CJEU decision on the compatibility with the TFEU of Danish legislation concerning the taxation of dividends paid by Danish resident companies to UCITS resident in another Member State

On 21 June 2018, the Court of Justice of the European Union ("CJEU") ruled on the Case C-480/16 concerning the compatibility with the TFEU of the Danish tax regime applicable to dividend distributions made by Danish resident companies to Undertakings for Collective Investment in Transferable Securities – within the meaning of the Council Directive 20 December 1985, n. 85/611/EEC ("UCITS") – not resident for tax purposes in Denmark.

Facts and relevant Danish legislation

According to the relevant Danish legislation in force in the period at stake, dividend distributions from companies resident for tax purposes in Denmark to UCITS resident in other States of the European Union are subjects to a withholding tax ("WHT") of 15%, to be reduced on the basis of the double tax treaty in force between Denmark and the State of residence of the UCITS concerned (if any). In principle, the same tax regime is also applicable to UCITS established in Denmark. However, the Danish resident funds are exempt from such WHT if they satisfy certain conditions provided by Art. 16 C of the Danish tax law (ligningslov). In particular, to obtain the status of Art. 16 C fund, the UCITS:

- must be a resident of the Denmark for income tax purposes;
- until 1 June 2005, had to make a minimum distribution to be taxed at the level of the participants;
- after 1 June 2005, had to calculate a notional minimum distribution to be taxed in the hands of the participants through a WHT applied by the fund itself.

Against this background, several UCITS having their registered offices in the United Kingdom and Luxembourg brought claims before the national Danish court for the refund of the WHT levied on dividends received from Danish resident companies, arguing that this difference in the tax treatment results in a restriction to the free movement of capital and liberalisation of payments and to the freedom to provide services as set out, respectively, in Art. 63 TFEU and 56 TFEU.

In this respect, the national court decided to refer the question to the CJEU.

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Findings of the CJEU

The CJEU first pointed out that the situation falls within the scope of the free movement of capital while the freedom to provide services is only secondary and does not justify an independent analysis. Indeed, the fact that the legislation at stake may have the effect of rendering less attractive the activities of a non-resident UCITS would be the unavoidable consequence of the tax treatment of the dividends paid to that UCITS.

Second, the CJEU held that the legislation at issue constitutes a restriction on the free movement of capital which may discourage, on the one hand, non-resident UCITS from investing in Danish companies and, on the other hand, investors resident in Denmark from acquiring shares/quotas of non-resident UCITS.

To reach this conclusion, the CJEU first assessed the comparability between resident and not resident UCITS having regard to the aims pursued by Art. 16 C of the ligningslov, namely:

- ensure equality of the tax burden on private individuals investing in companies established in Denmark through an UCITS and of that on private individuals investing directly in such companies; and
- avoid foregoing all taxation of dividends distributed by companies resident in Denmark, but defer their taxation to the level of the UCITS's members.

As far as the first aim is concerned, the CJEU pointed out that non-resident UCITS are in a situation comparable to that of UCITS resident in Denmark given that Denmark has chosen to exercise its power of taxation on the dividends received by non-resident UCITS.

With regard to the second aim, the CJEU held that even though the purpose of the legislation is to move the level of taxation from the UCITS to the participants, what is decisive is the substantive conditions of the power to tax members' income, and not the method of taxation used. In this respect, resident and non-resident UCITS are in an objectively comparable situation because a non-resident UCITS may have members with tax residence in Denmark on whose income such State may exercise its power of taxation.

The CJEU then analysed whether that restriction could be justified by any overriding reason in the public interest. In this respect, it discharged the possibility to invoke the argument of the balanced allocation of taxing rights, as where a Member State has chosen not to tax resident UCITS in receipt of nationally-sourced dividends, it cannot rely on the argument that there is a need to ensure a balanced allocation between the Member States of the power to tax in order to justify the taxation of non-resident UCITS in receipt of such income.

With regard to the justification represented by the need to preserve the coherence of the Danish tax system, the CJEU found that a national legislation, such as the one in the main proceeding, would go beyond what is necessary to safeguard the coherence of the tax system.

Final remarks

The decision at stake is the latest in a series of cases decided by the CJEU in the field of taxation of the investment funds. Such decision might be the end point of two arguments often invoked by the Member States to justify the taxation of non-resident funds against the exemption of the resident ones, namely ***(I)*** the objective to tax the fund's participants instead of the fund itself and ***(II)*** the need to preserve the coherence of the national tax system.

As regards the point ***(I)***, as already said above, the fact the Denmark cannot subject a non-resident UCITS to the obligation to apply a WHT to the proceeds it distributes to its participants is not decisive, but, on the contrary, is consistent with the logic of moving the level of taxation from the vehicle to its shareholders. Indeed, a non-resident UCITS could also have Danish resident participants that would suffer an economic double taxation once the proceeds are distributed to them.

As far as the point ***(II)*** is concerned, the CJEU held that the need to safeguard the coherence of the national tax system may be invoked when the exemption from WHT for resident UCITS is conditional on an actual or nominal minimum distribution to their participants, who are liable to tax on such distribution. In other terms, the advantage of the exemption in the hands of the resident UCITS is, in principle, offset by the taxation of the proceeds in the hands of their members. However, the CJEU concluded that a national legislation, such as the one in the main proceeding, goes beyond what is necessary to safeguard the coherence of the tax system. Indeed, the internal coherence could be maintained if non-resident UCITS were eligible for exemption from WHT, provided that the Danish tax authorities could ensure, with the full cooperation of such UCITS, that the latter pay a tax that is equivalent to the tax which Danish UCITS are required to levy on the minimum distribution.

With regard to the Italian tax system, it's worth mentioning that Italian resident UCITS are exempt from corporate income tax while non-resident UCITS are subject to tax (namely in the case of dividends received from an Italian resident company a WHT should be levied at the time of the distribution). Considering also that the exemption provided for Italian resident UCITS is not conditional on any specific requirement (except for regulatory ones), it may be argued that the Italian tax system may be deemed to be not compliant with the European Union law, thus opening the door to possible request for refund of WHTs unduly levied.

If further information is required, please refer to your **LED Taxand** contact or to ***eiascone@led-taxand.it*** or ***lgalliani@led-taxand.it***

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