary exists) that the intermediary can avail of legal professional privilege and (ii) that the reporting obligation therefore has been transferred to that other intermediary. The AG noted that communications between the intermediary and its client do not need to be disclosed. From a professional secrecy perspective, the AG concluded that, as the intermediary would either be notifying another intermediary that was already involved in the arrangement or the taxpayer itself, it is assumed that no breach of professional secrecy occurs as a result. On this basis, the AG concluded that the notification obligation would not constitute a breach of right to respect for private life, as guaranteed under Article 7

of the Charter, if information relating to the taxpayer was already available to the other intermediary.

While the AG stated that there may be cases where the notification obligation could potentially infringe on the right to respect for private life, the AG concluded that the notification obligation under DAC6 was introduced to pursue an objective of the European Union, namely targeting tax avoidance and evasion. The AG therefore concluded that any interference with the right to respect for private life was justifiable provided that it was considered to be necessary and proportionate, which the AG considered to be met in the case at hand.

The AG did however note that a requirement to disclose a requirement under Belgian law for the name of the intermediary claiming privilege to be disclosed to the tax authorities was disproportionate and unnecessary to achieve the objective of combating aggressive tax planning.

The AG therefore opined that the provision in the Belgian degree was compatible with Articles 47 and 7 of the Charter of Fundamental Rights of the European Union, provided that the name of the legal intermediary is not required to be disclosed to the Belgian tax authorities.

EU Tax Centre Comment

The challenge raised by the Flemish Bar Council represents the first case taken to the CJEU since the new mandatory reporting requirements were introduced under DAC6. Since this referral was made in December 2020, a similar question was also referred by the French Supreme Administrative Court (Conseil d'État) in the case of Conseil national des barreaux and Others, C-398/21, which also challenges the legal professional privilege notification obligations of DAC6, as introduced into French domestic law (as reported in E-News Issue 136).

It is also worth noting that, while the case was brought by the Flemish Bar Council and is therefore framed in the context of lawyers asserting legal professional privilege, it is also possible for members of the Belgian Institute for Tax Advisors and Accountants to rely on the same professional privilege. The CJEU findings in this case may therefore have also an impact on the position of recognized tax advisors and accountants in Belgium as a result.

Exclusion of certain foreign investment funds from Finnish investment fund exemption is contrary to EU law

On April 7, 2022, the CJEU rendered its decision in case C-342/20. The case concerns the compatibility with EU law of Finland's rules that exclude from an income tax exemption investment funds not set up in contractual form.

In line with the opinion of the AG, the CJEU ruled that the legislation in question is incompatible with the freedom of capital even though the rule in question applied equally to resident and non-resident investment funds.

Background

The applicant, 'A' SCPI, is an alternative investment fund constituted under French law in the form of a société civile de placement immobilier à capital variable – SCPI (open-ended real estate investment fund) and is treated as tax transparent in France. 'A' SCPI intends to perform several real estate investments in Finland. Based on Finnish domestic law and the double tax treaty concluded between France and Finland, non-residents deriving rental income (directly

or indirectly) from Finland are liable to tax there. Specific exemptions apply for Finnish investment funds and for equivalent EU investment funds. However, starting from 2020, a legislative amendment limits the applicability of the tax exemption to open-ended investment funds constituted by contract, meaning that investments funds set up as companies are no longer eligible to benefit from the exemption.

On October 7, 2021, AG Henrik Saugmandsgaard Øe of the CJEU suggested that the legislative provisions under dispute are not compliant with EU law. The AG concluded that the requirement that a fund must be set up based on a contract to benefit from the Finnish corporate income tax exemption represents a breach of the free movement of capital. The AG noted that French open-ended investment funds that may have the same characteristics as contractual-based funds are in a comparable situation with Finnish investment funds. In the AG's view, linking the corporate income tax exemption to a criterion such as the legal form of the investment fund is an arbitrary difference in the treatment of comparable entities. Details of the AG's opinion were previously reported in E-News Issue 140.

The CJEU decision

The Court identified an element of *de facto* discrimination. Despite the fact that the legislation does not specifically introduce a difference in treatment between resident and non-resident operators, it has the effect of placing cross-border situations at a disadvantage. The reasoning of the Court took into account that, under Finnish investment fund law, two types of collective investment undertakings covered by the legislation in question (i.e., investment funds and special investment funds) are constituted solely in contractual form.

As a result, by rendering the legal form that these Finnish funds satisfy by nature as a requirement for obtaining the exemption, the legislation effectively reserves the availability of the exemption mainly for these domestic funds. In contrast, foreign investment funds (even though comparable in general terms) may not necessarily meet the exemption criteria (e.g. in cases where they have chosen to be constituted in corporate form in their home jurisdiction). On this basis, the Court stated that even though the legislation applies without distinction to resident and non-resident operators, non-resident investment funds may in fact be placed at a disadvantage in light of this requirement.

The CJEU stated that the free movement of capital would be rendered ineffective if a non-resident fund, set up according to the legal form authorized or required by its Member State, is excluded from an exemption in the Member State in which invests solely on the grounds that its legal form does not correspond to the legal form required by that Member State.

The CJEU stressed that the above conclusion should not change even when considering the fact that Finnish law allows the set-up of another type of collective investment undertakings (i.e., alternative investment funds) in corporate form, which would not be entitled to the exemption under dispute. In this regard, the Court observed that Finnish funds have the choice to adopt the legal form that enables them to obtain the exemption. However, that might not necessarily be the case for non-resident collective investment undertakings, which remain subject to the conditions laid down by the legislation of their Member State.

The Court noted that the condition relating to contractual form does not constitute a condition which only resident collective investment undertakings are capable of fulfilling. However, that condition is liable to place those undertakings at an advantage over collective investment undertakings constituted in corporate form, as prescribed under the legislation of the Member State in which they are established.

The Court therefore concluded that the Finnish legislation is liable to deter non-resident collective investment undertakings from investing in immovable property in Finland and therefore constitutes a restriction on the free movement of capital.

The Court concluded that, in light of the objective of the measure in question, a non-resident fund constituted in corporate form, which benefits from an income tax exemption or is treated as tax transparent in its Member State of residence, is in a comparable situation to a Finnish investment fund formed in accordance with contract law.

Finally, the Court rejected the justifications brought forward by the Finnish Government, namely preserving the effectiveness of tax supervision, the collection of taxes and the coherence of the Finnish tax system.

EU Tax Centre Comment

The CJEU decision is broadly in line with its previous case law on the taxation of dividends paid to foreign funds. However, it also offers some new perspectives which will be welcomed by foreign investment funds trying to achieve a level playing field with domestic investment funds. Although a number of member states have changed their legislation in the past few years, there continues to be a number of member states that are still defending their regimes for investment funds. The Court reiterates that different treatment based *solely* on the legal form of the foreign investment fund may introduce unjustified restrictions to free movement of capital or establishment even if this rule applies without distinction to domestic and foreign operators.

In this respect, the decision has common elements with the earlier 2021 judgment of the CJEU in C-480/19 which concerned the taxation of a Finnish unitholder in a foreign corporate form fund, though no reference was made on this case in the text of the judgment. In the earlier judgment, the CJEU held that the income received from a foreign corporate form fund should not be treated differently from the income received from Finnish contractual based fund for Finnish income tax purposes, because the funds were in a comparable position despite their legal forms.

The CJEU also endorsed the Advocate General's remarks relating to the comparability assessment in general: it is not acceptable to base a tax exemption regime on such criteria that are natural for resident funds to meet. Such criteria are arbitrary and may form indirect discrimination.

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

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