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Exemption to investment funds established in collaborative third countries based on EU law

The decision regarding case C-545/19 of March 17, 2022 consolidates the position of the CJEU endorsing the reimbursement to EU funds of taxes levied on dividends in violation of the free movement of capital provided for by Article 63 of the TFEU (C-303/07, C-338/11, C-190/12, C-480/16 and C156/17). This judgment decides the dispute between an open-ended UCITS compliant with Directive 2009/65/EC set up in Germany and the Portuguese government concerning the reimbursement of withholding taxes on Portuguese dividends (which are instead exempt for domestic UCITS).

It is worthy of remarks that also Italian judges endorsed the right to dividend withholding tax refund with sentence no. 49/1/2022 of the Provincial Tax Court of Pescara (Commissione Tributaria di Pescara). The decision regards the dispute over the reimbursement of outbound dividend withholding taxes suffered in Italy by a harmonized Luxembourg UCITS discriminated against compared with Italian UCITS (exempt pursuant to Art. 73 of the Consolidated Income Tax Act).

The case law reported and the (dividends and capital gain) exemption regime accorded to EU/EEA funds of Article 1, paragraphs 631-633, of Law 178/2020, highlight a cultural maturity reached by the judges and our legislator with regard to international tax law issues of a European matrix of a certainly advanced level. However, some efforts are still needed to ensure perfect compliance of domestic tax law with the free movement of capital of the TFEU with regard to Italian taxation on dividends (and capital gains on qualified shareholdings) of UCITS set up outside the EU.

Having said that, the legal basis for the decisions in the aforementioned cases is the principle set forth by Article 63 of the TFEU, according to which "all restrictions on the movement of capital between Member States and between Member States and third countries are prohibited". This is the only one among the fundamental freedoms that applies not only between member States but also in relation to third countries. This freedom is limited since, in addition to the well-known exceptions based on the overriding reasons of the public interest (as long as these are necessary and proportional), according to Art. 65(1)(a) of the TFEU restrictions suffered by non-residents are legitimate if the reasons for the different treatment are attributable to their different place of (tax) residence or place where their capital is invested. However, the foregoing is subject to the limitation provided by Article 65(3) TFEU, according to which such restrictions must not constitute a means of arbitrary discrimination or a disguised restriction on the freedom in question. To sum up, and according to the Court's constant case law, such restrictions could therefore be justified if the difference in treatment concerns situations that are not objectively comparable.

Well, the European judges in Case C-545/19 uphold that the situation of a resident UCITS collecting dividends is comparable to that of a non-resident UCITS that likewise is beneficiary of dividends. Indeed, in both cases, the profits made may, in principle, be subject to double taxation or to multiple levies along the chain, so that the difference in tax residence does not reveal a difference in objective situation.

It is clear that the current exemption of EU/EEA funds provided by Law no. 178/2020 is only partially in line with the geographical scope of application of Art 63. In this regard, it is desirable a legislative or customary practice of the Revenue Agency completing the alignment of Italian domestic tax law with European law through the extension of this exemption also to funds set up in collaborative third countries that are similar to European UCITS and whose supervisory model is similarly effective with respect to the forms of supervision envisaged by Directives 2011/61/EU and 2009/65/EC (see the judgment handed down in case C-190/12 concerning the discriminatory taxation suffered in Poland by an American fund on Polish dividends, also referred to in case C-545/19).