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Comparability Approaches of the CJEU Regards Dividends Received by Non-Resident CIVs: Is the Primary Law Sufficient or Not?

by

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Summary

For preventing economic double taxation and neutralization of choice between direct and indirect investments, states might grant domestic funds certain tax advantages while not extending it to non-residents, which possibly result in international double taxation. This issue arises mostly because of the different features of the investment funds. Such as their legal form, tax treatment, regulatory framework, the aim may vary to the state to state. The author firstly examines if the DTTs are sufficient for solving this issue by focusing on the OECD MC (2017) and its Commentary for the entitlement of treaty benefits. Subsequently, the author investigates if the EU secondary law has adequate sources. Finally, this thesis focuses on detail to the case-law of the CJEU and tries to create a structure for the comparability test while aiming to find an answer to the question if the primary law can shed light on this issue.

Abbreviation List

AG	Advocate General
AIFM	Alternative Investment Fund Managers Directive
Art.	Article
BEPS	Base Erosion and Profit Shifting
CIV	Collective investment vehicle
CJEU/ Court	Court of Justice of the European Union
Commission	European Commission
DAC 6	The EU Council Directive 2011/16 in relation to cross-border tax arrangements.
DTT	Double Tax Treaty
EEA Agreement	the Agreement on the European Economic Area
EFAMA	European Fund and Asset Management Association
EU	European Union
EUR	Euro
MS(s)	Member State(s)
OECD	The Organisation for Economic Co-operation and Development
OECD Commentary	OECD Commentaries on the Articles of the Model Tax Convention
OECD MC	OECD Model Tax Convention
p.	Page
Para	Paragraph
PSD	Parent-Subsidiary Directive
SICAR	Société d'investissement en capital à risque
SICAV	Société d'investissement à capital variable
TFEU	Treaty on the Functioning of the European Union
UCITS	Undertakings for Collective Investment in Transferable

	Securities
UK	United Kingdom
US	United States of America

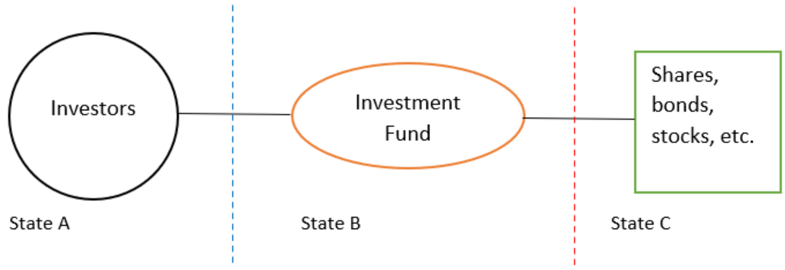
1 Introduction

1.1 Background

Investments can be made through CIVs or can be made directly without using an intermediary. In both options, they could be wholly domestic or might have cross-border elements. Investment funds are composed of three layers. The first layer is "investors," which pool their assets to invest collectively. The second layer is "investments" or objects that can be stocks, bonds, shares, real estate. The third layer is "CIV" which is a vehicle that investors structure a pool and provides investors to invest.[1]

One of the problems that can arise in the field of CIVs is that they might be facing economic double taxation. In wholly domestic situations, this can be solved by applying specific regimes. For instance, if we assume that a CIV is a corporate and its investors are private persons, there will be corporate tax in the level of the investment fund and income tax in the level of investors because that jurisdiction accepts it as an entity subject to corporate tax.[2] Additionally, there would be a withholding tax for distributed dividends. For ensuring neutralization of choice between direct and indirect investments, states apply specific regimes. CIVs might be exempted from corporate tax, for instance, SICAVs in Luxembourg. Secondly, they might be subject to a zero-tax rate so that they are not effectively taxed for corporate tax purposes. In some jurisdictions, they are allowed to deduct dividends that are distributed from their tax base. In a significant number of jurisdictions, CIVs are regarded as fiscally transparent. [3] Furthermore, states might give relief to dividends received by domestic funds, which they do not extend that relief to non-residents because of the different features of the non-resident investment funds.

[1] Hein Vermeulen, *The Tax Treatment of Collective Investment Vehicles and Real Estate Investment Trusts*, IBFD Online Books (2014) Chapter 1.
[2] Ibid.
[3] Ibid.



- Representation of three-country case.

Figure 1

As it is shown infra, some of the CIVs elements can be situated in different states, and a DTT between those states would be a solution for preventing double taxation in the cross-border case.[4] However, for DTT purposes, the source states' argumentation is usually that foreign funds are not entitled to treaty benefits since it does not comply with the residency criteria because it is not liable to tax in its residence state, not a person, or not a beneficial owner of the dividend. Consequently, DTTs might not be useful for eliminating the CIV's taxation issues.[5]

From the EU perspective, Member States do not have a harmonized secondary law regards CIVs, and each MS has its own rules. As it will be shown in subsequent headings, the Directives regarding CIVs are not sufficient enough for solving double taxation issues. So that, the choices of relief of the Member States to prevent economic double taxation is wholly left to their sovereignty. States base their arguments for different treatment on different legal forms, tax treatment, the aim of the non-resident funds. Additionally, they indicate that they are not obliged to accept and recognize the other MSs legislation about investment funds.

It is clear from the government arguments that usually, the aim of the Member States is ensuring the neutral treatment of indirect and direct investments. However, putting the foreign investment funds in a less advantageous position leads to discourage the investors from investing through CIVs, which affects the whole market, the idea of the common market in a negative way. However, the primary law of the EU, in other words, the TFEU freedoms, might be the only solution for these issues. Although the Member States have the discretion to determine their rules,

[4] Andreas Oestreicher and Markus Hammer, Taxation of Income from Domestic and Cross-border Collective Investment A Qualitative and Quantitative Comparison, Springer Online Book (2014), pages 20-22.
[5] Hein Vermeulen, *The Tax Treatment of Collective Investment Vehicles and Real Estate Investment Trusts*, IBFD Online Books (2014) Part 1.

they cannot be discriminatory. The first step of the CJEU is checking if domestic and foreign investment funds are comparable. Secondly, examining if there are justification grounds for treating differently. The author, for these reasons, finds it necessary to determine the case-law of the CJEU.

1.2 Aim and Purpose

In this thesis, the author will try to find an answer to some questions. Firstly, as it is stated, the differences of CIVs lead international double taxation, and this thesis mainly aims at finding an answer to the question if this is remedied under the EU law or not. The author will try to determine if the case-law of the CJEU is clear about the neutralization of choice between direct and indirect investments. Each case of the Court has circumstances that are peculiar to it. However, the Court has used specific approaches for the comparability test of the investment funds. It is necessary to put together the cases where the Court applies the same approach and concluding each category, which might shed light on to issue of double taxation of the CIVs from the EU perspective. Additionally, it is necessary to determine, if the CJEU compels the Member States to recognize the non-resident funds situated in other jurisdictions mutually.

1.3 Methodology and Materials

This thesis is based on a traditional legal research method.[6] Under this method, the starting point is authoritative sources such as existing rules, case law, doctrine, and literature. The author basis the thesis on the primary law of the EU. TFEU freedoms and the case-law of the CJEU, are the main scope of this thesis. The UCITS Directive[7], AIFM Directive[8], PSD[9], and DAC 6[10] will be used for showing the existing secondary law. The OECD

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[6] Sjoerd Douma, *Legal Research in International and EU Tax Law*, Kluwer Wolters (2014) Page 18-19.

[7] Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities, OJ L 302.

[8] Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations, OJ L 174.

[9] Council Directive 2011/96/EU of 30 November 2011 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States, OJ L 345.

[10] Council Directive (EU) 2018/822 of 25 May 2018 amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation in relation to reportable cross-border arrangements, OJ L 139.

MC (2017)[11] and its Commentary are also one of the essential sources for explaining the international aspect of this issue.

Doctrinal literature takes an essential place in this thesis. Such as the books of Hein Vermeulen, Werner Haslehner, Andreas Oestreicher, and Markus Hammer gave enormous perspectives to the author. Furthermore, the various articles regarding investment funds are used for this thesis. The author accessed to relevant sources from multiple databases which are: IBFD Tax Research Platform, Kluwer Law Online, Springer, Google Books, EC Tax Review. For the case-law of the CJEU, Curia is used.

The second feature of this method is, which stated in Douma's book, aiming for the consistency of the existing law.[12] Basically, "systemization of legal norms and case law." In this case, the author's one of the main objectives is creating a structure and examining the consistency of the case-law of the CJEU about funds, and that is why this method is used for this thesis.

1.4 Delimitations

In this thesis, the main scope is outbound dividends treatment by source state. Hence, inbound dividends will not be covered by the author, except the Orange European Smallcap[13] case, which deserves further analysis because the CJEU's approach to the aim criterion can be seen precisely. Secondly, the main subjects of this thesis are investment funds. However, as a second exception, some cases about pension funds will be examined but will not further elaborated more than comparability analysis. Real estate investment funds are out of the scope of this thesis since it deserves exhaustive and separate investigation.

Furthermore, while the cases are mostly about EU funds, third state funds will also be included, like the case Emerging Markets[14], because the free movement of capital is also applicable to funds outside the EU as well. The state aid perspective is also out of the scope of the limited length of the thesis and which requires specific analysis and case law about it, such as the case A-Fonds[15]. Finally, legislation of any MS will not be specifically investigated, but there will be given some information about specific legislations while examining the facts of the cases. Additionally, any particular DTT will not be further considered; only references will be made while showing the facts of the cases.

[11] OECD, Model Tax Convention on Income and on Capital: Condensed Version (2017).
[12] Ibid. Page 18.
[13] C-252/14, *Orange European Smallcap*, EU:C:2016:402.
[14] C 190/12, *Emerging Markets*, EU:C:2014:249.
[15] C-598/17, A-Fonds, EU:C:2019:352.

1.5 Outline

Firstly, under the relevant sources of law heading, the sources of law that an investment fund might be under the scope will be examined. The first one is OECD MC (2017) and its Commentary. The conditions for treaty entitlement and person, resident, beneficial owner terms will further be elaborated. Then, EU secondary law tools UCITS Directive, AIFM Directive, Parent-Subsidiary Directive and, DAC 6 will be checked in detail for examining if they are sufficient tools or not. Furthermore, under the DAC 6, the author will investigate the future relationship between justification grounds and DAC 6 in general. In the subsequent heading, relative TFEU freedoms that are affected, and the conditions for discrimination will be investigated.

Further, the comparison of the funds, in theory, will be explained, and the problems that arise from the differences between legislation will help the reader to understand the causes that occur in practice, which will be discussed in the subsequent heading. Five approaches have been used by the Court, which are subject to tax criterion, legal form criterion, aim criterion, distinguishing criterion, and regulatory framework criterion. Each approach and the relevant cases facts and the comparison of the Court will be explained in detail. Also, there are two pending cases about the investment funds in which the author will check the facts and future applicable approaches. Finally, the author will finalize the thesis with the consequences of the relevant cases.

2 Relevant Sources of Law

2.1 OECD MC (2017) and its Commentary

Before determining the CJEU's approach regards the different treatment of investment funds, it is necessary to examine if the source taxation by a state can be released through tax treaties. Also, it is essential to qualify conditions for claiming the benefits of the tax treaty that will be examined infra.

In 1963, the OECD drafted the influential OECD MC(1963)[16] to ensure the conformity of double taxation treaties in the international area[17] because

[16] OECD, Draft Double Taxation Convention on Income and Capital (1963).

there were dissimilarities of agreements and specific gaps in those conventions.[18] As stated in the preamble of MC 2017, since 1963, the MC has a broad impact on negotiation, drafting, application, and interpretation of tax treaties, which has a benefit of both taxpayers and administrations through standard solutions to similar cases of double taxation.[19] In December 2017, the revised version of the OECD Model Convention had published by the OECD. The text of Art. 7 and 9 had remained the same, but the commentaries of the relevant provision has changed. The text and the Commentary of the Art. 25 revised.[20] Despite these changes, The OECD MC (2017) still does not contain any rule about CIVs. Nowadays, funds are mostly processing globally, and the application of tax treaties have gained more importance. So that, the OECD decided to take action to relieve this ambiguity. The Committee on Fiscal Affairs established the Informal Consultative Group on the Taxation of Collective Investment Vehicles and Procedures for Tax Relief for Cross-Border Investors in 2006. The report called "The granting of treaty benefits concerning the income of collective investment vehicles" adopted the ICG's Report with some modifications. This report is situating under the Commentary on Article 1 of the OECD MC (2017) and deals with the legal and policy issues regards CIVs. [21] In the preamble of the OECD MC (2017), it is stated that MSs of the OECD should conclude bilateral treaties in conformity with the model as interpreted by the Commentaries, and tax authorities should follow them as well.[22]

Nevertheless, the Commentary of the OECD MC (2017) also does contain a clear definition of the CIV. The scope of this report is limited to widely held funds, which holds a diversified portfolio of securities and subject to investor-protection regulation in its establishment state.[23] A CIV needs to meet some conditions to be entitled to DTT benefits. Due to the lack of specific provision regards CIVs, the general requirements to benefit from tax treaties apply. Those conditions are being a person that is a resident in a contracting state and is the beneficial owner of the income it receives.[24]

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[17] Donald. R. Whittaker, *An Examination of the O.E.C.D. and U.N. Model Tax Treaties: History*, Provisions and Application to U.S. Foreign Policy, North Carolina Journal of International Law (1982) Article 4.
[18] OECD, Model Tax Convention on Income and on Capital: Condensed Version (2017) Preamble para. 9.
[19] Ibid. paras.12-13.
[20] Ibid.
[21] OECD, “The granting of treaty benefits concerning the income of collective investment vehicles”, Committee on Fiscal Affairs of the OECD, 23 April 2010, page. 3-4.
[22] OECD, Model Tax Convention on Income and on Capital: Condensed Version (2017) Preamble para.3.
[23]OECD, “The granting of treaty benefits concerning the income of collective investment vehicles”, Committee on Fiscal Affairs of the OECD, 23 April 2010, page 3.
[24] Ibid. pages 7-8.

According to the Commentary, the legal form of the CIV might be decisive for determining if a CIV is treated as "person."[25]Legal types vary states to states; for instance, they can be in the form of company, trust, joint ownership, contractual arrangement. Under the Commentary on Art. 3(1)(a), it is stated that the term "person" should be given a broad sense.[26] It will be an indicator for considered as a person if the residence state of the CIV treats it as a tax subject. Furthermore, contracting states can bilaterally modify the definition to include such CIVs.[27]

The second criterion, "residency," is placed under Art. 4 of the OECD MC (2017). It states that "any person who, under the laws of that state, is liable to tax therein because of his domicile, residence, place of management or any other criterion of a similar nature… "[28]Tax liability has to be determined according to the laws of the residence state. The legal form is of no importance for determining residence criterion, but the tax treatment has significance. The intent behind this condition is ensuring only one level of tax and providing neutrality between direct investments and investments held through CIVs.[29] States have different approaches regards tax treatment of CIVs. Some states treat them as flow-through entities which cannot be considered as a resident. In some other countries, CIVs might be regarded as opaque, which is subject to tax. However, in some states, it can be fully exempted from tax if it meets certain conditions. Also, there might be deductions in the tax base by reference to distributions that are paid to investors. In some other, it might be liable to tax but with an exclusive low or zero tax rate. Some states impose CIVs entirely but with integration at the level of investor level, which can be regarded as exemption or imputation at the level of investor.[30]

If a state adopts the view of being "liable to tax" principle, the CIV can be considered as a resident, even if the establishment state does not de facto impose a tax. However, the conditions of qualifying for a lower rate or exemption has to be stringent enough.[31] So that, transparent entities and unconditionally exempted entities cannot be regarded resident under this principle. According to the second doctrinal opinion, a non-transparent CIV,

[25] Ibid.
[26] OECD, Commentaries on the Articles of the Model Tax Convention, page. 78.
[27] OECD, "The granting of treaty benefits concerning the income of collective investment vehicles", Committee on Fiscal Affairs of the OECD, 23 April 2010, page 8.
[28] OECD MC, art. 4.
[29] OECD, "The granting of treaty benefits concerning the income of collective investment vehicles", Committee on Fiscal Affairs of the OECD, 23 April 2010, page 8.
[30] Andreas Oestreicher and Markus Hammer, *Taxation of Income from Domestic and Cross-border Collective Investment A Qualitative and Quantitative Comparison*, Springer Online Book (2014), p.14-15.
[31]. OECD, "The granting of treaty benefits concerning the income of collective investment vehicles", Committee on Fiscal Affairs of the OECD, 23 April 2010, page 17.

which is subject to an exemption, cannot be considered as a resident since it does not pay taxes.[32] It can be summarized that for residency criterion, firstly, it should be determined whether a CIV is transparent or non-transparent. Secondly, the impact of the exemption given to a CIV must be checked. [33]

As regards to "beneficial owner" criterion, there are some doubts if a CIV can qualify as a beneficial owner of the income it receives.[34] The term beneficial owner is not defined in the OECD MC (2017). In the report, it is stated that the position of an investor in a CIV differs legally and economically from an investor who invests directly.[35] Since a CIV has to be widely held, there is no impact of a single investor. If a widely held CIV's managers have the discretion to manage assets and perform significant functions, then a CIV can be regarded as the beneficial owner of the income.[36]

Since the nature of the principles are general, it is not always clear if a CIV meets those conditions. Furthermore, states or tax authorities mutually agree that some type of CIVs satisfies those requirements. Additionally, it is necessary for calculating the net asset values of CIVs. If a CIV does not meet those criteria, then it cannot claim treaty benefits. If, however, the investors of the CIV are residents of different states, then they may claim tax treaty benefits. However, there must be a tax treaty between the source state and investors residence state. In practice, there are administrative difficulties when investors claim those treaty benefits. In those situations, it is suggested that CIVs can claim tax treaty benefits on behalf of their investors.[37]

2.2 The UCITS and AIFM Directives

The most known classification of funds is UCITS and non-UCITS, CIVs and non-CIVs. UCITS and AIFM Directives are specific directives regarding investment funds in the EU law.[38] A UCITS is defined as an undertaking which its sole object is investment in transferable securities and

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[32]Keith Lawson - Werner Haslehner, *Investment Fund Taxation*, Wolters Kluwer E-book (2017) Chapter 10.
[33] Ibid pages 269-271.
[34] OECD, "The granting of treaty benefits concerning the income of collective investment vehicles", Committee on Fiscal Affairs of the OECD, 23 April 2010, pages .9-10.
[35] Ibid.
[36] Keith Lawson - Werner Haslehner, *Investment Fund Taxation*, Wolters Kluwer E-book (2017) Chapter 10, page.271.
[37]. OECD, "The granting of treaty benefits concerning the income of collective investment vehicles", Committee on Fiscal Affairs of the OECD, 23 April 2010, pages 10.
[38] Katerina Pantazatou - Werner Haslehner, *Investment Fund Taxation*, Wolters Kluwer E-book (2017) Chapter 8, pages. 231-232.

spreading risk while operating.[39] Investment funds have to be in the form of either company or common fund to be under the scope of the UCITS Directive,[40] whereas in the AIFM Directive, they can be constituted under any form.[41] The other difference is, UCITS have to be established in the EU or EEA; however, AIFs can be established anywhere. [42]

These directives are mostly composed of rules about requirements of authorization, management, organization are primarily about the financial sector, and there is no provision about taxation about funds nor investors. These loopholes have been loading up with the case-law of the ECJ and with existing directives. One of the essential features of the UCITS Directive is ensuring the mutual recognition: "..to secure the mutual recognition of authorization and prudential supervision systems, making possible the grant of a single authorization valid throughout the Community,"[43] which provides the recognition of a UCITS throughout the EU and might be an advantage for comparability test.

2.3 The Parent-Subsidiary Directive (PSD)

As stated in the preamble, the objective of the PSD is preventing double taxation of entities, by exempting them from withholding tax when the distribution of profits and dividends take place from subsidiary to parent company.[44] Nevertheless, to benefit from this exemption, an entity must qualify certain conditions which are stated in Art. 2(a) of the Directive. The first condition is; A company has to take one of the forms listed in Annex I, Part A. Secondly, according to the laws of MS it has to be regarded as a resident for tax purposes and must not be considered as resident outside the EU under a DTT with a third state. Thirdly, it must be subject to one of the taxes listed in Annex I, Part B. There should not be a possibility of being exempt or substituted for any of those taxes.[45] The CJEU stated that the list in Annex I is exhaustive due to the necessity of legal certainty. Regarding the "subject to tax listed in annex without the possibility of an option and being exempted" criterion, it was ambiguous whether the subject to zero tax

[39] Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities, OJ L 302, preamble para. 38.
[40] Ibid. art. 2(b).
[41] Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations, OJ L 174, art. 2(b).
[42] Ibid.
[43] UCITS Directive, Preamble para.8.
[44] Council Directive 2011/96/EU of 30 November 2011 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States, preamble para 3.
[45] Ibid. art. 2(a).

also included. However, the CJEU stated that it is also included because there is no liability for paying the tax.[46]

In the *Aberdeen case*, which is about dividends received by Luxembourg SICAV (parent) from a Finnish company (subsidiary) the question was whether it is necessary to provide a withholding tax exemption on outbound dividends received by non-resident investment fund.[47] The CJEU stated that a SICAV does not meet the criteria in PSD, not listed in the Annex, and not subject to tax. So, it is not under the scope of the Directive. Nevertheless, the Court noted that being outside the scope of the Directive does not mean that a discriminatory withholding tax can be imposed on it and does not prevent it from being under the protection of freedom of establishment. [48] This case shows that the exclusion from the secondary law does not mean that it is also out of the scope of primary law.[49] The fact that dividends received by the non-resident fund, which does not meet subject to tax and listed in the Annex criterion, is not essential for the application of equal treatment principle.

Another essential provision regarding funds in the PSD is article 4(2). "..Directive shall prevent the Member State of the parent company from considering a subsidiary to be fiscally transparent on the basis of that Member State's assessment of the legal characteristics of that subsidiary arising from the law under which it is constituted and therefore from taxing the parent company on its share of the profits of its subsidiary as and when those profits arise. In this case, the Member State of the parent company shall refrain from taxing the distributed profits of the subsidiary."[50] This provision explains the situation of entities which are considered as opaque in their residence state, while deemed as transparent in parent company's residence state.

2.4 Directive on Administrative Cooperation 6 (DAC6)

For reaching the aim of tax transparency, especially in the latest 15 years, many information exchange agreements have concluded between states, the OECD imposed some common standards, and also domestic actions to have taken. The main objective of the BEPS project was preventing tax avoidance

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[46] Katerina Pantazatou - Werner Haslehner, *Investment Fund Taxation*, Wolters Kluwer E-book (2017) Chapter 8, pages. 232-235.
[47] C-303/07, *Aberdeen Property Fininvest Alpha*, EU:C:2009:377.
[48] Ibid. para.76.
[49] António Calisto Pato and Priscila Goes Seize, EC Law and Investment Funds: The Aberdeen Case, EC Tax Review (2009) page 117.
[50] Council Directive 2011/96/EU of 30 November 2011 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States, art. 4(2).

and providing that profits are taxed where economic activities performed, and value created.[51] The 12th action of the BEPS action plan was the implementation of mandatory disclosure rules.[52] The reflection of this action at the EU level is DAC 6 aims at minimizing tax base erosion and profit shifting by increasing transparency in the EU market.[53] Regarding this Directive, specific cross border arrangements should be reported by intermediaries, and it provides reporting the arrangements between EU administrative authorities. The first step is the obligation of certain intermediaries to share some mechanisms which can be used for aggressive tax planning. Secondly, the exchange of information between member states will take place. If a transaction can be considered under a hallmark, then it means it is reportable because it shows the existence of the potential risk of tax avoidance.[54] From 20 July 2020, MSs have to start to apply. On 31 August 2020, reporting of the arrangements by intermediaries will take place, and on 31 October 2020 first automatic exchange of information between MSs will take place.[55] Investment fund managers can be accepted as intermediaries due to their specific features, which are acting on behalf of the investors and organizing and implementing cross border arrangements.

Even though the objective of this thesis is investigating the comparability requirement, it is foreseeable that the DAC 6 will impact the justification grounds test. For instance, the justification of overriding reason in the public interest, and particularly ensuring fiscal coherence. However, as it is indicated in CJEU's cases: *"For an argument based on such a justification to succeed, however, the Court requires a direct link between the tax advantage concerned and the offsetting of that advantage by a particular tax levy"*[56] There must be a link between the advantage given to the resident and subsequent taxing at the level of the shareholder. For ensuring the taxation of the shareholder in cross border situations, the Court stated in Fidelity Funds case that UCITS resident in another MS, which satisfies conditions by taxing the ultimate shareholder, must be eligible for an exemption if Danish authorities ensure that those tax has paid in its residence state.[57] In Emerging Markets case it is stated that "*Nor can the UCITS Directive permit a supervisory authority in one Member State to exchange with the supervisory authority in the Member State of taxation*

[51] OECD,Action Plan on Base Erosion and Profit Shifting, 2013.
[52] OECD, Mandatory Disclosure Rules, Action 12 - 2015 Final Report.
[53]<https://ec.europa.eu/taxation_customs/sites/taxation/files/dac-6-council-directive-2018_en.pdf> (accessed on 05/04/2020).
[54] Council Directive (EU) 2018/822 of 25 May 2018 amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation in relation to reportable cross-border arrangements, OJ L 139.
[55] Ibid. *'Article 27 and article 2.*
[56] C-484/93, *Svensson and Gustavsson*, EU:C:1995:379 para. 18.
[57] C-480/16, *Fidelity Funds*, EU:C:2018:480, para.84.

information obtained following checks made by the former authority on investment funds established in its territory, to enable the supervisory authority in the Member State of taxation to transmit that information to the national tax authorities."[58] So that, even if the fund in question is not under the scope of the UCITS Directive, a Member State cannot rely on the reason that the information is not accessible due to not being under UCITS Directive. With DAC 6, each MS will be able to provide relevant information, and this will support MS to rely on justification ground since they will be able to get relevant information or promote the CJEU for non-applicability of the justification ground, according to the facts of the cases.

2.5 TFEU Freedoms and Restriction Test

The aim of the common market is reachable if only TFEU freedoms effectively apply. The essential freedoms for the investment funds are fundamentals of "free movement of capital"[59] and "freedom of establishment."[60] Freedom of establishment cannot be invoked in third-country situations while it is possible under the free movement of capital due to the aim of attracting foreign investments in the common market. Under the free movement of capital, as stated in Art. 63, all the restrictions on the movement of capital and payments between MSs and MSs and third states shall be prohibited. Free movement of capital might be restricted, for instance, by way of exemption granted to the national investment funds while not allowing the exemption to non-residents, then this might discourage non-resident funds to invest in that MS. At the same time, resident investors might also deter from obtaining a share in a non-resident fund since that fund is subject to a less advantageous taxation regime. Art. 65 constitutes a derogation to Art. 63 of TFEU. Shortly, for a different treatment to be not considered as discriminatory, they should not be objectively comparable, or there must be a justification ground.[61] This provision, however, shall not be interpreted widely. Otherwise, Art.63 will lose its meaning.[62] Justification grounds are somewhat more precise than the comparability test in the CJEU's case law. That is why the comparability test is the main scope of this thesis.

[58] C 190/12, *Emerging Markets*, EU:C:2014:249, para. 78.
[59] Treaty on the Functioning of the European Union, OJ C 326, Art.63.
[60] Ibid. art.49.
[61] Ibid. art. 65.
[62] K. O'Donell & U.M March- Werner Haslehner, *Investment Fund Taxation*, Wolters Kluwer E-book (2017) Chapter 8, pages 231-232.

2.6 Comparison in Theory

The confusion about investment funds arises from the fact that they are characterized in different ways by different Member States. For instance, as stated, they can be in the form of company, trust, contractual type. Some of them are considered legal persons, some of them not according to the laws of the states. If a legal form of foreign fund is not permitted in the source MS, that might create an issue for comparison. Additionally, tax treatment at the level of the investment fund and investor differs from MS to MS. Some states treat them as flow-through. Some of them treat investment funds as opaque, which are subject to tax. In some, they are subject to tax but subject to a zero-rate tax, exempted, deductions in the tax base, etc.

Moreover, there might be conditions that must be met to be granted favorable treatment. Also, considering the tax position at the level of investor or fund level varies as well, which causes complexity while comparing them. Also, the purposes of the national laws in question and CIVs may differ. In that case, legal forms and national laws might not be significant.[63]

For all these reasons, there is a massive ambiguity about the comparison of the investment funds, which causes uncertainty in the internal market of the EU. This blurred field, indeed, is the consequence of different objectives of each Member States' tax policies and not having a fully harmonized legislation which eliminates the barriers for cross-border transactions. However, if we examine the CJEU's case law, it can be seen that the Court various approaches for comparison, which in some cases leads to clarity to issues, sometimes causes more blur. As stated in the Haslehner's book, there is no hierarchy between does criteria, but the Court's choice may differ according to the laws of the relevant state.[64] In some cases, the Court uses more than one test. The complexity regards CIVs might be decreased through structuring the case-law of the CJEU by taking into account the approaches which are dominant in each of the cases. Under the subsequent heading, the author will examine those approaches and cases in detail.

[63] Tomi Viitala and Hein Vermeulen, *The Tax Treatment of Collective Investment Vehicles and Real Estate Investment Trusts*, IBFD Online Books (2014) Part 3, Chapter 8.

[64] Mario Tenore-Werner Haslehner, *Investment Fund Taxation*, Wolters Kluwer E-book (2017) Chapter 7, page 216.

3 The Criteria of the CJEU for Comparison

3.1 Subject to Tax Criterion

3.1.1 Introduction

Subject to tax criterion has an essential place in the case-law of the CJEU. This criterion applies when the source state imposes a tax on the outbound dividends, while residents are put in a more advantageous situation by the domestic legislation. The form of the charge to tax is of no importance. In this situation, the Court implies that; "*Once a Member State, unilaterally or by way of a convention, imposes a charge to income tax not only on resident shareholders but also on non-resident shareholders in respect of dividends which they receive from a resident company, the position of those non-resident shareholders becomes comparable to that of resident shareholders.*"[65] If there is a relief for resident funds, the source state must extend it also to non-resident funds that are comparable to it because it uses its tax jurisdiction over them.[66] There must be some conditions that have to meet to apply this criterion; Firstly, as it is stated above, there must be a tax imposed on dividends by the source state. Secondly, the source state in question must apply an exemption to its residents to relieve economic double taxation. When these two criteria meet, the legal forms of the entities are not necessary for comparison. In other words, the "substance over form" approach is taken by the CJEU while using this criterion.[67] Additionally, the legal form, tax treatment of the foreign investment fund, or the shareholder is also not relevant. Furthermore, whether it is under the scope of the PSD or not is not essential.

[65] C-303/07, *Aberdeen*, EU:C:2009:377, para. 43.
[66] C-170/05, *Denkavit*, EU:C:2006:783, para.37.
[67] Mario Tenore-Werner Haslehner, Investment Fund Taxation, Wolters Kluwer E-book, Chapter 7, page 216-218.

3.1.2 CJEU Case Law

3.1.2.1 Aberdeen Property Fininvest Alpha

The *Aberdeen* case is chronologically the first case that the CJEU has decided on the compatibility of the MS legislation, which imposing withholding tax only on dividends received by non-resident investment funds, while not imposing on resident investment funds with TFEU freedoms. Aberdeen is a Finnish resident real estate company in which a Luxembourg SICAV owns 100 % of its shares. The SICAV is not subject to corporate tax in Luxembourg. According to Finnish legislation, dividends received by non-resident investment funds were subject to withholding tax at the rate of 28%. In this case, however, a 5% rate applies due to a tax treaty between Finland and Luxembourg, whereas Finnish domestic parent companies were exempted from withholding tax and corporate income tax. The case is referred to the CJEU with the question of whether this legislation is contrary to the free movement of capital and freedom of establishment. [68]

The Finnish government initially stated that since the lack of identical legal form of SICAV in Finnish law, they are not comparable. The Italian government initiated that it is not covered under the UCITS Directive. Also, it is not subject to corporate tax in its residence state. However, Finnish investment funds are subject to tax at the level of shareholders. Furthermore, it stated that the problem of double taxation does not arise at the level of SICAV because it is transparent, and series of charges arise at the level of shareholders, which should be prevented by the resident states of the shareholders.

The CJEU rejected all the arguments and pointed out that it is not necessary if the receiving fund subject to corporate tax in its resident state or whether it is in more advantageous conditions or not. Also, the tax treatment of dividends that are received by investors is irrelevant for comparison. The difference between legal forms does not prevent the comparability.[69] It is stated that a resident and non-resident does not have to be regarded comparable in the situations of measures taken for avoiding double taxation.[70] In the subsequent paragraph, the Court say:*"... once a Member State imposes a charge to income tax not only on resident shareholders but also on non-resident shareholders in respect of dividends which they receive*

[68] C-303/07, *Aberdeen*, EU:C:2009:377.
[69] Ibid. paras. 50-56.
[70] Ibid. para.42.

from a resident company, the position of those non-resident shareholders becomes comparable to that of resident shareholders."[71] The national legislation aims to prevent economic double taxation, and by taxing non-residents Finnish law, it is putting them under the same risk. In this case, the criteria that has taken into account by the CJEU is being "subject to tax." As the AG stated, the fact that the outbound dividend received by SICAV is exempted in its residence state does not justify different treatment.[72]

This approach of the CJEU has its roots from withholding tax on the distribution of dividends cases, even though they are not about investment funds. In *ACT Group Litigation*[73], to prevent double taxation, only domestic shareholders of a UK company were entitled to an income tax credit in respect of dividends paid by UK companies to UK resident shareholders. However, there was no entitlement of tax credit to non-resident companies. The CJEU indicated that, as regards the legislation of the UK, when a UK resident company pays dividends to another company, neither the resident company nor the non-resident company subject to tax in the UK. Therefore, it did not find any difference in treatment. CJEU has stated that they are not in the same situation as regards to preventing economic double taxation due to a lack of income tax on outbound dividends. If a Member State imposes income tax both residents and non-residents, they would have been comparable and must extend the credit to non-residents as well, which stated in para 68. However, this is not the case because: "*As regards the national legislation at issue in the main proceedings, it must be pointed out that, where a company resident in the United Kingdom pays dividends to another company, neither the dividends received by a resident company nor those received by a non-resident company are subject to tax in the United Kingdom."* [74]

The other reflection of this approach is situated in also another case called *Denkavit Internationaal and Denkavit France*[75]. It is about two French subsidiaries that distributed dividends to their parent company located in the Netherlands. Under the relevant legislation, French shareholders were exempted from withholding tax. Dutch shareholders were subject to withholding tax at the rate of 5% according to a tax treaty between Netherlands and France and grants a tax credit to Dutch shareholders. However, in the Dutch system, dividends were exempted, and Dutch shareholders could not use this credit. The French government argued that parent companies with no fixed place of business in France are not

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[71] Ibid, para. 43.

[72] AG Opinion in C 303/07, *Aberdeen,* EU:C:2008:742, para. 23.

[73] C-374/04 *ACT Group Litigation*. EU:C: 2006:773.

[74] Ibid. para.61.

[75] C-170/05, *Denkavit,* EU:C:2006:783.

comparable with the ones with a fixed place of business in France, and this exemption to non-residents might cause escaping from tax liability in both states. The CJEU has rejected both arguments. Like in the *ACT Group Litigation*, the CJEU stated that an MS must grant non- residents the same tax treatment if it taxes the dividends given to non-residents because as it is indicated in the *Denkavit* case, the situation of the resident and non-resident shareholders, becomes comparable in that case and must extend the exemption to the non-residents.[76]

The *Amurta*[77]case is about a Portuguese company that held 14% of the shares in the Retail box company, which is a resident in the Netherlands. The Retail box distributed dividends to *Amurta*, which was subject to withholding tax at a rate of 25%. According to the Dutch legislation, to benefit from the exemption, it must hold 25% of the shares, or it must be a foreign shareholder, with having a PE in the Netherlands that its shares form part of the assets of that PE. The CJEU was asked whether these requirements are compatible with the free movement of capital. As it is stated in the other cases, residents and non-residents are not necessarily in comparable situations as regards to measures aims at preventing double taxation. If, however, the source state levies income tax both residents and non-residents, they must extend that action to mitigate economic double taxation to non-resident companies. The Court concluded that this constitutes a restriction to the free movement of capital.

3.2 The Legal Form Criterion

3.2.1 Introduction

The legal form criterion can be considered as one of the most concrete criteria, and the CJEU has used it in most of its cases. Investment funds can be established under a variety of forms; MSs mainly regulate them in the form of trust, company, or contractual type. Despite the efforts for harmonization of the laws of the MSs, for instance, by the UCITS directive, Member States' legislations are not fully harmonized. Different legal forms that are adopted by some Member States might not be recognized or permitted, which is another issue for comparability.[78] Some of them are named as SICAV, SICAR, FCP, that are not known in all of the EU MSs. According to the Viitala's view, the legal form approach is not necessary in

[76] C-170/05, *Denkavit*, EU:C:2006:783.
[77] C-379/05 *Amurta*, EU:C:2007:655.
[78] Tomi Viitala and Hein Vermeulen, *The Tax Treatment of CIVs and REITs,* IBFD Online Books (2014) Part 3, Chapter 8.

the cases of UCITS. With the feature of the mutual recognition, even the legal structure of a non-resident UCITS is not recognized or permitted in the source state, it must be comparable to resident funds. [79]

3.2.2 CJEU Case Law

3.2.2.1 Aberdeen Property Fininvest Alpha

The facts of the relevant case are stated supra. The Finnish government put forward that a Luxembourg SICAV is not comparable to a Finnish company because it does not recognize that form in its legislation. However, the Court stated that the fact that it is not known in the source state legislation does not make it incomparable because the company laws of the MSs are not unified. MSs cannot be expected to have the same type of legal form for comparability. Otherwise, freedom of establishment will lose its meaning.[80]

Furthermore, the residence state must find the closest domestic entity to a SICAV, which is in the form of corporate, and minor differences do not affect the comparability test. The CJEU has found that a Luxembourg SICAV is closest to the Finnish limited company, even though it has a fixed capital share. As a consequence, it is indicated that there is an unjustified breach, and the Court did not find it necessary to compare a SICAV and Finnish investment fund since it has already found comparable to Finnish company. Pato and Seize are of the view that a SICAV must be compared to the Finnish investment fund due to the aim, and the rationale of the SICAV is closer to the Finnish investment fund.[81] In the present case, the outcome would be the same in both cases.

3.2.2.2 Commission v. Belgium

Before the amendment in 2013, the Commission stated that the Belgium legislation is discriminatory due to the different treatment to non-resident investment companies. According to the Belgium national law, both residents and non-residents were subject to withholding tax. However, the tax bases of the resident investment companies and non-resident companies having an establishment in Belgium were narrower, and there was an option of crediting withholding tax against the corporate tax. In the situation of

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[79] Hein Vermeulen, *The Tax Treatment of CIVs and REITs*, IBFD Online Books (2014) Part 3, Chapter 8.
[80] C-303/07, *Aberdeen*, EU:C:2009:377, para.50.
[81] António Calisto Pato, EC Law and Investment Funds: The Aberdeen Case, EC Tax Review, Issue 3, p. 114–121.

overpayment, there was an option of a refund. In the case of non-residents, there were no such possibilities. The CJEU was asked whether it is contrary to the free movement of capital and freedom of establishment. [82]

The Belgium government argued that non-resident investment companies are comparable to resident common funds, which are flow-through entities, and the tax burden on those entities are final as non-resident investment companies.

The CJEU pointed out the subject to tax criterion in this case as well and stated that resident and non-resident investment funds are comparable with regards to the risk of double taxation because it exercises its power of taxation over them.[83]As regards to the Belgium governments argument, the Court stated that the non-resident investment funds have legal personality, while common funds do not have. The CJEU decided that common funds and non-resident investment companies are non-comparable because their legal forms are different and cannot be regarded as similar merely based on the tax treatment[84], as stated: " *first, to the comparability of the situation of non-resident investment companies with that of the Belgian common funds, it must be stated that, although non-resident investment companies have legal personality, that is not the case in respect of the Belgian common funds. Accordingly, the Kingdom of Belgium cannot claim that the situation of non-resident investment companies must be compared to that of common funds, on the sole ground that the Belgian tax legislation treats those two categories of taxpayers, which moreover do not have the same legal form, identically."*[85]So that, the Court has decided to apply formal comparability instead of substantive comparison. Since both non-resident and resident entities are in the form of a company and have legal personality, they found in comparable situations.

3.3 The Aim Criterion

3.3.1 Introduction

The Court has used this criterion almost in every case since the purpose that is aimed by the source state legislation is one of the essential elements for the Court for denying or supporting the comparability.[86] Most of the

[82] Case C-387/11 *Commission v. Belgium,* EU:C:2012:670.
[83] Ibid. para. 51.
[84] Ibid. para. 54.
[85] Ibid para. 59.
[86] Hein Vermeulen, *The Tax Treatment of CIVs and REITs*, IBFD Online Books (2014) Part 3, Chapter 8.

Member States' legislation aims at ensuring the neutralization of choice between direct and indirect investments. In other words, the purpose of favorable treatment is usually basing on mitigating double taxation. However, the aim pursued by the source state legislation might not be sufficient for non-comparability, because it should be remembered that when an MS impose its tax jurisdiction over a non-resident investment fund, subject to tax criteria will mostly likely applies. In addition, the legislation in question might be aiming at effective taxation of the dividend. For pension funds, the aim might be ensuring neutrality between different types of pension funds. Sometimes, the legislation might have particular purposes like, in some cases, examined infra. However, it does not always make it non-comparable to non-resident investment fund. Additionally, various criteria set by national legislation for being under the scope of the exemption's consequences may differ depending on the objective of the legislation in question.

3.3.2 CJEU Case Law

3.3.2.1 Fidelity Funds

Fidelity Investment Funds and Fidelity Institutional Fund were residents of the UK and Luxembourg in the form of UCITS. Between the years 2000 and 2009, they received dividends from a Danish portfolio, and those dividends were subject to withholding tax in Denmark. According to the Danish legislation, to be under the scope of the exemption, it has to be resident in Denmark and comply with 16C criteria of the Danish law. For complying with this provision, a minimum distribution is required. Minimum distribution is composed of calculating the sum of revenue and net amounts that are received during the one year and losses, while expenditures are deductible. Also, there is an option of merely calculating without any distribution. So that, it compromises of basis for taxation of the shareholders and UCITS act as agents for withholding tax. The CJEU was asked whether this is contrary to the free movement of capital.[87]

It is stated for this case by the CJEU that to determine if situations are comparable objectives of the legislation must be evaluated, which is indicated as:" *... comparability of a cross-border situation with an internal one must be examined having regard to the aim pursued by the national provisions at issue as well as their purpose and content*."[88] There are two

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[87] C-480/16, *Fidelity Funds*, EU:C:2018:480, para.14-15.
[88] Ibid. para. 50.

objectives of the Danish legislation.[89] The first one is preventing economic double taxation and, in other words, ensuring the neutralization of choice between direct and indirect investments. The Court reaffirmed that since the Danish legislation taxes non-resident's dividends, then residents and non-residents are comparable. Consequently, subject to tax criterion applies here as well.[90]

The second aim of the legislation is ensuring the effective taxation of the dividends by at least taxing once, at the investor level. [91]According to the Court, to assess whether situations are comparable, the distinguishing criteria has to be determined. The first one is the residency, and the second one is the minimum distribution requirement, which is not found decisive due to being related to the tax method of taxing investors. *"Although the aim of the legislation at issue in the main proceedings is to move the level of taxation from the investment vehicle to the shareholder of that vehicle, it is, in principle, the substantive conditions of the power to tax unit-holders' income that must be considered decisive, and not the method of taxation used."*[92] The Court noted that a non-resident fund might have shareholders resident in Denmark, and Denmark could tax them.[93] In those circumstances, a non-resident UCITS and resident UCITS are comparable. Consequently, the Court did not accept the justification based on the Art 65(1) of the TFEU. The aim of this legislation is reaching the shareholder, and it is not possible for non-residents situated in other MSs, but by providing conditions that are acting as an agent by a non-resident fund, then it should have granted the exemption.

In contrast to the Santander and PMT, the Court considered the comparability at the level of investor level due to the nature of Danish legislation, which gives exemption to the UCITS in condition to the specific investor requirements. In the Santander case, there are no such conditions, and it is examined at the level of the investment fund.

3.3.2.2 Pensioenfonds Metaal en Techniek (PMT)

This case is about the Swedish pension fund taxation regime. Swedish pension funds were taxed according to a special regime in which dividends paid to domestic pension funds were subject to capital yield tax, and that notional yield is taxed at the rate of 15%. In other words, it is calculated as a definitive lump sum and on a notional yield, while a Dutch pension fund is

[89] Ibid. Para 52.
[90] Ibid. Para. 53.
[91] Ibid. Para. 57.
[92] Ibid, Para 60.
[93] Ibid. Para.61.

subject to withholding tax at the rate of 15% on the gross amount of the dividend. PMT asked the Court whether this different treatment is contrary to the free movement of capital.[94]

In this case, tax rates are identical; however, the difference arises in calculating the tax bases. The Swedish government argues that the different treatment occurs due to the aim of the legislation, which the CJEU has also agreed on. For the comparability of non-resident and resident investment funds, the CJEU examined the purpose of the Swedish law: *"comparability of a cross-border situation with an internal situation must be examined having regard to the aim pursued by the national provisions at issue."*[95] The legislation aims at ensuring neutral taxation of different pension funds. According to the Court: "..*the application of neutral taxation independent of the economic climate surrounding various kinds of assets as well as all the kinds of pension products concerned, which presupposes that pensions funds are taxed on the whole of the assets."*[96] This approach presupposes that Swedish pension funds are subject to worldwide taxation. At the same time, it is not possible for non-resident pension funds since they are only subject to source taxation in Sweden. Consequently, the Court found that they are not in comparable situations, and concluded that different treatment does not constitute a restriction of free movement of capital.

Willems stated that, in this case, the Court finally accepted that the regarding the taxation technique, it is impossible for MSs to apply the same tax treatment for non-residents, without occurring a higher tax burden. [97]However, as stated by the Willems, it is not correct to generalize this, and specific features of the Swedish legislation must be taken into attention.[98]

[94] C-252/14, *Pensioenfonds Metaal en Techniek*, EU:C:2016:402.
[95] Ibid. para. 48.
[96] Ibid. para 59.
[97] Ward Willems, "Withholding Taxes Within the Internal Market After Sofina: Chronicle of a Death Foretold?", EC Tax Review (2019), page. 170.
[98] Ibid.

3.3.2.3 Orange European Smallcap (OESF)

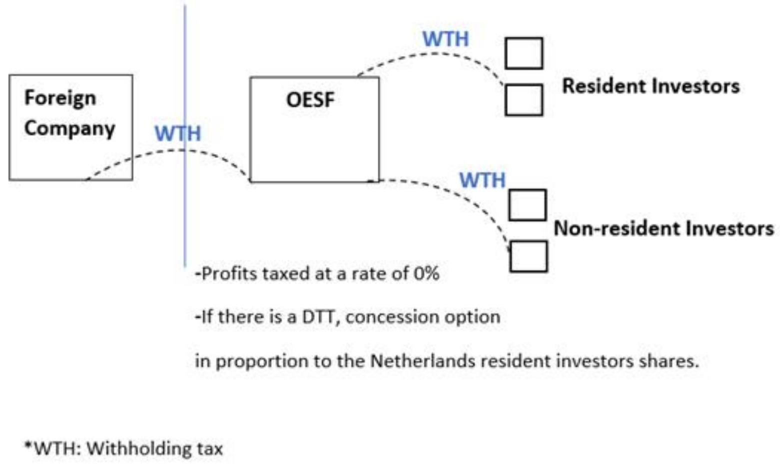

Figure 2

The OESF case is concerned about inbound dividends. Nevertheless, since it is the first case that the aim of the legislation has examined by the CJEU, it deserves further analysis. In this case, the Netherlands resident portfolio investment receives dividends from various EU and non-EU states. According to the Dutch tax regime, investment funds were subject to tax, but its profits were taxed at the rate of 0% if it distributes the profits to the shareholders within eight months. For dividends received from a Dutch company, there was also withholding tax, which subsequently refunded. For foreign dividends, there was also a concession option. However, it was not possible in all cases. There were some restrictions in cross-border situations. The first restriction is, withholding tax on dividends from Portugal and Germany cannot be credited due to the non-existence of DTT between those states and the Netherlands. A concession for withholding tax is restricted to an amount which, according to a DTT, a Dutch resident individual could have credited. Secondly, there was also no concession for dividends that arise from countries that provide credit for withholding tax against Dutch income tax. For the rest of the states, there was a concession. Nevertheless, the amount was reduced in proportion to the non-resident shareholders' participation—the Dutch regime aimed at neutral treatment between direct investments and investments held through intermediaries. The OESF could not get the full credit and claimed that it should have been granted full credit. [99]

The CJEU indicated that Dutch sourced dividends and foreign-sourced dividends are treated the same since both taxed at the rate of 0%. The reason why German and Portuguese sourced dividends are in a less advantageous situation is the result of the fiscal sovereignty exercised by the Netherlands. However, treating differently to dividends from one MS to one MS

[99] C-252/14, *Orange European Smallcap*, EU:C:2016:402.

constitutes a restriction to the free movement of capital. The Court stated that the aim of the legislation is providing an equal treatment between direct and indirect investments. *"...in order to make the tax treatment of direct investments and of those made through the intermediary of investment enterprises the same."*[100] In this situation, there is also no concession for individual direct investors because of the lack of DTT between those states. So that the result would have been the same if the investor had invested directly.[101] The Court concluded that dividends received from a country that it has been concluded a DTT, and has been not concluded are not comparable. Hence this restriction can be justified by the objective differences between situations, and the Court did not find any breach. The AG was also of the view that they are incomparable situations since the dispute arises from the application of domestic legislation, which limits the benefit to the existence of DTT.[102]

As regards to the second restriction of reducing the credit in proportion of non-residents is found as a restriction. The Court stated that funds with resident shareholders and non-resident shareholders are comparable. There is no measurable difference between them since both subject to Dutch taxation regardless of the residence of the shareholders.[103]The Court concluded that this constitutes a breach of free movement of capital.

So that, if the aim of the legislation is linked with the applicability of DTTs, in other words, if the measure is connected with the right of the investor according to a DTT, then situations became non-comparable.[104]Moreover, there would be an advantage if the direct investors would have been granted the concession. Still, since there is no concession for direct investors as well, there is less no favorable treatment, which is consistent with the aim of the national legislation.[105]

3.3.2.4 Commission v. Finland

Under the Finnish legislation, dividends received by resident pension funds were subject to withholding tax at a rate of 19.5%. Nevertheless, the Commission claimed that Finland de facto applies tax exemption to dividends received by resident pension funds since they were authorized to deduct the amount reserved to meet the obligations. In other words, the tax

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[100] Ibid. paras. 44 and 64.
[101] Ibid. paras. 60-65.
[102] AG Opinion in C-252/14 Orange European Smallcap, EU:C:2007:403, para.78.
[103] C-252/14, *Orange European Smallcap*, EU:C:2016:402, para.78.
[104]Thomas Spaas, An Weyn, “The Lessons of Orange European Smallcap Fund”, EC Tax Review (2009).
[105] I.M de Groot, “Member States Must Apply Most Favoured Nation Treatment Under EU Law”, Intertax, page 7.

was imposed on a net basis. Resident pension funds were capable of deducting pension liabilities from the base by showing them as a cost. Dividends received by other pension funds were subject to withholding tax at a rate of 19.5% on the gross basis that they cannot deduct expenses or pension liabilities from the tax base. The CJEU was asked whether this treatment is a breach of the free movement of capital.[106]

In this case, as the other several cases, the approach taken by the Court is the aim approach, which is stated as: *"...it must be recalled that the comparability of a cross-border situation with an internal situation must be examined having regard to the aim pursued by the national provisions at issue."*[107] The Court referred to the Schröder[108] case and stated that residents and non-resident are in a comparable situation as regards to the expenses if those expenses are directly linked to an activity that is generating the taxable income.[109] The particular purpose of the legislation providing the pension funds to accumulate capital to meet obligations under its contracts. So that it is found that foreign pension funds are in a comparable situation with resident funds because they both pursue the same activity, and their purpose is the same*:"... specific purpose is also that of the non-resident pension funds which pursue the same activity; the latter are in a situation objectively comparable to that of resident pension funds as regards Finnish sourced dividends."*[110] The Court concluded that the Finnish legislation constitutes a restriction of free movement of capital since it is discriminating based on nationality. The AG is in the same view as CJEU, and states that their objective is: "making transfers to reserves is an essential element of their activities."[111]

[106] C-342/10, *Commission v. Finland*, EU:C:2012:670.
[107] Ibid. para. 36.
[108] C-450/09, *Schröder*, EU:C:2011:198.
[109] Ibid. para.37.
[110] Ibid. para. 43.
[111] AG Opinion in C-342/10, Commission v. Finland, EU:C:2012:474, para. 43.

3.3.2.5 *Köln-Aktienfonds Deka (KA Deka)*

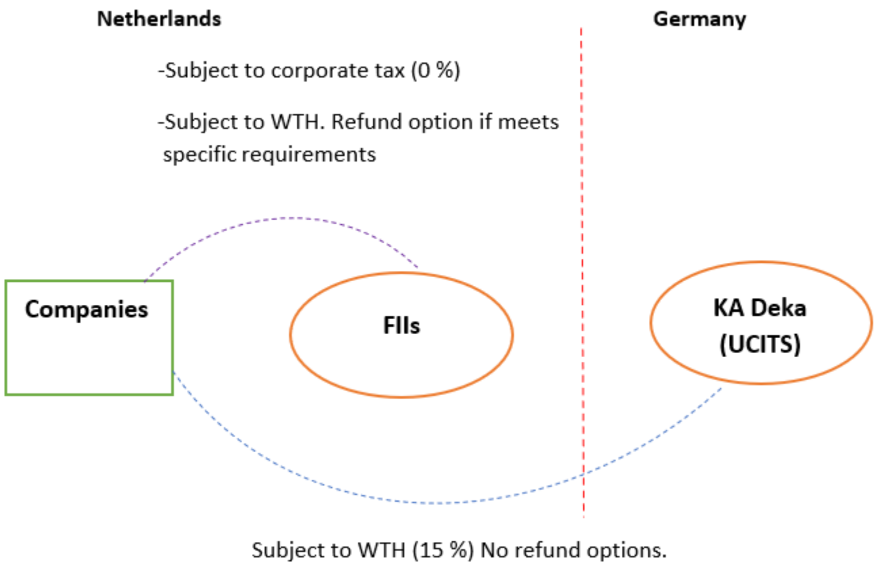

Figure 3

KA Deka is an investment fund under the scope of the UCITS Directive, which is a resident in Germany. Its shares were traded via a system called the global stream system. The legislation in question belongs to the Netherlands, which impose residents and non-residents withholding tax at the rate of 15%. Resident investment funds could be considered as FII and granted a refund if they comply with specific distribution and investor requirements. However, KA Deka had no such opportunity due to not being able to meet shareholder and distribution requirements.[112]As regards the shareholder requirement, shareholders required to hold various amounts of shares or participations.[113] The second requirement is distributing the income within eight months after the end of the financial year.[114] The questions were, if it is contrary to the free movement of capital, when non-resident cannot prove that it meets shareholder requirement and the income is not distributed to the shareholders but deemed to be distributed and hence could not benefit from the exemption.

According to the CJEU, The Dutch legislation in question does not distinguish between resident and non-resident investment funds by the shareholder requirements. Nevertheless, they might be de facto giving advantages to resident funds, which constitutes a restriction to free

[112] Case C-156/17 *Köln-Aktienfonds,* EU:C:2020:51.
[113] Ibid. para.13.
[114] Ibid. para.8.

movement of capital.[115] In those situations, or when a non-resident cannot prove that requirement, it constitutes restriction. For this criterion, it is noted that the national Court should determine if similar funds are deprived of this advantage or not. The Court stated that the problem of providing shareholder identity arises from the system that has chosen by the investment fund, and it is indicated as: *" In those circumstances, the inadequate flow of information to the investor is not a problem for which the Member State concerned should have to answer."*[116]

The distribution requirement also does not distinguish between resident and non-resident, but it can also lead to do in practice as well. The CJEU stated that for examining if the resident and non-resident investment funds are comparable, the objective of the distribution requirement should be considered.[117] The CJEU argues that if the aim is to ensure the profits to reach the investor immediately, then the investment fund that has a deemed distribution in its legislation is not comparable to the resident investment funds that distribute within eight months. If the objective is to ensure the taxation of profits made by an investor, then they become in comparable situations and may constitute a restriction of freedom of capital. The Court referred it to the national courts for the assessment.[118]

According to the AG, the distribution requirement aims to prevent double taxation and move the level of taxation from investment funds to investor level. Also, it states that the impossibility of taxing non-residents is merely the consequence of the free choice of the governments and concluded that residents and non-residents comparable.[119]

3.3.2.6 College Pension Plan of British Columbia

A pension fund resident in Canada received dividends from German public limited companies, between the years 2007 and 2010, which were subject to withholding tax at a rate of %15 and were final. According to German legislation, resident pension funds were subject to withholding tax at a rate of 25%. However, they could offset the withholding tax against corporate tax and apply for a refund for the excess amount. Additionally, dividends received do not increase corporate tax liability because resident pension funds may reduce the taxable profits by deducting technical reserves taking account of its future pension liabilities. Consequently, they were exempted from corporate tax in practice. The British Columbia claimed the refund of

[115] Ibid. para. 55.
[116] Ibid. para.65.
[117] Ibid. paras. 77-78.
[118] Ibid. paras. 80-82.
[119] AG opinion in Case C-156/17 *Köln-Aktienfonds*, EU:C:2019:677, paras. 128-131.

the tax and an exemption for future withholding taxes. The CJEU was asked whether this different treatment causes the breach of free movement of capital.[120]

The German authorities claimed that residents and non-residents are not comparable in the light of the legislation, and difference stems from the application of different taxation arrangements. Also, they stated that there is no direct connection between the receipt of dividends in Germany and expenditure constituted by the allocations to the technical provisions.

As regards the comparability, the Court reaffirmed that the aim, purpose, and content of the national legislation should be taken into account.[121] Additionally added that if a non-resident fund imposed a charge to tax, the resident and non-resident become comparable.[122] Furthermore, it is indicated that: "*Accordingly, the national legislation at issue in the main proceedings does not simply provide for different procedures for charging tax depending on the place of residence of the recipient of nationally sourced dividends…"*[123] So that the distinguishing criterion approach is also mentioned by the Court, which is residency. Secondly, for the deduction of technical reserves, the Court takes the aim approach. The aim of the national legislation in question is accumulation for pension liabilities in the future. Consequently, the CJEU pointed out that: *"A non-resident pension fund, which allocates the dividends received to provisions for pensions that it will have to pay in the future, intentionally or pursuant to the law in force in its State of residence, is in that regard in a situation comparable to that of a resident pension fund."*[124] However, this is referred to as the national Court to determine.

3.4 Distinguishing Criterion

3.4.1 Introduction

The Distinguishing criterion is also one of the concrete approaches. For comparability, only the distinguishing criterion set by the national law in question must be taken into attention. As can be seen from the cases, the test which affects the tax treatment of investment funds is usually the residence of the investment fund criterion. Consequently, if the distinguishing criterion is determined as residency of the investment fund and if the sole basis for the taxation is the residency, then comparability should be

[120] C-641/17 *College Pension Plan of British Columbia*, EU:C:2019:960.
[121] Ibid. para.65.
[122] Ibid. para.66.
[123] Ibid. para.72.
[124] Ibid. para.81.

examined only at the investment fund level, not the shareholder level.[125] CJEU has been using this approach in various cases and usually use it with other methods.

3.4.2 CJEU Case Law

3.4.2.1 Santander

Under the French legislation, dividends paid to the non-resident investment funds were subject to withholding tax at variable rates, while resident UCITS were exempted from tax. UCITS from various MSs and investment funds from the US argued that this regime is contrary to the free movement of capital. The CJEU was asked whether the comparability should be determined at the level of the shareholders or investment funds. [126]

The French government claimed that the object of the UCITS is to act on behalf of its investors. Also, argued that CIVs are tax neutral, and comparability has to be determined by taking the position of investor and UCITS together.

Nevertheless, the Court rejected the French government's arguments. It indicated that the shareholders' tax treatment is not necessary for determining if the legislation in question is discriminatory, if the MS chooses to impose withholding tax based on the residence of the investment funds. The exemption granted to the resident funds is not conditional upon the taxation of investors. The CJEU did not take into account the tax situation of the shareholders, and for this, the comparability should take place at the investment funds level. It is stated that: *"…where national tax legislation establishes a distinguishing criterion for the taxation of distributed profits, account must be taken of that criterion in determining whether the situations are comparable"*[127] In this case, it is the residency of the investment fund because residents are exempted regardless of it is further taxed at the level of a shareholder or not and was no link between exemption of UCITS and taxing at the level of shareholders.[128] Hippert states this the Court has adopted the "entity" approach instead "look-through approach."[129]

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[125] C-338/11 *Santander*, EU:C:2012:286, para. 28.
[126] C 338/11 Santander, EU:C:2012:286.
[127] Ibid. para.27.
[128] Ibid. paras. 28-30.
[129] Geoff Hippert, “The TFEU Eligibility of Non-EU Investment Funds Subjected to Discriminatory Dividend Withholding Taxes”, EC Tax Review (2016) page.79

The Court also noted that the reasoning of the French government which is investors of the domestic funds are resident for tax purposes in France and non-resident funds investors are resident for tax purposes in another state is not valid. Since, a French resident shareholder can participate in the non-resident fund, and a non-resident shareholder can participate in French investment funds.[130]The CJEU concluded that they are under comparable situations, and the French legislation is contrary to the free movement of capital.

This distinguishing criterion approach has emerged with the Aberdeen case, where the Italian government argued that comparability should be examined by taking into account the shareholders treatment as well, which is not accepted by the Court.[131]This approach has been used in various cases mixed with other methods as well, for instance, PMT, Emerging Markets, College Pension Plan, and Fidelity Funds. Different from those cases, in the OESCP case under the Dutch legislation to be granted an exemption, the profits of the UCITS must be distributed to the shareholders. So, the residency of the investment fund is not found the distinguishing criterion, and the Court took account of the investor level. However, in the Santander case, the French legislation does not consider the tax treatment of the investors, but only investment fund. In the Commission v. Belgium case, the Court referred to Santander and stated that the Belgium legislation treats differently based on the residence state of the investment company. Therefore, its shareholders' situation would not be decisive for comparability, and conditions must be compared at the level of investment companies."*In the light of the distinguishing criterion established by that legislation, based solely on the investment company's place of residence, the situations must be compared only at the level of the investment company to determine whether that legislation is discriminatory."*[132]

3.5 The Regulatory Framework

3.5.1 Introduction

Under the regulatory framework approach, the Court considers whether the non-resident is complying with conditions that are imposed by the source states' source of law. In practice, it is almost impossible for non-residents to comply with other states' legislation. That is why the Court states in its cases that this approach should not be interpreted strictly. Otherwise, freedoms

[130] Ibid. para. 33
[131] C 303/07, Aberdeen, EU:C:2009:377, paras. 54-55.
[132] Case C-387/11 *Commission v. Belgium,*para. 67.

will be deprived of their meanings. Mario Tenore believes that this is partly true since the other comparison approaches can be applied. [133]

3.5.2 CJEU Case Law

3.5.2.1 Emerging Markets

Emerging Markets is an investment company resident in the US and made investments in Polish companies. Under the Polish legislation, investment funds located in Poland were exempted from tax, which is extended to the EU/EAA resident funds with an amendment in 2011. Funds that are resident in other states were subject to withholding tax, like Emerging Markets. The CJEU was asked whether the legislation in question is contrary to the free movement of capital. [134]

The Commission, Polish, French, Italian, Finnish, Spanish, and German governments claimed that a non-resident investment fund is not comparable to EU resident investment funds since EU investment funds are subjects of UCITS Directive, which unifies the legislation of those states.

The CJEU's view regards comparability is, being outside the scope of the UCITS directive does not automatically make them non-comparable.*"... the fact that non-resident investment funds are not part of the European Union's uniform regulatory framework cannot in itself be sufficient reason to find that the situations of those funds are, in fact, different.*"[135] Otherwise, the free movement of capital would lose its meaning. It has to be checked whether the non-EU fund operates under the conditions similar to EU investment funds. The Polish legislation has relied on the UCITS directive, [136] and an investment fund has to satisfy those conditions to be under the scope of the exemption.

The Court indicates that, in the situations of the legislation which considers the residence to be granted exemption, the regulatory framework approach does not apply. However, if the domestic law of the source state would have taken the regulatory status of the fund in addition to the residence into account, then the regulatory approach could be applied according to the CJEU.[137] In this case, the Court found that it is not necessary to examine

[133] Mario Tenore-Werner Haslehner, *Investment Fund Taxation*, Wolters Kluwer E-book (2017) Chapter 7, page.227.
[134] C-190/12 *Emerging Markets*, EU:C:2014:249.
[135] Ibid. para. 67.
[136] Ibid. para.66.
[137] Mario Tenore-Werner Haslehner, Investment Fund Taxation, Wolters Kluwer E-book (2017) Chapter 7, page.225.

whether Emerging Markets complying with the UCITS' conditions since its tax treatment has determined based on its residency." *Since the main criterion laid down by the national tax legislation at issue in the main proceedings is based on the place of residence of an investment fund, enabling solely investment funds which are established in Poland to qualify for the tax exemption, in this case, a comparison of the regulatory framework governing funds established in a non-Member country and the uniform regulatory framework applied within the Union is of no relevance, in that such a comparison forms no part of the applicable legislation at issue in the main proceedings."*[138]

The Court applied the principles that it structured in Aberdeen and Santander. Since both resident and third-country investment funds are under the risk of economic double taxation, the relief granted to residents should be extended to the third country investment funds as well. So that, subject to tax criteria is applied by the Court even though the non-resident investment fund is located in a third country since the free movement of capital is also applicable in third-country cases.

3.5.2.2 Köln-Aktienfonds Deka

The facts of the case are stated supra. The CJEU's view is that obliging non-resident investment funds to comply with strict domestic conditions laid by the national legislation might cause that the benefits of refund are only applicable to residents in practice. Since each investment fund meets the criteria in its MSs and it is not always possible to meet those criteria in other MSs in a strict manner.[139] The Court argues that: "*In those circumstances, it cannot be excluded that a non-resident investment fund which, because of the regulatory framework in force in its State of establishment, does not meet all the conditions laid down by the Member State conferring the tax advantage in question, is nevertheless in a situation which is essentially comparable to that of a resident investment fund meeting such conditions."*[140] The Court concluded that for comparability, the aim of the provisions should be determined in this case, which are examined supra.

[138] Ibid. paras. 68-69.
[139] C-156/17 Köln-Aktienfonds Deka, EU:C:2020:51, para 73.
[140] Ibid. para 74.

4 Pending Cases and Applicable Approaches

4.1 Korkein hallinto-oikeus

E is a natural person residing in Finland who has invested in a Luxembourg SICAV. E asked to Finnish authorities how the dividend distributed from Luxembourg SICAV will be classified for taxation in Finland, whether as capital income or income from employment. The tax authority decided that it must be considered as dividends and hence income from paid employment under the national legislation. E claims that this constitutes the breach of free movement of capital because it causes a higher tax burden and states that it should be taxed as income from capital. The question is whether Art. 63 and 65 TFEU[141] precludes an interpretation which income received by a natural person residing in Finland from a non-resident UCITS (fund in the form of investment company) is not treated the same way as income derived from a Finnish UCITS(fund in the contract form) because the legal forms of the funds do not correspond each other. [142]

The case is about inbound dividends received by a natural person. However, the author believes that it is not an obstacle for the comparison approaches to be applied. Due to the limited information given, it is not possible to foresee if the aim criterion and subject to tax criterion are applicable since there is no information about the aim of the Finnish legislation. It is foreseeable that the CJEU might take the distinguishing criterion as a residency and legal form approach. Nevertheless, it is not possible to specify precisely which criterion the Court will use.

4.2 the Allianzgi-Fonds Aevn

The applicant is a CIV resident in Germany and exempted from corporate tax in Germany. It held shares from Portuguese companies. Under the Portuguese legislation, dividends paid by a resident company to taxable persons also resident in Portugal were subject to withholding tax, which is final, at a rate of 25%. Dividends received from UCITS incorporated under Portuguese legislation were exempted from corporate tax. Incorporation of

[141] Treaty on the Functioning of the European Union, OJ C 326.
[142] C-480/19 *Korkein hallinto-oikeus* (Pending).

investment fund requires it to be established in Portugal, which excludes CIVs resident in another MS to benefit from the exemption. Additionally, incorporation in Portugal does not require prior authorization from authorities, unlike other member states. For that, dividends received by Portuguese CIVs from Portuguese companies benefit a more favorable tax treatment than non-resident CIVs receives dividends from Portuguese companies. The applicant claims that there is a breach of free movement of capital on the grounds of nationality. Portuguese authorities state that CIVs that are incorporated in Portuguese and Germany are not comparable since former CIVs pay corporate tax on its taxable profits, which also include marginal returns and are taxed primarily through the provisions on stamp duty. At the same time, the latter is exempted from taxes in the residence state. They also indicate that the taxation of dividends done through two separate mechanisms and that there is no discrimination. The claimant asked whether this tax scheme is contrary to Art. 63 and Art. 56, TFEU. The other question is whether it should be examined at the level of the shareholder or investment fund level.[143]

The same explanations regarding the aim and subject to tax criteria apply to this case. The distinguishing approach might be applicable because of the different treatment basis on the residency of the fund if both entities are UCITS, the comparison issue based on the applicability of legal form or regulatory framework approach because Member States mutually recognize UCITS. Nevertheless, it is also not possible to strictly foresee which method will be applied by the Court.

[143] C-545/19 *the Allianzgi-Fonds Aevn* (Pending).

5 Conclusion

There is a series of cases where the CJEU has found resident and non-resident investment funds comparable and non-comparable. For reaching that result, the Court has used some criteria as examined infra. From all these cases, we can see that the Court has some decisive and explicit criteria and some inconsistent approaches for the comparability test. Firstly, as regards to subject to tax criterion, the Court has a consistent approach since the Aberdeen case[144], which has its roots from dividend distribution cases.[145] In all these cases, the source state imposes withholding tax on both resident and non-resident funds. However, for preventing double taxation, it grants its resident funds a relief while not granting to non-residents. The Court point outs that both residents are non-residents are under the same threat. Hence, they are comparable. The most significant feature of this approach is that the Court does not take into account the tax treatment, form, whether it is under the scope of the UCITS Directive or PSD or not. In almost all of its cases, the Court refers to this approach. It shows that the CJEU has broader protection than DTTs.

As regards the legal form approach, the Court takes into account the formalistic approach rather than substantive approach. For instance, in the Aberdeen case, the non-resident entity is a SICAV, which is in the form of a company. It is stated that even though the outcome will be the same for the Finnish company or fund, it determined the comparability with the Finnish company. In Commission v. Belgium case[146], the comparison of the CJEU made between companies instead of funds because the non-resident entity was in the form of a company. The Court stated that their tax treatment is not essential for being comparable; the decisive factor was, having a legal personality. So that, we can assume that the Court has a consistent law about legal form approach.

Thirdly, for the aim criterion, the Court has examined the objective of several national laws. In a significant number of cases, it can be seen that the national legislations, base their favorable treatment toward residents based on the objective of preventing double taxation. However, in almost all of the cases, the “subject to tax” criterion becomes a resistance against it since non-residents are facing the same threat when resident states impose a tax. The another aim of the national legislation would be ensuring the taxation at the level of the investor while investment funds act as an agent like in the Fidelity Funds case. The Court stated that since there was a

[144] C 303/07, *Aberdeen*, EU:C:2009:377.
[145] C-374/04, *ACT Group Litigation*. EU:C: 2006:773, C-170/05, *Denkavit*, EU:C:2006:783 and C-379/05 *Amurta*, EU:C:2007:655.
[146] Case C-387/11 Commission v. Belgium, EU:C:2012:670.

possibility of exercise its power of taxation in the situation of a non-resident UCITS having a shareholder in Denmark, then the Court found them comparable[147] It is stated that with the possibility of cooperation of the UCITS, there is no lack of information. So, it was not proportional to not give exemption to non-residents that have satisfied the conditions.[148] It is foreseeable that, with the application of DAC 6[149], there will be not specifically UCITS cooperation requirement for getting relevant information.

In the KA Deka case, the redistribution requirement has found linked to the neutral treatment of direct and indirect investments. However, determining the objective of redistribution is left to the national Court. In the OESF case, the aim is also ensuring neutrality between indirect and direct investments. Since there was also no concession if an investor had invested directly, the Court has decided that there is no unfavorable treatment and concluded that they are not comparable. In the pension funds cases, there are mainly two specific aims. In the PMT[150] case, the objective was ensuring the neutral treatment of different pension funds, which presupposes that they are subject to worldwide taxation, and it is not possible for non-resident funds. Hence, the Court did not find them comparable. The author believes that the intent behind this provision in domestic legislation might be excluding non-residents, which should have taken into account by the Court and is not clear enough. The second aim that is given by the rest of the pension fund cases is the accumulation of the capital for meeting the future obligations which, if the non-residents aims the same thing, they are considered comparable. The Court has a consistent approach to this objective, which can be seen from British Columbia[151] and Commission v. Finland[152] cases. Even though the fact that the Court has a consistent approach regards the aim criterion, in some cases, there is ambiguity because for determining the objective of the law, the Court refers the case to the national courts. As regards to distinguishing criterion, the most used criterion is residency, which does not justify different treatment. The Court uses this approach, usually with other criteria and mostly with aim criterion, and has been using it consistently. Finally, the regulatory framework approach is one of the problematic criteria to apply since a non-resident cannot comply with other MSs legislation in most of the cases. Especially in third-country situations. The CJEU is also aware of this issue, and the author believes that it should

[147] C-480/16, *Fidelity Funds*, EU:C:2018:480, para. 60-61.
[148] Ibid para.84.
[149] Council Directive (EU) 2018/822 of 25 May 2018 amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation in relation to reportable cross-border arrangements, OJ L 139.
[150] C-252/14, *Pensioenfonds Metaal en Techniek*, EU:C:2016:402.
[151] C-342/10, *Commission v. Finland*, EU:C:2012:670.
[152] C-641/17, *College Pension Plan of British Columbia*, EU:C:2019:960.

not be interpreted strictly. There is a need for clarity or renovation for this approach for preventing double taxation in comparable situations.

Consequently, the author is of the view that the international double taxation has remedied in EU law to a large extent under the light of primary law. Despite the certain unclarities in the case law as stated above, it can still provide more benefits than DTTs and EU secondary legislation. It does not take the different characteristics of the funds strictly, which mostly results in the interest of non-residents. The vast amount of the existing case-law, and probably new coming cases, of the Court sheds light on the issue of double taxation. Additionally, the author believes that the CJEU does not strictly compel MSs to recognize the other MSs fund features but tries to maintain that MSs have non-discriminatory legislations. Finally, the author believes that for the sake of precise clarity in the EU law, the harmonization of the legislation would be the most effective solution for the mentioned issues. However, it is not possible to foresee this for the near future due to economic and political reasons.

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