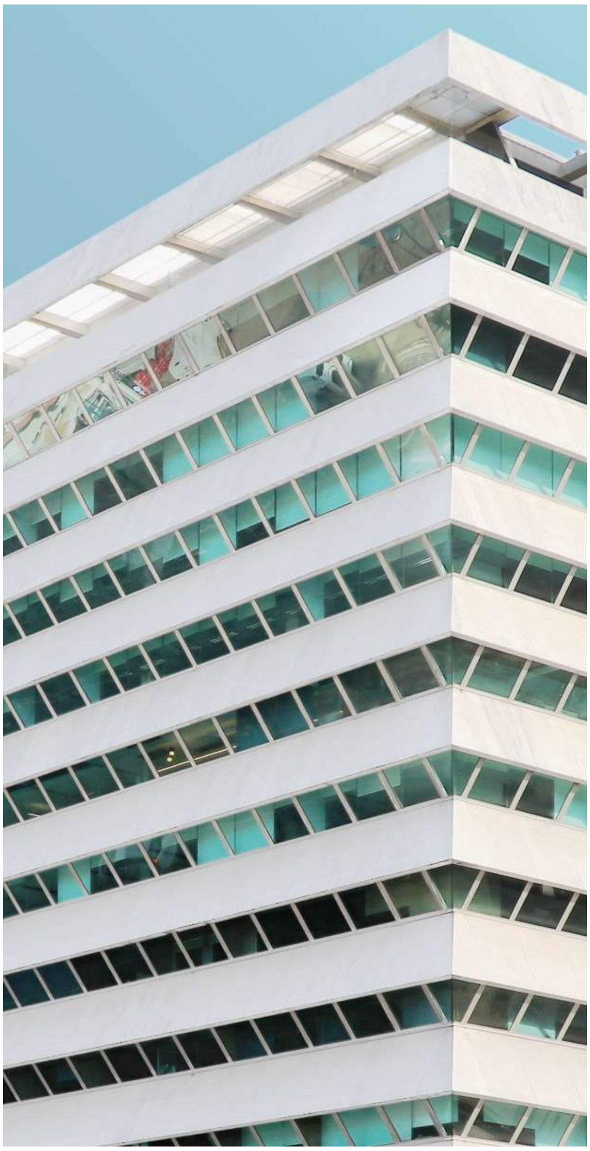
AllianzGI-Fonds ruling: the end of discrimination against foreign investment funds

The CJEU has ruled that the way that dividends paid to foreign investment funds are taxed in Portugal is incompatible with the Treaty on the Functioning of the European Union.

Tax Litigation Legal Flash

March 24, 2022



The Court of Justice of the European Union (CJEU) has ruled that Portugal cannot discriminate against foreign investment funds by applying corporate income tax to dividends paid to these entities:

- Foreign investment funds can now ask the tax authorities to refund all corporate income tax withheld over the past four years.

- Funds from both third countries and EU Member States may now ask for corporate income tax to be refunded.

AllianzGI-Fonds AEVN ruling: the end of discrimination against foreign investment funds

In its ruling of March 17, 2022 (*AllianzGI-Fonds* Case), the CJEU ruled that the system Portugal uses to tax dividends paid to foreign undertakings for collective investment in transferable securities (UCITS) is incompatible with the free movement of capital, as provided for in the Treaty on the Functioning of the European Union (TFEU).

To summarize, under the above tax regime, dividends paid to foreign UCITS are taxed as corporate income and subject to a 25% withholding tax rate, while dividends paid to Portuguese UCITS are not subject to corporate income tax.

The CJEU considered that dividends paid to foreign UCITS are objectively comparable to dividends paid to Portuguese UCITS. Therefore, foreign UCITS cannot be treated differently for tax purposes solely because of where they are registered.

In this context, the CJEU considered the following irrelevant: (i) that Portuguese UCITS may be subject to stamp duty (while foreign UCITS are not), and (ii) the taxation of income distributed by UCITS to their shareholders.

The CJEU also added that the need to guarantee the preservation of the coherence of the Portuguese tax system and the need to ensure the balanced allocation of the power to impose taxes between Member States cannot be used to justify the differential treatment of dividends paid to foreign UCITS under the Portuguese legislation.

Based on this decision, it is now up to the legislature to adapt the domestic tax regime applicable to nonresident UCITS in accordance with the CJEU's conclusions, eliminating the existing discrimination.

In any case, by clarifying the doubts that still exist in some case law, this ruling has the immediate effect of substantially strengthening the position of foreign UCITS, including those registered outside the European Union, that intend to challenge the legality of the withholding tax they have been subject to as a means to recover the tax paid over the past four years.

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