Case C-602/23

Summary of the request for a preliminary ruling pursuant to Article 98(1) of the Rules of Procedure of the Court of Justice

Date lodged:

3 October 2023

Referring court:

Verwaltungsgerichtshof (Austria)

Date of the order for reference:

20 September 2023

Appellant on a point of law:

Finanzamt für Großbetriebe

Interested party:

Franklin Mutual Series Funds – Franklin Mutual European Fund in San Mateo

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Subject matter of the case in the main proceedings

Restriction on the free movement of capital – no refund of income tax – preservation of the balanced allocation of the power to impose taxes

Subject matter and legal basis of the reference

Request for a preliminary ruling, Article 267 TFEU

Questions referred for a preliminary ruling

1. Does a provision such as Paragraph 188 of the Investmentfondsgesetz 2011 (Law on Investment Funds 2011, 'the InvFG 2011'), which has the effect of precluding foreign entities that are comparable to a domestic corporation from receiving a refund of income tax in Austria if they correspond in substance to a UCITS within the meaning of Directive 2009/65/EC, and are therefore not permitted to operate as a corporation in Austria because only the legal form of a transparent special fund is provided for in respect of such entities in Austria, constitute a restriction on the free movement of capital within the meaning of Article 63 TFEU?

2. If that question is answered in the affirmative: is there an objectively comparable situation between, on the one hand, a domestic corporation that invests its assets in accordance with the principles of risk spreading, but does not constitute a UCITS due to the fact that funds are not raised from the public, and is thus permitted to operate as a corporation even in the domestic market and, on the other hand, a foreign investment fund company which would constitute a UCITS according to the domestic principles – on account of the fact that funds are raised from the public – and is therefore not permitted to operate as a corporation in the domestic market?

3. If that question is answered in the affirmative: does preservation of the balanced allocation of the power to impose taxes constitute a ground of justification for a restriction on the free movement of capital in view of the fact that Paragraphs 186 and 188 of the InvFG 2011 seek to ensure that neither a domestic mutual fund nor a foreign mutual fund can produce a tax shielding effect vis-à-vis the unit-holders and that, consequently, relief from income tax is to be provided only at the level of the unit-holders in those cases in which Austria has waived its taxing right under the terms of a double taxation agreement?

Provisions of European Union law

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 (UCITS), Article 63 TFEU.

National legislation cited

Paragraphs 2, 3, 46, 186 and 188 of the Investmentfondsgesetz 2011 (Law on Investment Funds 2011, 'the InvFG 2011'), in the version published in the BGBl.

I No 77/2011, Paragraph 93 of the Einkommensteuergesetz (Law on Income Tax, 'the EStG'), Paragraph 21 of the Körperschaftssteuergesetz 1988 (Law on Corporation Tax 1988, 'the KStG 1988')

Paragraph 186 of the InvFG 2011 states: '(1) The distributed profits from income … after deduction of the related expenses of an investment fund form part of the taxable income of the unit-holders. …'

Paragraph 188 of the InvFG 2011 states: 'The provisions of Paragraph 186 are also applicable to foreign investment funds. Foreign investment funds shall be deemed to mean any assets, irrespective of their legal form, that are subject to foreign law and are invested, pursuant to legislation, articles of association or actual practice, in accordance with the principles of risk spreading. …'

Paragraph 21(1)(1a) of the KStG 1988 states:

'1a. Limited taxpayers who are resident in a Member State of the European Union or a State of the European Economic Area with which there is a comprehensive mutual assistance agreement with regard to administrative matters and enforcement shall, upon application, be refunded the income tax on the income received by them […], provided that the income tax cannot be offset in the State of residence pursuant to a double taxation agreement. The taxpayer must provide proof that the income tax cannot be offset in whole or in part.'

European Union case-law cited

Judgment of 10 April 2014, *Emerging Markets Series of DFA Investment Trust Company*, C-190/12, EU:C:2014:249

Judgment of 21 June 2018, *Fidelity Funds and Others*, C-480/16, EU:C:2018:480

Judgment of 20 September 2018, *EV*, C-685/16, EU:C:2018:743

Judgment of 4 October 2018, *European Commission* v *French Republic* (Advance payment for distributed dividends), C-416/17, EU:C:2018:811

Judgment of 7 April 2022, *Veronsaajien oikeudenvalvontayksikkö* (Tax exemption for investment funds constituted by contract), C-342/20, EU:C:2022:276

Brief summary of the facts and procedure

1 The interested party is an investment company established in the United States. It is known as a 'series' – that is to say a separate sub-fund – of a trust domiciled in the United States (Delaware). Under US law (Delaware Statutory Trust Act, 12 Del. C. ss. 3801 et seq.) a trust is regarded as a separate legal entity that can sue and be sued. According to US law, the trust is the civil-law owner of the sub-fund that is ascribed to the interested party, and that interested party is the beneficial

owner of the sub-fund. Under US law, each 'series' is regarded as a taxable corporation. All domestic and foreign income, including income from realised capital gains, is subject to taxation in the United States. Allocation of income to unit-holders in the United States is conditional upon a distribution; otherwise, it is allocated to the 'series' (no pass-through taxation). A tax advantage is available for 'series' in the United States: provided that they distribute at least 90% of the taxable income (excluding realised capital gains), they are entitled to claim deduction of that distribution for tax purposes. This can reduce the amount of US federal income tax that is payable to as low as zero. According to the findings of the Bundesfinanzgericht (Federal Finance Court, Austria), which are undisputed in that respect, the interested party made a full distribution for 2013, to the effect that no US federal income tax was payable.

2 The interested party is a freely tradable mutual fund that invests primarily in European listed shares and is subject to financial market supervision – according to a set of rules comparable to European and national supervisory law – in the State of domicile. Its fund management strategy follows the same principles and investment criteria as those of an investment fund of the same name authorised in Luxembourg. The activity corresponds in all material respects to a domestic investment fund and thus to an 'undertaking for collective investment in transferable securities' (UCITS) within the meaning of Directive 2009/65/EC.

3 Based on portfolio holdings in two listed, Austrian public limited companies, dividends amounting to EUR 387 679 were distributed to the interested party during the course of the 2013 calendar year. The distributing companies withheld the 25% income tax and paid it to the tax office. The withholding tax withheld in 2013 amounted to EUR 96 920.

4 At the request of the interested party, the tax office – acting on the basis of the double taxation agreement between the Republic of Austria and the United States of America – reduced the income tax to 15% and refunded the difference (EUR 38 768) vis-à-vis the income tax withheld at 25% to the interested party for its unit-holders resident in the United States. By submitting further applications – based on Paragraph 21(1)(la) of the KStG 1988 – the interested party requested, on its own behalf, the refund of the remaining withholding tax in respect of the same income for 2013 (EUR 58 152), such that the overall income tax would be reduced to zero.

5 The tax office rejected those applications on the grounds that the interested party was not domiciled in the EU/EEA area. By its decision of 3 October 2017, the Bundesfinanzgericht (Federal Finance Court) also refused to order a refund of the income tax.

6 In its judgment of 13 January 2021, the Verwaltungsgerichtshof (Supreme Administrative Court, Austria) annulled that decision on the ground that its content was unlawful because, for the purposes of examining whether an income tax refund is payable, it was first necessary to determine – by means of a type

comparison – whether the foreign entity is comparable to an Austrian corporation and then, in a second step, to examine the allocation of that income. If allocation of the income to the foreign entity is precluded solely by Paragraph 188 of the InvFG 2011, there is a restriction on the free movement of capital and the justification for that restriction must be examined. In the resumed proceedings, the Bundesfinanzgericht (Federal Finance Court) granted the interested party a refund of the income tax at issue. The appeal on a point of law brought by the Finanzamt für Großbetriebe is directed against that judgment.

Principal arguments of the parties in the main proceedings

7 The Finanzamt für Großbetriebe argues, in essence, that the type comparison should take into account the fact that the interested party is regarded as an investment fund also under the supervisory law of the interested party's home State. Within the EU, the interested party would be subject to approval under the UCITS Directive. Domestic entities that would be classified as investment funds under supervisory law and that correspond to a UCITS would, without exception, have been subject to transparent fund taxation in 2013. The same would have to apply in the case of a foreign entity that is also to be classified as an investment fund under foreign supervisory law and that corresponds to a UCITS. Even if comparability were to be assumed, the provision would be justified based on the needs for preservation of the balanced allocation of the power to impose taxes, to ensure the coherence of the tax system and to avoid abuses.

8 The interested party argues, in essence, that Paragraph 21(1)(la) of the KStG 1988 is – according to its wording – applicable only to limited taxpayers domiciled in a Member State of the EU or a State of the EEA, but that, taking into account the European Union case-law governing the free movement of capital under Article 63 TFEU, legal entities from third countries are also to be granted the opportunity to apply for a refund of any withholding taxes paid.

Brief summary of the basis for the reference

9 Under Paragraph 2(2) of the InvFG 2011, Austrian investment funds that are to be regarded as a UCITS could – for supervisory law purposes – be established only as special funds. According to Paragraph 46 of the InvFG 2011, that special fund was to be allocated to the respective unit-holders; the investment fund itself had no legal personality. Under Paragraph 186 of the InvFG 2011, a transparent fund taxation was mandatory for such types of UCITS. This means that the fund itself is not a taxable entity and the income is to be allocated to the unit-holders.

10 If an Austrian investment fund receives portfolio dividends from an investment in an Austrian corporation, the income is not allocated to the fund for tax purposes, but rather to the unit-holders. If the unit-holders are not resident in Austria, they are to receive a refund of the income tax in accordance with the terms of the double taxation agreement entered into with their State of residence.

11 Paragraph 188 of the InvFG 2011 provided that in the case of foreign investment funds, Paragraph 186 of the InvFG 2011 – that is to say the provision concerning transparent fund taxation – is always applicable, through allocation of the income to the unit-holders regardless of their legal form, if the assets subject to foreign law were invested – pursuant to legislation, articles of association or actual practice – in accordance with the principles of risk spreading. Thus, in the case of foreign companies investing their assets in accordance with the principles of risk spreading, Paragraph 186 was thus also applicable even if a type comparison revealed that those companies were comparable to a domestic legal entity.

12 By contrast, domestic companies that were organised as corporations were always assessed according to their legal form and taxed according to corporate tax legislation, even if the assets were invested – pursuant to legislation, articles of association or actual practice – in accordance with the principles of risk spreading.

13 Under Austrian supervisory law, the interested party would be classified as a UCITS and could have been established in Austria only in the form of a special fund co-owned by the unit-holders. A special fund of that type was always subject to transparent investment fund taxation, without exception.

14 The Verwaltungsgerichtshof (Supreme Administrative Court) seeks to ascertain whether a provision such as Paragraph 188 of the InvFG 2011, which, in the specific case of a UCITS or a foreign mutual fund that corresponds to a UCITS, serves to ensure equal tax treatment as between domestic and foreign investment funds, constitutes a restriction on the free movement of capital. This is because if the interested party had been operating as an Austrian investment fund, it would also have been unable to obtain an income tax set-off or a refund of the income tax. Hence, it would not be a more attractive option for a unit-holder to invest in domestic mutual funds instead of foreign mutual funds. In the opposite scenario: if application of Paragraph 188 of the InvFG 2011 is precluded by EU law even the case of a UCITS, this would make it more attractive to invest in a foreign mutual fund rather than a domestic mutual fund, because only the foreign fund would have a shielding effect.

15 From the outset, the Austrian investment fund taxation concept was closely linked to supervisory law, which did not permit establishment as a corporation, and aimed at ensuring transparent taxation at the level of the unit-holders in the case of domestic and foreign mutual funds. This is already clear from the common rules of supervisory law and tax legislation, as laid down in a single statute from 1963 onwards (Paragraph 23 of the Investmentfondsgesetz 1963 (Law on Investment Funds 1963, ‘the InvFG 1963’)). A separate regime for the taxation of domestic mutual funds was deemed unnecessary because the supervisory law provided only for transparent entities in the form of funds, and those funds could not therefore be a taxable entity.

16 That link is also apparent from the provisions of the Alternative Investmentfonds Manager-Gesetz (Law on Alternative Investment Fund Managers, ‘the AIFMG’),

which are not yet applicable for the purposes of the present case, and pursuant to which – in accordance with Directive 2011/61/EU, which has thus been transposed at the national level – certain types of public AIFs may also be established in Austria as corporations, which was not previously the case (for example, real estate investment funds). At the same time, the rules governing taxation of investment funds as laid down in Paragraphs 186 and 188 of the InvFG 2011 were amended in such a way that – even in Austria – it was thenceforth only a matter of determining whether the fund is classified as an investment fund (such as a UCITS or AIF) for supervisory law purposes, and hence the legal form is no longer relevant. For all forms of mutual funds, there is thus a continued guarantee that those funds – even if they now take the form of a domestic corporation – cannot produce a tax shielding effect and that the unit-holder is subject to transparent taxation. A tax rule for domestic mutual funds – comparable to that laid down in Paragraph 188 of the InvFG 2011 – became necessary only as a result of the supervisory law amendment introduced by the AIFMG.

17 Against that background, the Verwaltungsgerichtshof (Supreme Administrative Court) has doubts as to whether there is objective comparability between foreign mutual funds that substantively constitute a UCITS and corporations that, although investing their assets according to the principles of risk spreading, do not constitute a UCITS.

18 If the Court of Justice of the European Union were to hold that the situations were objectively comparable, it would be necessary, in the opinion of the Verwaltungsgerichtshof (Supreme Administrative Court), to examine whether a ground of justification existed for the restriction on the free movement of capital. In that respect, it would be necessary to examine, in particular, whether the ground of justification based on the preservation of the balanced allocation of the power to impose taxes could be applicable.

19 Under Austrian law, a domestic UCITS is not eligible for relief from income tax. Relief can only ever be granted at the level of the unit holders. The Austrian investment fund taxation concept thus ensures that investment income taxable under domestic tax law is relieved from income tax (by set-off or refund) only if and to the extent that the respective unit-holders are covered by a double taxation agreement (between Austria and their states of residence) granting a reduction of, or an exemption from, income tax. In the case of foreign investment funds that also equate to a UCITS, Paragraph 188 of the InvFG 2011 similarly ensures that unit-holders benefit from relief only in accordance with double taxation agreements entered into with the States of residence.

20 This is particularly relevant in the case of natural persons who, as unit-holders, are liable for taxation on their domestic investment income but who are, as a general rule, eligible only to receive a partial refund of their income tax under the terms of a double taxation agreement. If those unit-holders invest in a domestic fund, a refund is made only in accordance with a double taxation agreement. If a shielding effect of the interested party were to be allowed, the entire income tax amount

would be refunded to the fund and thus also, as a consequence thereof, to the unit-holders, irrespective of whether they were entitled to a refund under the terms of the double taxation treaty applicable to them.

21 Overall, the interpretation of EU law relating to these referred questions does not appear to be so obvious as to leave no scope for any reasonable doubt.