CJEU Ruling in Santander: Withholding Tax on Dividends Distributed to Non-Resident UCITS Infringes EU Freedoms

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On 10 May 2012, the Court of Justice of the European Union (CJEU) issued its judgment in Santander (joined cases C-338/11 to C-347/11), stating that the French legislation that imposes a withholding tax on French-sourced dividends when they are received by Undertaking for Collective Investments in Transferable Securities (UCITS) that are resident in another Member State, infringes the free movement of capital provided for by Articles 63 and 65 of the treaty on the functioning of the European Union (TFEU). Although this principle has been reinforced by the CJEU many times, this case is noteworthy for being the first time it has been applied to UCITS.

The CJEU Judgment

Santander concerned the compatibility with EU Law of the provisions of the Code General des impôts, which levies a 25 per cent withholding tax on dividends originating in France and received by non-resident UCITS. This is in contrast with dividends distributed to French-resident UCITS, which are exempted from the withholding tax. According to well-established CJEU case law, having two such different regimes constitutes a restriction of fundamental freedoms under EU law. Different laws are permissible only if the difference in treatment relates to situations that are not comparable objectively, or if the restriction is justified by an overriding reason of public interest.

As far as comparability is concerned, the referring tribunal, Montreuil, asked the CJEU if the comparability had to be ascertained taking into account (a) only the applicable tax regime of the UCITS, or (b) if the tax regime applicable to the shareholders (the investors) is also relevant. In this respect, the Montreuil Tribunal noted that, while in (a) the resident and non-resident UCITS had to be regarded as being in an objectively comparable situation, the relevance of the shareholders’ regime in (b) could have led to a different conclusion.

The CJEU stated that the tax regime of the shareholders was irrelevant for the purpose of determining whether the French legislation was discriminatory. The judges grounded their decision on the basis that the French legislation established a distinguishing criterion based on the place of residence of the UCITS, irrespective of the tax regime applicable to the dividends in the hands of the shareholders. As a consequence, the CJEU stated that the situations had to be compared only at the level of the investment vehicle, i.e., the difference in treatment that qualifies as a discriminatory restriction contrary to the TFEU provisions on the free movement of capital.

By the same token, the CJEU also ruled out the possibility of such a restriction being justified by the need to safeguard the balanced allocation among EU Member States of their power to impose taxes, the need to guarantee the effectiveness of fiscal supervision, and the preservation of the integrity of their tax systems.

With regard to safeguarding the balanced allocation of the power to impose taxes, the CJEU noted that, where a Member State has chosen not to tax resident UCITS that receive nationally-sourced dividends, it can not rely on this argument to justify the taxation of non-resident UCITS that receive the same type of income.
In reference to the preservation of the integrity of Member States’ tax systems, the CJEU pointed out that for such a justification to succeed, a direct link must be established between the exemption from the withholding tax granted to resident UCITS and the compensation of that advantage granted by a particular tax levy. However, in Santander, such a link did not exist, as the exemption regime on dividends was granted to resident UCITS, irrespective of the tax regime applicable to the same dividends that are in the hands of the shareholders.

Finally, the CJEU noted that the argument based on the need to ensure the effectiveness of fiscal supervision could not be accepted, as the French Government had failed to put forward any evidence to substantiate this justification.

**Implications for Italy**

Although the judgment relates specifically to the French tax system, it may well impact on the tax systems of other EU Member States, including Italy.

Italian tax rules provide for a 27 per cent withholding tax on dividends distributed to non-resident entities, including UCITS. Other than in situations where the Parent-Subsidiary Directive is applied, a derogation from a withholding tax can only apply on dividends distributed to EU-resident or European Economic Area-resident companies; in this case a 1.375 per cent (instead of 27 per cent) withholding tax applies. However, as UCITS are generally not considered as companies under Italian civil and tax law, non-resident UCITS are generally not granted the 1.375 per cent withholding tax, being the dividends received by them, subject to the ordinary 27 per cent withholding tax (or lower tax treaty rate, if applicable).

On the other hand, Italian-resident UCITS benefit from an exemption from the dividend withholding tax, being subject only to a 12.5 per cent tax (20 per cent as of 1 January 2012) levied on the year-end result, which in certain cases can be credited when dividends are distributed by the UCITS. Moreover, similar to the French legislation, the Italian rules provide for the difference in treatment irrespective of the tax treatment of shareholders, so—as clarified by the CJEU—the comparability of the situations should be ascertained only with regard to the tax regime applicable to the UCITS.

The CJEU judgment in the Santander case provides grounds for non-Italian-resident UCITS to claim reimbursement of the withholding tax levied on Italian-sourced dividends. According to ordinary tax provisions, taxpayers can file a tax reimbursement claim with the Italian tax authorities within a four year period, starting from the date of the tax payment.

1 The withholding tax rate may be reduced depending on the existence and applicability of a Double Taxation Convention between Italy and the country of establishment of the UCITS involved.

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