Tax Flash

Portuguese taxation of dividends paid to foreign undertakings for collective investment and EU law – Recent judgements

Decisions recently made public by Portuguese arbitration tribunals – an alternative route to standard tax courts – have confirmed that the taxation of dividends paid to EU undertakings for collective investments (UCI) is illegal as a result of an infringement of fundamental principles of EU law, in particular the freedom of movement of capitals.

Pursuant to Article 22 of the Tax Incentives Statute, capital income, real estate income and capital gains obtained by UCIs incorporated and operating according to Portuguese are not considered in the calculation of the taxable profits for corporate income tax (CIT) purposes. However, this regime is not applicable to UCIs incorporated under a foreign law, which are taxed in accordance with the general framework set out in the CIT Code and do not avail of this exemption.

UCIs incorporated under the laws of Germany – exempt from German CIT pursuant to domestic legislation – and a Portuguese branch of a *Société Civile de Placement Immobilier* (SCPI) incorporated under French law successfully claimed before arbitration tribunals the annulment of CIT levied on Portuguese sourced dividends. The key argument put forward by the taxpayers was that Article 22 of the Tax Incentives Statute discriminates non-residents and violates the free movement of capital within the EU (Cases no. 90/2019-T, of 23 July 2019, no. 194/2019-T, of 19 September 2019, and no. 528/2019-T, of 27 December 2019).

The arbitration tribunal found that the German UCIs and the branch of the French SCPI should be considered equivalent to UCIs incorporated under Portuguese law. Based on this conclusion, the arbitration tribunals held that the different tax treatment of UCIs established in another Member State exclusively based on their non-incorporation under domestic legislation – *i.e.*, the place of residence – represents an inadmissible discrimination and a restriction of the fundamental freedom of capital movements between EU Member States.

The arbitrators rejected the Portuguese tax authorities' argument that a UCI incorporated under Portuguese law and a UCI incorporated under foreign law are in objectively different situations and, therefore, tax differentiation is allowed. In fact, pursuant to Article 65 (1) (a) of the Treaty on the Functioning of the EU (TFEU), the provisions of Article 63 in relation to the freedom of movement of capitals do not prevent Member States from distinguishing between taxpayers who are not in the same situation with regard to their place of residence or with regard to the place where their capital is invested.

The arbitration tribunals refer to Article 65 (3) of the TFEU and quote case law of the European Court of Justice (ECJ) to stress that domestic measures and procedures that distinguish between taxpayers based on their place of residence shall not constitute a means of arbitrary discrimination or a disguised restriction on the free movement of capital. It is also made clear that the comparability test should be performed at the UCI's level rather than at the investor's level. Quoting judgements of the ECJ, arbitration tribunals state that residents and non-residents are in a comparable situation when the source state – in this case, Portugal – opts to tax the latter in a less favourable way than the former in relation to dividends distributed by resident companies. By imposing a higher tax burden to non-residents than to residents in respect to the same type of income, foreign investment in Portuguese companies become less attractive than purely domestic investments and that leads to an unwanted distortion in the European internal market.

According to the arbitration tribunals' findings, none of the valid justifications accepted by the ECJ to restrict the freedom of movement of capitals – prevention of tax fraud and abuse, safeguard of the effectiveness of fiscal supervision, the cohesion (or coherence) of the tax system, ensuring a balanced allocation of taxing powers between the Member States – should be applicable.

In the abovementioned cases the arbitration tribunals declared illegal Article 22 of the Tax Incentives Statute insofar as it limits the non-taxation of dividends to UCIs incorporated under Portuguese law, excluding its application to UCIs incorporated under the laws of another Member State. Consequently, income tax paid by EU UCIs was annulled by arbitration tribunals and reimbursed, together with the payment of interest (calculated at an annual rate of 4% from the date of payment).

In another case brought before an arbitration tribunal in 2019 by a UCI from Germany – an open-ended investment vehicle managed by a German company – the former decided to request a preliminary ruling (Case C-545/19 – *Allianzgi-Fonds Aevn*), which is still pending. Despite this request for a preliminary ruling, in Cases no. 90/2019-T, 194/2019-T and 528/2019-T the arbitration tribunal understood that the violation of EU was sufficiently clear, meaning that a referral to the ECJ was found to be unnecessary (*acte eclairé* doctrine).

The discrimination and violation of EU law resulting from Article 22 of the Tax Incentives Statue has not been eliminated. As a matter of fact, this legal provision has remained largely unchanged over the last few years.

This allows other taxpayers from EU Member States to claim the refund of CIT unduly charged on dividends distributed by companies established in Portugal.

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