Tax Neutrality Treatment of Investment Funds in the European Union

9 July 2025

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Working paper | 2025-04

Volume 16 – Issue 3 – August 2024

World Tax Journal

IBFD

World Tax Journal

The World Tax Journal (WTJ) is a multidisciplinary platform for premium and ground-breaking academic research specialized in international, comparative and regional taxation. It is fully peer-reviewed and published four times a year.

ISSN 1878-4917 (print) / 2352-9237 (online) / © IBFD

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This article examines the legal consequences and assesses the economic impact of the differing tax treatment of investment funds in Portugal, Germany and Luxembourg before and after the *Allianzgi-Fonds* landmark decision, by the CJEU. Before the *Allianzgi-Fonds* decision the Portuguese investment taxation discriminated against foreign investments by levying a withholding tax on foreign compared to domestic investments. The *Allianzgi-Fonds* decision prohibited this discriminatory treatment. Therefore, our article examines whether the Portuguese CIT exemption extended to non-resident UCITS will lead to tax neutrality treatment of investment funds in the EU. Overall, we confirm that the abolishment of the discriminatory withholding tax can considerably reduce the effective tax levels for cross-border investments. Moreover, the abolishment also diminishes the domestic investment bias. Nonetheless, the results do not confirm the achievement of neutrality.

Contents

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1. Introduction

This article examines the legal consequences and assesses the economic impact of the differing tax treatment of investment funds in Portugal, Germany, and Luxembourg before and after the *Allianzgi-Fonds*[1] case decided by the Court of Justice of the European Union (CJEU or the Court) and concerning taxation of investment funds by a Member State of the European Union (EU). In *Allianzgi-Fonds* and in the absence of tax harmonization of investment funds, the CJEU examines the Portuguese tax regime after 2015 applied to resident and non-resident investment funds considering the free movement of capital.

The influence of the CJEU on direct tax matters in the EU has been the focus of the research on EU tax law since its first case in 1986 (the *Avoir Fiscal* case).[2] The CJEU has been examining the Member States' legislation in light of the fundamental freedoms in the Treaty on the Functioning of the European Union (TFEU) and deciding whether that legislation is discriminatory toward or restrictive of cross-border movements. In the event of discriminatory or restrictive measures and in the absence of valid justifications and proportionality of those measures, the CJEU will declare a Member State's legislation incompatible with the TFEU.

It is known that the role of the CJEU assumes greater relevance due to the (still) scarce harmonization in direct tax matters.[3] Judicial review of domestic direct taxes in light of fundamental freedoms also means that Member States find themselves in an uncertain situation because fundamental freedoms are principles, and principles are inherently vague. Legal uncertainty is only reduced when there is settled case law on specific types of regimes – e.g. cross-border losses, transfer pricing, or taxation of investment funds. For example, the CJEU decision in *Allianzgi-Fonds* goes in a different direction from the Advocate-General Opinion on the case,[4] illustrating the lack of legal certainty concerning taxation of investment funds. Even though the Court has developed a precedent system to a certain extent there is no *stare decisis*[5] and, in direct tax matters, it is often difficult to predict the decisions.

1. CJEU, 17 Mar. 2022, Case C-545/19, *Allianzgi-Fonds Aevn v. Autoridade Tributária e Aduaneira*, at para. 11, Case Law IBFD.
2. CJEU, 28 Jan. 1986, Case C-270/83, *Commission of the European Communities v. French Republic (Avoir Fiscal)*, Case Law IBFD. On the EU competences in direct taxation, *see*, among others: G. Bizioli, *Balancing the Fundamental Freedoms and Tax Sovereignty: Some Thoughts on Recent ECJ Case Law on Direct Taxation*, 48 Eur. Taxn. 3, pp. 133-140 (2008); A.P. Dourado, *No Taxation Without Representation in the European Union: Democracy, Patriotism and Taxes*, in *Principles of Law: Function, Status and Impact in EU Tax Law*, pp. 205-234 (C. Brokelind ed., IBFD 2014); G. Kofler, *EU Power to Tax: Competences in the Area of Direct Taxation*, in *Research Handbook on European Union Taxation Law*, p. 11 et seq. (C. Panayi, W. Haslehner & E. Traversa eds., Edward Elgar Publishing 2020).
3. F. Vanistendael, *The Functioning of Fundamental Freedoms and Tax Neutrality in the Internal Market*, in *Research Handbook on European Union Taxation Law* 160, p. 142 et seq. (C. Panayi, W. Haslehner & E. Traversa eds., Edward Elgar Publishing 2020).
4. Opinion of Advocate General Kokott, 6 May 2021, Case C-545/19, *Allianzgi-Fonds Aevn v. Autoridade Tributária e Aduaneira*, at para. 49, Case Law IBFD.
5. P. Craig & G. de Búrca, *EU Law, Text, Cases, and Materials*, 7th ed., pp. 522-529, 549 (Oxford University Press 2020); A.P. Dourado, *Is it Acte Clair? General Report on the Role Played by CILFIT in Direct Taxation*, in *The Acte Clair in EC Direct Tax Law*, pp. 25-28 (A.P. Dourado & R.P. Borges eds., IBFD 2008).

Notwithstanding the legal uncertainties resulting from the CJEU case law, it is important to recall that there is a multilateral effect of the CJEU decisions[6] because of the *acte clair* doctrine as designed by the Court in the *CILFIT* case.[7] This multilateral effect implies that a case examining one Member State's legislation regarding the fundamental freedoms and declaring it incompatible with the TFEU will not only require an amendment of that state's legislation but also an amendment of the other Member States' legislations with similar regimes.[8]

Additionally to the legal consequences of the case law that is based on a discriminatory or restrictive assessment between domestic and cross-border movements, we claim that it is important to verify whether the CJEU's decisions and the corresponding reactions by the Member States actually contribute to tax neutrality between domestic and cross-border investments at the whole EU level.

We address tax neutrality in the sense that taxes shall not distort the decisions of investors in the EU. Hence, we focus on an investment fund case, departing from the *Allianzgi-Fonds* decision[9] as a call for a critical scrutiny of the Court's methodology. Considering investment funds, neutrality depends not only on the effective tax level of the investment fund at the geographical source of the income (here: Portugal) but also on the effective tax level at the fund's location (here: Portugal, Germany or Luxembourg), as well as on the effective tax level falling at the unit holder level. Thus, our concept of tax neutrality compares a domestic situation (Portugal) and the interaction of two different domestic tax regulations (Portugal plus Germany; Portugal plus Luxembourg) and requires approximate effective tax levels.

As will be recalled in the next section, the Court has demonstrated awareness in its case law that interpretation of the non-discrimination principle might have undesired consequences in some cases, and has opted for self-restraint. We herein contend that the Court takes a similar self-restraint attitude in the case of taxation of investment funds, when distortions caused by unilateral legislation in investment decisions and judged by the Court will be replaced by new distortions to investment decisions after the Court's judgment.[10] It is known that some barriers to EU integration can only be truly overcome by positive integration.[11]

In general, there is doubt whether neutrality between domestic and cross-border investment in the internal market is achieved by the CJEU case law. On the one hand, the CJEU is not competent to determine how domestic law declared incompatible with the fundamental freedoms should be amended.[12] On the other hand, due to the inherent vagueness of the non-discrimination principle and the difficulty in achieving *acte clair* situations in direct tax matters, the Member States' adjustments are mostly heterogeneous and show varying levels of compliance.[13]

6. Dourado (2008), *supra* n. 5, at pp. 26-27; Craig & Búrca, *supra* n. 5, at p. 533.
7. CJEU, 6 Oct. 1982, Case C-283/81, *Srl CILFIT and Lanificio di Gavardo SpA v. Ministry of Health*, Case Law IBFD; Craig & Búrca, *supra* n. 5, at pp. 529-548.
8. Dourado (2008), *supra* n. 5, at p. 26 et seq.
9. *Allianzgi-Fonds Aevn v. Autoridade Tributária e Aduaneira* (Case C-545/19), *supra* n. 1.
10. As our model demonstrates, the German cross-border investment becomes more tax-beneficial compared to the domestic Portuguese investment.
11. Craig & Búrca, *supra* n. 5, at pp. 664, 671-672.
12. Craig & Búrca, *supra* n. 5, at pp. 527-529.
13. C. Spengel, L. Fischer & K. Stutzenberger, *Breaking Borders? The European Court of Justice and Internal Market*, ZEW – Centre for European Economic Research Discussion Paper No. 20-059. p. 3 (2020).

Accordingly, previous research on landmark decisions has shown that the CJEU decisions have not reduced tax distortions, tax neutrality in the EU has not been achieved, and cross-border investment continues to be discriminated against domestic investments in some Member States.[14] More than that, different country-specific outcomes in terms of effective average tax rate (EATR) across Member States might even increase divergences in tax levels and hence tax distortions to investment location decisions in the EU.[15] Therefore, previous research has also concluded that a comprehensive harmonization of Member States' tax rules by means of directives (positive integration) seems necessary to implement an internal market without tax distortions to investment.[16]

The effective tax levels assessment of this article is based on the Devereux/Griffith methodology.[17] We incorporate the *Allianzgi-Fonds*[18] case in the model whereas some slight adjustments have been made due to inherent methodological limitations.[19] We then compare the Portuguese tax regime applicable to non-resident investment funds before and after the *Allianzgi-Fonds* case with the tax regime applicable by Germany (a high tax jurisdiction[20]) to its resident investment funds with assets in Portugal and the tax regime applicable by Luxembourg to its resident investment funds with assets in Portugal. We adopted Luxembourg as a low tax jurisdiction because it is recognized an attractive one due to its regulatory and tax frameworks.[21] The tax regime applicable by Portugal, Germany, and Luxembourg to resident unit holders is also compared.

The article is structured as follows: section 2. claims that the Court's self-restraint is legitimate. In section 3., collective investment undertakings (investment funds) will be defined, and the broad aspects of their EU harmonized regime will be described. Section 4. focuses on the specific tax neutrality issues concerning investment funds. Section 5. describes the taxation of investment funds and investors in investment funds in a domestic and cross-border setting regarding cross-border and EU scenarios. Section 5.1. will describe the tax treatment of collective investments undertakings and investors in Portugal before and after 2015. In section 5.2., the *Allianzgi-Fonds* case will be examined. Hence, in section 6., the main key tax figures of the investment funds in two Member States, Germany and Luxembourg, will be presented. In section 7., the effective tax levels and the underlying methodology are explained. Section 8. concludes.

14. Spengel, Fischer & Stutzenberger, *supra* n. 13, at p. 3.
15. Id.
16. Id.
17. M.P. Devereux & R. Griffith, *The Taxation of Discrete Investment Choices*, Institute for Fiscal Studies (IFS) Working paper Series no. W98/16 (1999); M.P. Devereux & R. Griffith, *Evaluating tax policy for location decisions*, 10 International Tax and Public Finance, pp. 107–126 (2003).
18. *Allianzgi-Fonds Aevn v. Autoridade Tributária e Aduaneira* (Case C-545/19), *supra* n. 1.
19. For example, we always assume investment funds investing in Portuguese assets.
20. Moreover, Germany is directly related to the *Allianzgi-Fonds* case.
21. *See*, for example, J. Fisch, P. Goebel & F. Trouiller, *Luxembourg – Investment Funds & Private Equity* p. 6, Country Tax Guides (accessed 23 May 2022).

2. The Fundamental Freedoms as Interpreted by the Court of Justice: Why the Court's Self-Restraint Is Legitimate

Fundamental freedoms in the TFEU are necessary and instrumental for creating the internal market, are not an end as such,[22] and taxes can be an obstacle to them. Regarding direct taxation, the Court of Justice interprets the fundamental freedoms comparing the treatment granted by a Member State to a domestic situation with the treatment granted to a cross-border situation. Less favourable treatment of non-residents (also called inbound situations) is held to be discriminatory treatment unless the Court accepts the justifications put forward by the Member State that are normally based on the rule of reason (allocation of taxing rights or territoriality, abuse, risk of tax evasion, among others).[23] Besides, discriminatory rules need to be proportionate even if they are justified according to the Court's view.[24] Among others, abuse is accepted as a justification for discriminatory tax measures but only as long as the Member States' law does not contain an irrebuttable presumption of abuse.[25] An example of discriminatory treatment is the one examined in this article – the *Allianzgi-Fonds* case – according to which domestic investment funds are exempt from corporate income tax (and instead submitted to a stamp duty tax) whereas foreign investment funds are submitted to a withholding tax. Moreover, obstacles to investment abroad (outbound situations) are prohibited restrictions in light of the fundamental freedoms unless, again, a justification is accepted by the Court. A typical example of a restriction was the UK legislation examined in the *Marks & Spencer* case.[26]

This approach of dealing with the fundamental freedoms has been characterized as classic, essentially negative, and deregulatory and is one of the instruments used to achieve the internal market.[27]

Along the years, clusters of cases have led to more or less settled jurisprudence on personal and family benefits,[28] business expenses,[29] international juridical double taxation,[30] economic double taxation,[31] permanent establishment,[32] cross-border dividends,[33]

22. Claiming that the Court is not interpreting the non-discrimination principle and the fundamental freedoms consistently which results "in the impossibility of achieving a consistent competitive neutrality for the internal market": F. Vanistendael, *The Functioning of Fundamental Freedoms and Tax Neutrality in the Internal Market*, in *Research Handbook on European Union Taxation Law* (C. Panayi, W. Haslehner & E. Traversa eds., Edward Elgar Publishing 2020), pp. 142-149, 153-154, 155-160. On the fundamental freedoms as instrumental to the internal market, *see also* I. Lazarov, *The Relevance of the Fundamental Freedoms for Direct Taxation*, in *Introduction to European Tax Law on Direct taxation*, 7th ed., p. 66 et seq. (M. Lang et al. eds., Linde 2018).
23. I. Lazarov, *supra* n. 22, at pp. 66-68.
24. Id., at pp. 102-105.
25. Id., at p. 105; CJEU, 12 Sep. 2006, Case C-196/04, *Cadbury Schweppes*, at paras. 57-72, Case Law IBFD; CJEU, 3 Oct. 2013, Case 282/12, *Itelcar*, at paras. 37-38, Case Law IBFD.
26. CJEU, 13 Dec. 2005, Case C-446/03, *Marks & Spencer*, Case Law IBFD.
27. Again, Craig & Búrca, *supra* n. 5, at p. 664.
28. For example: CJEU, 12 Dec. 2002, Case C-385/00, *de Groot*, Case Law IBFD; CJEU, 14 Feb. 1995, Case C-279/93, *Schumacker*, Case Law IBFD; CJEU, 9 Feb. 2017, Case C-283/15, *X.*, Case Law IBFD.
29. For example: CJEU, 12 Jun. 2003, Case C-234/01, *Gerritse*, Case Law IBFD; CJEU, 13 Jul. 2016, Case C-18/15, *Brisal*, Case Law IBFD.
30. CJEU, 12 May 1998, Case C-336/96, *Gilly*, Case Law IBFD; CJEU, 14 Nov. 2006, Case C-513/04, *Kerckhaert-Morres*, Case Law IBFD; CJEU, 12 Feb. 2009, Case C-67/08, *Block*, Case Law IBFD.
31. Among many others: CJEU, 7 Sep. 2004, Case C-319/02, *Manninen*, Case Law IBFD.
32. CJEU, 28 Jan. 1986, Case C-270/83, *Commission of the European Communities v. French Republic (Avoir Fiscal)*, Case Law IBFD; CJEU, 21 Sep. 1999, Case C-307/97, *Saint-Gobain*, Case Law IBFD.
33. Inbound (among others): CJEU, 7 Sep. 2004, Case C-319/02, *Manninen*, Case Law IBFD; CJEU, 15 Jul. 2004, Case C-315/02, *Lenz*, Case Law IBFD; Outbound (among others): CJEU, 14 Dec. 2006, Case

foreign losses,[34] exit taxes,[35] horizontal discrimination,[36] third states,[37] abuse,[38] among others.

The Court has broad discretion in interpreting the fundamental freedoms laid down in the TFEU and their reference to the prohibition of restrictions or discriminatory treatment based on nationality. Such discretion is inherent to the vagueness of those rules and the Court's competence.[39] It is also a consequence of scarce harmonization in direct taxes.[40]

In the context of that discretion, the Court settled some limits to its own assessment of Member States' legislation in light of EU Law. One example are ordinary tax credits granted by residence states to reduce international juridical double taxation instead of full credits.[41] It is difficult to deny that ordinary credits to deal with international juridical double taxation, instead of full credits, are restrictions to the exercise of a fundamental freedom. Another example of restrictions are the favourable regimes granted bilaterally by tax treaties and not extended to all Member States.[42] Yet, none of the two examples was declared discriminatory or restrictive in light of the fundamental freedoms. They were instead explained as distortions caused by the interaction of legislations enacted by different Member States (or one Member State and a third country), and they constitute two cases of self-restraint by the Court. Moreover, the Court has accepted (the internal market) cohesion as a relevant justification (among others) for discriminatory or restrictive tax treatment. For example, discriminatory withholding tax in the source state of outbound dividends can be justified if the residence state grants a full credit under a bilateral tax treaty.[43]

The mentioned examples illustrate the Court's awareness that its interpretation of the fundamental freedoms based on concepts of discrimination and restriction would have (undesirable) consequences. If it had ruled otherwise in the case of international juridical double taxation, it would have favoured the position of the source state by requiring the residence

C-170/05, *Denkavit France*, Case Law IBFD; CJEU, 3 Jun. 2010, Case C-487/08, *Comm v. Spain*, Case Law IBFD; CJEU, 10 Feb. 2011, Joined Cases C-436/08 and C-437/08, *Haribo and Salinen*, Case Law IBFD.

34. Among others: CJEU, 15 May 1997, Case C-250/95, *Futura*, Case Law IBFD; CJEU, 13 Dec. 2005, Case C-446/03, *Marks & Spencer*, Case Law IBFD; CJEU, 18 Jul. 2007, Case C-231/05, *Oy AA*, Case Law IBFD; CJEU, 17 Dec. 2015, Case C-388/14, *Timac Agro*, Case Law IBFD; CJEU, 12 Jun. 2018, Case C-650/16, *Bevola*, Case Law IBFD; CJEU, 22 Sep. 2022, Case C-538/20, *W.*, Case Law IBFD.
35. Among others: CJEU, 11 Mar. 2004, Case C-9/02, *De Lasteyrie*, Case Law IBFD; CJEU, 29 Nov. 2011, Case C-371/10, *National Grid Indus*, Case Law IBFD; CJEU, 23 Feb. 2006, Case C-513/03, *Van Hilten*, Case Law IBFD.
36. Among others: CJEU, 5 Nov. 2022, Joined cases C-466/98, C-467/98, C-468/98, C-469/98, C-471/98, C-472/98, C-475/98 and C-476/98, *Open Skies*, Case Law IBFD; CJEU, 5 Jul. 2005, Case C-376/03, *D.*, Case Law IBFD.
37. Among many others: CJEU, 24 May 2007, Case C-157/05, *Holböck*, Case Law IBFD; CJEU, 18 Dec. 2007, Case C-101/05, *A.*, Case Law IBFD; CJEU, 13 Nov. 2012, Case C-35/11, *FII GLO II*, Case Law IBFD.
38. Among many others: CJEU, 21 Feb. 2006, Case C-255/02, *Halifax*, Case Law IBFD; CJEU, 12 Sep. 2006, Case C-196/04, *Cadbury Schweppes*, Case Law IBFD; CJEU, 5 Jul. 2007, Case C-321/05, *Kofoed*, Case Law IBFD; CJEU, 11 Nov. 2011, Case C-126/10, *Foggia*, Case Law IBFD; CJEU, 26 Feb. 2019, Joined Cases C-116/16 et al., *T Danmark (Danish beneficial ownership)*, Case Law IBFD.
39. On the competence of courts: H.L.A. Hart, *The Concept of Law* ch. 7 (Oxford university Press 1961); A.P. Dourado, *General Report – In Search of Validity in Tax Law: The Boundaries between Creation and Application in a Rule-of-Law State*, in *Separation of Powers in Tax Law*, pp. 47-49 (A.P. Dourado ed., IBFD 2010).
40. On the EU competences to harmonize direct taxes, *see*: Kofler, *supra* n. 2, at pp. 11-34.
41. CJEU, 12 May 1998, Case C-336/96, *Gilly*, Case Law IBFD; CJEU, 14 Nov. 2006, Case C-513/04, *Kerckhaert-Morres*, Case Law IBFD; CJEU, 12 Feb. 2009, Case C-67/08, *Block*, Case Law IBFD.
42. CJEU, 5 Jul. 2005, Case C-376/03, *D.*, Case Law IBFD.
43. CJEU, 3 Jun. 2010, Case C-487/08, *Comm v. Spain*, Case Law IBFD.

state to grant a full credit on the basis of higher tax rates in the source state, while the latter would keep its revenue. If, on the other hand, a most-favoured nation clause were to be applied to bilateral tax treaties, the Court's decision would encourage tax planning and tax competition. In the case of withholding taxes on dividends, simply prohibiting them would interfere with the allocation of taxing rights under bilateral tax treaties. The examples previously mentioned remind us that a court's function is limited to interpreting the law in light of specific facts.[44] Due to the inherent limitation of the CJEU's function, interpretation of the fundamental freedoms can only ensure that certain obstacles to the internal market are removed and cannot lead to full accomplishment of the internal market.[45] We do not suggest that the CJEU's task is to fully accomplish the internal market with its jurisprudence even if the fundamental freedoms were drafted as they were as vague norms.

Conversely, it can be argued that the Court should be mindful of its limited remit in relation to potential legislative action and should be reluctant to declare a Member State's legislation contrary to the fundamental freedoms unless it is certain that there is no risk of new distortions.

For the purposes of this article, we want to stress that self-restraint by the Court is legitimate as it expresses weighing principles and consequences. It also acknowledges that the Court's decisions are not always capable of replacing legislative action, which is known as positive integration.[46] On the basis of such premises, we suggest a critical scrutiny of the *Allianzgi-Fonds* decision.[47]

3. Investment Funds in the EU

Investment funds can assume the form of contractual arrangements, companies, partnerships, trusts, among others. They can invest in tangible or intangible property and on synthetic investments (e.g. combinations of derivatives, structured products, hybrid instruments).[48] The legal term for investment funds is collective investment undertakings, where the latter are used for collective investment management in financial instruments[49] such as transferable securities and money market[50] instruments.[51] There is a variety of investment funds' regulatory definitions and classifications[52] adopted by the Member States.

44. A more extreme position against judicial revision when democratic institutions and culture are in force can be found in: J. Waldron, *The Core of the Case Against Judicial Review,* 115 The Yale Law Journal 6, pp. 1346-1406 (2006). *See also*, claiming that decisions on individual rights should belong to the parliaments: J. Waldron, *Law and Disagreement*, pp. 10-17, 211-312 (Oxford University Press, 1999).
45. Even if interpretive functions are not equivalent to a literal reading of legal sources and such literal reading will not always yield answers to all legal questions: L. Murphy, *What Makes Law, An Introduction to the Philosophy of Law*, p. 11, and fn. 4 (Cambridge University Press, 2014).
46. Craig & Búrca, *supra* n. 5, at pp. 605-606.
47. For different approaches on the CJEU case law on investment funds and discriminatory tax treatment, see, among others: Moritz Scherleitner, *The Fundamental Freedoms and the Taxation of Dividends Received by Non-resident Investment Funds: Some Thoughts on Non-discrimination with a Special Focus on Recent ECJ Case Law,* 50 Intertax 6-7, pp. 484-498 (2022).
48. S. Hwang & O. Weidmann, *General Report*, in *Investment Funds,* IFA Cahiers 104B, p. 14 (IFA 2019).
49. P. Câmara, *Manual de Direito dos Valores Mobiliários*, 4th ed., p. 875 (Almedina 2018).
50. Admitted to or dealt in on a regulated market or admitted to official listing on a stock exchange.
51. Art. 50 of Directive 2009/65/EC of 13 Jul. 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS), OJ L 302, 17 Mar. 2009.
52. *See*, in respect of concepts and classifications adopted by the countries, Hwang & Weidmann, *supra* n. 48, at pp. 14-17 (5-61).

The aforementioned diversity and the different Member States regulation of investment funds encouraged the adoption of EU Directives, providing common minimum rules for certain investment undertakings established in the EU.[53] Among the various directives approved over the years, the most important[54] are the Undertakings for Collective Investment in Transferable Securities (UCITS) Directive;[55] and the Directive on Alternative Investment Fund Managers (AIFM).[56] The two Directives allow the grant of a single authorization valid throughout the EU via mutual recognition of authorization and of prudential supervision systems and the application of the principle of home Member State supervision.[57] Both Directives aim at achieving a proper functioning of the EU internal market, and especially: to eliminate obstacles to the activity of the collective investment undertakings and the free movement of unit holdings; to provide conditions of competition among undertakings and to increase the investors' protection; to contribute to the stability of the financial system and to provide common basic rules for the authorization, supervision and structure of UCITS.[58]

The UCITS and AIF Directive, as well as domestic laws adopt criteria that allow to identify several categories of collective investment undertakings, such as mutual funds, exchange-traded funds (ETFs), hedge funds, private equity funds, and real estate funds.[59]

4. Specific Tax Neutrality Issues Concerning Investment Funds

We assume that taxes can be obstacles to the activity of collective investment undertakings and the free movement of unit holdings. We further assume that taxes can distort conditions of competition among undertakings. As demonstrated in this and the next sections, the results meant to be achieved by EU harmonization of investment funds face obstacles when the Member States' not harmonized tax regimes (falling on investment funds and their investors) are examined.[60]

For tax purposes, investment funds can be treated as transparent (a pass-through entity), partially transparent (tax deductions being allowed upon distribution of income), or opaque (taxed on its own).[61] The interposition of an investment fund, between the investor and the assets, raises specific neutrality issues, in comparison to an investment in assets without

53. Hwang & Weidmann, *supra* n. 48, at pp. 15-16.
54. Id., at pp. 15-17.
55. Directive 2009/65/EC of 13 Jul. 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS), OJ L 302, 17 Mar. 2009, at pp. 32-96.
56. Directive 2011/61/EU of 8 Jun. 2011 on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) no. 1060/2009 and (EU) no. 1095/2010, OJ L 174, 1 Jul. 2011, at pp. 1-73.
57. Directive 2009/65/EC of 13 Jul. 2009 (UCITS), Preamble, no. 8, p. 33; Directive 2011/61/EU of 8 Jun. 2011 on Alternative Investment Fund cit, e.g.: Preamble, nos. 34, 35, 21, at pp. 4-5.
58. Preamble of Directive 2009/65/EC of 13 Jul. 2009 (UCITS), (3)-(5), (8).
59. *See*, in this respect, Hwang & Weidmann, *supra* n. 48, at pp. 27-43. *See also* the classification of open-ended (when there is a variable number of units) and closed-ended (fixed number of units) in Câmara, *supra* n. 49, at p. 880.
60. For the purposes of simplification of the neutrality analysis, application of bilateral tax treaties will not be taken into account, as it would not change the results achieved. Since tax treaties do not always apply, neutrality or its absence can be assessed in light of the combination of domestic laws.
61. Hwang & Weidmann, *supra* n. 48, at p. 10. On taxation of investment funds in EU Member States, *see*, e.g.: Moritz Scherleitner, *Veronsaajien Oikeudenvalvontayksikkö C-480/19: A Remarkable Case*, 50 Intertax 4, pp. 367-369 (2022).

the interposition of another entity.[62] In fact, if the fund and the investor are both subject to tax, economic double taxation occurs, and a direct investment in the assets can receive a more advantageous tax treatment. In contrast, if either the fund or the investor are taxed, domestic neutrality between an investment in an investment fund and a direct investment in assets might be achieved, depending on the tax base and rates.

However, cross-border neutrality will be difficult to achieve, because taxation of investment funds and their investors is carried out by each source or residence jurisdiction, with no international or EU tax coordination, and economic double taxation might occur when source and residence countries are considered together. This is so, even if a Member State taxes domestic and the cross-border situations in the same manner.[63]

It results from the above, that cross-border double taxation of investment funds and unit holders is an obstacle to the internal market. Besides, a neutral treatment of investment funds vis-à-vis a direct investment in the assets would imply that the CJEU checks the final burden borne by the investment funds and the unit holders in all involved jurisdictions. Such a global (cohesion) assessment is not required by free movement of capital, under Article 63 of the TFEU, and the Court has not engaged in that cohesion assessment.

This cautious jurisprudence can be justified, because investment funds are typically located in specific jurisdictions with overall attracting conditions, including favourable tax regimes.[64] Moreover, investment funds invest in assets located elsewhere, and the jurisdictions where to invest are chosen according to the anticipated investment assets return. Investors in a specific investment fund will, in turn, be resident in multiple jurisdictions. Therefore, a three-fold investment relationship with tax implications occurs frequently. In fact, several possible combinations exist, resulting from the fact that: some jurisdictions tax fully, partially, or exempt the distribution of income (e.g. dividends, interest, capital gains) to the investment fund; others tax fully, partially or exempt the investment fund; others tax fully, partially or exempt the unit holders.[65] In sum, the absence of coordination and harmonization will often either lead to economic double taxation, or to double non-taxation of the investment funds and their investors, in a cross-border scale.

The hypothetical cases described below illustrate the lack of cross-border neutrality and the challenges raised by taxation of investment funds. Case 1 corresponds to the *Allianz-Gi Fonds* case described in section 5.2., before the CJEU decision, and case 2 describes the potential outcome of the *Allianz-Gi Fonds* decision.

Case 1

We assume that state 1 aims at taxing the resident unit holders rather than the investment funds. This is allegedly so, in order to attract investment from investment funds. Hence, state 1 exempts domestic funds. However, it taxes non-resident funds. It justifies the different treatment of resident and non-resident funds, claiming that the latter will receive a credit in their residence state (e.g. state 2) under its bilateral tax treaties, to eliminate international juridical double taxation; it further contends that the unit holders will either be exempt or probably receive a credit in their residence state in order to eliminate economic double taxation. Alternatively, state 1 does not put forward justifications concerning economic double taxation, because it is not responsible for it. In taxing non-resident investment funds, state 1 does not differentiate between those jurisdictions with which it exchanges information following the OECD standard, and the other jurisdictions.

62. Id., at p. 17.
63. Id., at pp. 10-13, 24, 27.
64. Id.
65. Hwang & Weidmann, *supra* n. 48, at p. 18.

However, if the unit holders of the non-resident investment fund are resident in state 1, economic double taxation would occur. If state 2 taxes the fund and does not grant a credit, international juridical double taxation would add to economic double taxation.

Case 2

In the second case, state 1 aims at taxing the resident unit holders rather than (any) investment funds, to attract investment from domestic and foreign investment funds. Hence, resident and non-resident investment funds are exempt from tax on their income. However, such regime does not guarantee that the investment fund in state 2 is taxed or that non-resident unit holders (in state 3, for example) are taxed. If neither state 2 nor state 3 taxed the income, there would be international double non-taxation, and neutrality would not be achieved, because state 1 would tax their resident unit holders.

Case 2 illustrates that the case law by the CJEU is neither enough to eliminate obstacles to the activity of the funds, nor to the free movement of unit holdings, and to provide conditions of competition among undertakings. Achieving such objectives in the internal market would also require EU tax harmonization to prevent international double taxation, double non-taxation, as well as discriminatory economic double taxation.

5. Tax Treatment of Collective Investments Undertakings and Investors in Portugal

5.1. Tax treatment since 2015

Under the Portuguese tax regime, resident UCITS are corporate income tax (CIT) subjects since 2015. However, they benefit from a broad income tax exemption on investment income (including dividends), real estate income and capital gains,[66] and no withholding (income) tax is applicable on received dividends. According to the legislator, the former regime, which was applicable before 2015, reduced the competitiveness of Portuguese UCITS.[67] Under the former regime income was taxed at the funds level, and the non-resident unit holder was exempt. Hence, the latter was not able to recover the tax paid on the dividends in its residence country. In case the investor was subject to tax in the residence state, economic double taxation occurred. We summarize the core characteristics of the new regime in Table 1.

The new tax regime was meant to shift taxation to the investors' level, upon income realization (i.e. distribution, redemption or sale of units). This has been characterized as an "exit taxation" model. Nevertheless, resident UCITS are subject to a quarterly stamp duty on their total net asset value at a rate of 0.0125%.[68] In turn, non-resident UCITS are subject to CIT on investment income. Dividends distributed by Portuguese corporations are withheld at a tax rate of 25%.[69] Non-resident UCITS are not subject to stamp duty. Moreover, although the CIT code provides for a participation exemption regime, it is not applicable to foreign transparent entities.

The tax treatment of unit holders of Portuguese UCITS varies according to the residence of the unit holders. Among resident unit holders, income from individuals is submitted to

66. Art. 22, para. 10 Tax Benefits Code: Decree-Law no. 7/2015, 13 Jan. 2015, available at: https://www.pgdlisboa.pt/leis/lei_mostra_articulado.php?nid=2258&tabela=leis&so_miolo=S.
67. Preamble of Decree-Law no. 7/2015, 13 Jan. 2015, available at: https://www.pgdlisboa.pt/leis/lei_mostra_articulado.php?nid=2258&tabela=leis&so_miolo=S.
68. Art. 5 Tax Benefits Code; no. 29 Stamp Duty General Tax Rates, available at: https://info.portaldasfinancas.gov.pt/pt/informacao_fiscal/codigos_tributarios/selo/Pages/ccod-selo-tabgiselo.aspx.
69. Art. 87, para. 4 Corporate Income Tax Code, available at: https://info.portaldasfinancas.gov.pt/pt/informacao_fiscal/codigos_tributarios/CIRC_2R/Pages/circ-codigo-do-irc-indice.aspx.

a final withholding tax of 28%, unless the income derives from business activity.[70] In the latter case, they will be included in the tax base of the business activity income and taxed at a rate of 21%.

Income from resident CIT payers is submitted to an advance payment tax of 25%. However, the 25% becomes a final tax, in the case of taxpayers benefiting from corporate income tax exemption, excluding capital income.[71] In turn, non-resident unit holders of movable assets investment funds are exempt from income tax.[72] Non-resident unit holders of real estate investment funds are submitted to a final withholding tax of 10%.[73]

Table 1. Portuguese tax regimes on investment funds and unit holders as of 2015

<table>
<tr><th>Dividends distributed by Portuguese corporations to investment funds</th><th>Taxation of investment funds</th><th>Taxation of unit holders</th></tr>
<tr><td rowspan="2">Residents:
– no withholding tax applicable</td><td rowspan="2">Residents:
– subject to CIT but exempt on investment income (dividends, real state income and capital gains)
– subject to a quarterly stamp duty on total net asset value at a rate of 0.0125%</td><td>Residents:
– individuals:
– subject to a final 28% withholding tax
– in the case of business activity, included in the tax base and submitted to a tax rate of 21%
– corporate taxpayer:
– advance payment tax of 25%</td></tr>
<tr><td>Non-residents:
– exempt from income tax</td></tr>
<tr><td>Non-residents:
– submitted to a final 25% withholding tax</td><td></td><td></td></tr>
<tr><td colspan="3">Notes: This table summarizes the Portuguese tax regimes on investment funds and unit holders as of 2015 referred to the CJEU and assessed in the Allianzgi-Fonds case. Resident investment funds are not subject to withholding tax, but there are taxation rules under the Portuguese regime applicable to the investment fund itself and its unit holders, depending on whether the latter are resident or non-resident. On the other hand, in the case of non-resident investment funds, the Portuguese regime establishes the application of a withholding tax.
Source: Own illustration.</td></tr>
</table>

5.2. Assessment under the Allianzgi-Fonds *case*

5.2.1. Facts of the case

As mentioned above, the landmark case to be examined in this article is the *Allianzgi-Fonds*. According to the facts of the case, Allianzgi-Fonds is a German undertaking for collective investment in transferable securities (UCITS),[74] which in 2015 and 2016 owned shares in several Portuguese resident corporations that distributed dividends.[75] Dividends paid to Allianzgi-Fonds were subject to withholding tax at 25% under Portuguese CIT.[76]

70. Art. 22-A, para. 1 a), i), and b) Tax Benefits Code.
71. Art. 22-A, para. 1 a), ii) Tax Benefits Code.
72. Art. 22-A, para. 1 d) Tax Benefits Code.
73. Art. 22-A, para. 1 c) Tax Benefits Code.
74. *Allianzgi-Fonds Aevn v. Autoridade Tributária e Aduaneira* (Case C-545/19), *supra* n. 1, at para. 11.
75. Id., at para. 13.
76. Id.

Allianzgi-Fonds had no permanent establishment in the Portuguese territory.[77] In 2015, a partial refund was obtained by applying the Portuguese-German tax treaty and its 15% withholding tax rate.[78]

Allianzgi-Fonds is a tax transparent entity in Germany, which implies that the Portuguese participation exemption on dividends extended to foreign entities is not applicable.[79] This is so, because, according to Article 14(3) of the Portuguese CIT Code, exemption from CIT in the source state (Portugal) only benefits foreign investors taking the legal form of a corporation (and as long as the foreign investor has a minimum holding of 10% in the capital of the resident entity). An exception to this exemption exists, if the payments are taxed in the EU or European Economic Area (EEA) Member State of residence at a rate less than 60% of the corporation tax rate applicable in Portugal (Article 14(3)(b) CITC).

Because of the different treatment granted to resident and non-resident UCITS, the Portuguese tax arbitration court referred the case to the CJEU on 9 July 2019.[80] The CJEU decision was made public on 17 March 2022.[81]

5.2.2. The Advocate General Opinion and the CJEU's reasoning

In her opinion, the Advocate General suggested that the stamp duty tax is a taxation technique, and not substantially different from the Portuguese CIT,[82] and that there are justifications for the different treatment of resident and non-resident UCITS. She broadly follows the *PMT* case.[83] First, the referring court would need to determine whether the quarterly stamp duty represented a comparable tax burden of 15% of the burden on the dividends paid to the applicant.[84] Exemption of CIT in the case of resident UCITS would be justified by the purpose of taxing the unit holders (exit taxation).[85]

According to the Advocate General, resident UCITS are not necessarily treated more favourably, because a resident UCITS needs to pay tax on its entire capital stock on a quarterly basis, reducing the return of the investors of that UCITS. Moreover, in the years in which a resident UCITS does not distribute dividends, its tax treatment would be disadvantageous in comparison to a non-resident UCITS.[86]

The CJEU builds on the argumentation of the *Fidelity Funds*[87] case. Concerning the applicable freedom, the CJEU held that free movement of capital was at stake, and that the Portuguese regime led to a less favourable treatment of dividends paid to non-resident

77. Id., at para. 11.
78. Id., at para. 14.
79. Id., at paras. 12 and 47.
80. Id., at paras. 11-16.
81. *Allianzgi-Fonds Aevn v. Autoridade Tributária e Aduaneira* (Case C-545/19), *supra* n. 1.
82. AG Opinion in *Allianzgi-Fonds Aevn v. Autoridade Tributária e Aduaneira* (Case C-545/19), *supra* n. 4, at para. 49. This conclusion is similar to the Finnish regime examined under the *PMT* case CJEU, 2 Jun. 2016, Case C-252/14, *Pensioenfonds Metaal en Techniek v. Skatteverket*, paras. 22, 32, 43, 60, 64, Case Law IBFD.
83. *Pensioenfonds Metaal en Techniek v. Skatteverket* (Case C-252/14), *supra* n. 82.
84. AG Opinion in *Allianzgi-Fonds Aevn v. Autoridade Tributária e Aduaneira* (Case C-545/19), *supra* n. 4, at para. 60.
85. Id., at para. 81.
86. Id., at para. 50.
87. CJEU, 21 Jun. 2018, Case C-480/16, *Fidelity Funds, Fidelity Investment Funds, Fidelity Institutional Funds v. Skatteministeriet*, Case Law IBFD.

UCITS, which may dissuade them from investing in Portugal. Moreover, the Portuguese regime might as well dissuade the investors resident in Portugal from acquiring units in non-resident UCITS.[88]

In contrast to the Advocate General and the *PMT* case, the CJEU argued that the Portuguese legislation does not amount to a different taxation technique falling on residents and non-residents, but on systematic income taxation falling exclusively on non-residents. Also different from the *PMT* case, the immediate distribution of income prevents application of the stamp duty tax on residents: only accumulated capital income is taxed under the stamp duty.[89]

For the purposes of the comparability analysis, the CJEU examines whether taxation of the unit holders is relevant. Because it is the exercise of its tax competence by a Member State that creates the risk of taxation in chain, resident and non-resident UCITS become comparable. Thus, the residence Member State of the distributing company is responsible to avoid the risk of double taxation/taxation in chain.

It seems that the Portuguese legislation could be made compatible with the TFEU, if the exemption of withholding tax concerning resident UCITS is submitted to the condition of redistribution by the UCITS and taxation of the unit holders.[90] However, if the exemption is extended to non-resident UCITS, it is clear that no discriminatory treatment would exist in light of the TFEU. As a result of the *Allianzgi-Fonds* landmark case, our article examines whether the Portuguese CIT-exemption extended to non-resident UCITS will lead to tax neutrality treatment of investment funds in the EU, whenever non-resident UCITS invest in assets in the Portuguese territory. This analysis is pursued by examining the UCITS tax regimes in Germany and Luxembourg. Within the EU, both member states represent countries with a well- established environment for investment funds, which differ in respect of the taxation concept.

6. Tax Treatment of Collective Investments Undertakings and Investors in Selected Member States

6.1. Germany

6.1.1. Taxation of UCITS between 2015 and 2018

The period under analysis in the *Allianzgi-Fonds* case, considers the Portuguese legislation after 2015. For the period under examination, there are two relevant German regimes whose core components are displayed in Table 2. The first one was in force before 2015 and until 31 December 2017, and it was based on the look-through approach.[91] Thus, collective investment undertakings established under German law were treated as transparent investment vehicles, considered tax-exempt entities, and the income generated by them was taxed in the investors' sphere regardless of distribution. In general, since the collective investment undertaking was exempt from income tax, it would not be allowed to neutralize the tax paid in another jurisdiction through tax credits provided in some tax treaties. Hence, in certain

88. Following: *Fidelity Funds, Fidelity Investment Funds, Fidelity Institutional Funds v. Skatteministeriet* (Case C-480/16), *supra* n. 87, at paras. 44-45.
89. Furthermore, Art. 88(11) CIT falls on resident UCITS, but only when the shares are not held for a minimum uninterrupted period of 1 year, which implies that it falls on limited cases.
90. *Allianzgi-Fonds Aevn v. Autoridade Tributária e Aduaneira* (Case C-545/19), *supra* n. 1, at paras. 79-81.
91. P. Eckl, *Proposed Draft of the Investment Tax Reform Act*, 56 Eur. Taxn. 7, p. 298 (2016).

circumstances economic double taxation of income from the dividend could occur, like in the scenario in the *Allianzgi-Fonds* case.[92]

At the investors' level, the scheme provided for a flat tax rate for private individuals. As of 2009, a maximum tax rate of 26.3755% applied, consisting of a withholding tax of 25% and an added solidarity surcharge of 5.5% on the withholding tax.[93] In the case of other investors, such as corporations, the withholding tax could be deducted from the tax obligations as it was held to be a prepayment.[94]

6.1.2. Taxation of UCITS since 2018

Since 1 January 2018, a new regulatory and tax regime for investment funds has been in place in Germany, introduced by the German Investment Tax Act[95] (hereinafter, GITA). Although the German Capital Investment Act[96] adopts various criteria and categories of investment funds, for the purposes of tax treatment the GITA only uses two classifications: the investment funds and the special investment funds.[97]

Collective Investment Undertakings are treated as corporate taxpayers[98] and, except when treated differently by law, they are subject to the general corporate tax rate of 15%[99] plus the solidarity surcharge of 5.5%. Therefore, they are treated separately from their investors. However, although they are corporate taxpayers, collective investment undertakings are not taxed on foreign income: according to Section 6 of the GITA, only the income of domestic shareholdings and participations (e.g. dividends), domestic immovable property and other miscellaneous domestic income will be subject to the CIT. Therefore, foreign-sourced dividends, for example, will not be subject to taxation under this rule. Consequently, juridical double taxation of foreign income is avoided.[100]

Section 7 of the GITA contains a special rule: domestic dividends and other income received by the UCITS with a certificate status[101] will be subject to a final withholding tax of 15%. In this case, the aforementioned revenues will not be included in the tax base of UCITS.

6.1.3. Tax treatment of the unit holders

As described in the following section, investment funds' income is (also) taxed at the investors' level, combined with a partial exemption. This is so, in order to reduce economic double taxation, since some income received by the unit holders has already been taxed at

92. *Allianzgi-Fonds Aevn v. Autoridade Tributária e Aduaneira* (Case C-545/19), *supra* n. 1, at para. 13.
93. 26.375% = 25% + 25% * 5.5%.
94. S. Angsten, *Germany – Investment Funds & Private Equity* pp. 16-17, Country Tax Guides (accessed 15 Apr. 2021).
95. DE: German Investment Tax Act (*Investmentsteuergesetz*).
96. DE: German Capital Investment Act (*Kapitalanlagegesetzbuch*), available at https://www.gesetze-im-internet.de/kagb/.
97. *See*, in relation to the new regulatory and tax regime, among others: Angsten, *supra* n. 94, at pp. 1-32; Eckl, *supra* n. 91, at pp. 298-305; P. Eckl & D. Berka, *The Implications of the New German Investment Tax Regime on German and Non-German Fund Vehicles*, 59 Eur. Taxn. 1, pp. 12-22 (2019); and F. Haase, *Germany*, in *Investment Funds,* IFA Cahiers 104B (IFA 2019).
98. Sec. 6, subsec. 1 GITA.
99. Sec. 23, subsec. 1 GCITA.
100. Haase, *supra* n. 97, at pp. 376-377.
101. Regarding certificate status, *see*: https://www.bzst.de/EN/Businesses/Foreign_investment_funds/Status_Certificate/status_certificate_node.html.

the undertaking level.[102] At the unit holder level, the taxation regime may vary depending on whether it is an individual or corporate investor, as well as, in the first case, according to whether the fund units are private or business assets. Investor income is defined by the Income Tax Act,[103] which establishes that the income from capital investment is taxable at the level of investors and, according to Section 16 of the GITA, capital income covers the distributions made by the UCITS, the advance lump sum payments and the income from the sale of fund units.

When individuals treat fund units as private assets, investment income will be subject to a flat rate of 25% and a solidarity surcharge of 5.5% leading to a taxation of 26.375%. In contrast, if fund units are maintained as a business asset, the investment income is taxable through a progressive rate that can reach a maximum of 45% plus a solidarity surcharge of 5.5%. In turn, income from fund units accrued to corporations is subject to CIT of 15%, the solidarity surcharge of 5.5% as well to the trade tax, according to the rate applicable for each municipality.

Moreover, Section 20 of the GITA provides for a partial exemption from taxable income tax at the level of the UCITS investor. In the case of individual investors, 30% of the revenue is exempt if the fund units are private assets; the percentage becomes 60% when the assets are business assets. For corporate holding fund units, the exemption is 80%.

Therefore, the major change implemented by the reform in the taxation of investment funds was the abolition, as a general rule, of the old tax transparency regime, in which income was taxed at the investor level by a new system in which taxation occurs first at the level of the investment fund and then at the level of the investor.

Table 2. German tax regimes on investment funds and unit holders (2015-2017 and since 2018)

Regime	Taxation of investment fund	Taxation of unit holder
Tax regime in force 2015-2017	– Tax transparency vehicles: tax-exempt entities	– Private individuals: withholding tax of 25% plus 5.5% solidarity surcharge – Corporations: withholding tax could be deducted from the tax obligations
Tax regime in force since 2018	– Held to be taxpayers – Subject to the general CIT rate of 15% plus solidarity surcharge of 5.5% – Not taxed on foreign-source income – Funds with certificate status (special regime): domestic dividends and other specific income subject to final 15% withholding tax and not included in tax base of fund	– Individual investor: – private assets: – flat rate of 25% plus solidarity surcharge of 5.5% – partial exemptions: 30% – business assets: – progressive rate with maximum of 45% plus 5.5% of solidarity surcharge – partial exemption: 60% – Corporation: – rate of 15% under CIT plus 5.5% of solidarity surcharge plus trade tax – partial exemption: 80%
Notes: This table summarizes the German tax regimes on investment funds in effect between 2015-2017 and since 2018. For each regime, the main tax rules applicable to investment funds and their unit holders are presented. In the latter case, the table shows separately the regimes applicable to individual investors and corporations. *Source:* Own illustration.		

102. Angsten, *supra* n. 94, at p. 16.
103. DE: Income Tax Act (*Einkommensteuergesetz*).

6.2. Luxembourg

6.2.1. Tax regime applicable to transparent and opaque funds

The regulatory framework of the UCITS in Luxembourg allows these investment funds to be configured both in contractual form and in corporate form.[104] In the category of contractual funds are the *Fonds Commun de Placement* (FCP), while in the category corporate form are the UCITS set out as *Sociétés d'Investissement à Capital Variable* (SICAV) or as *Société d'Investissement à Capital Fixe* (SICAF). The tax regime applicable to the income of investment funds and their investors varies according to the configuration adopted by the UCITS. The core components of the tax treatment are displayed in Table 3. According to the regime currently in force,[105] contractual funds are treated as tax transparent, while funds that take the corporate form are treated as fiscally opaque structures. Regarding the taxation of the investment funds, those considered tax transparent are not taxed at the UCITS level, but at the level of their investors.[106]

According to the Luxembourg tax legislation, funds that adopt the corporate form (opaque funds) are tax residents in Luxembourg[107] and, therefore, would be subject to income tax. However, the income tax law provides that special legislation may grant exemptions to resident companies. Thus, due to a provision contained in the Collective Investment Undertakings Law of 2010,[108] considered a special law for tax purposes, these investment funds are exempt from income tax.

Although the tax transparency regime for contractual funds and the exemption regime granted by the special legislation to corporate funds lead to the absence of taxation at the level of the investment fund, Luxembourg tax law provides for the subjection of UCITS to an annual subscription tax called *taxe d'abonnement*. Through this tax, investment funds are subject to a rate of 0.05% on fund's net value assets and which is charged quarterly. This rate can be reduced to 0.01% in special situations.[109] When the Luxembourg tax regime is analysed from the perspective of taxation of income obtained by UCITS investors, whether in the form of dividends received or gains on the disposal of their units, it is also observed that the rules vary according to the regime applied to the fund and also depending on the investor's residence.

6.2.2. Taxation of unit holders in tax transparent funds

Resident individuals and corporate investors investing in tax transparent investment funds must include income and gains realized by the funds in their taxable income, regardless of the distribution[110] of such income by the funds. Currently, income tax rates applicable to

104. The UCITS Directive was transposed into domestic law in Luxembourg by the Law of 17 December 2010 (hereinafter UCI Law), which transposed Directive 2009/65/EC into domestic law and was later amended to incorporate the evolution of that directive.
105. *Loi modifiée du 4 décembre 1967 concernant l'impôt sur le* revenu (hereinafter, Luxembourg Income Tax Law or LITL), available at https://impotsdirects.public.lu/dam-assets/fr/legislation/LIR/LIR2023.pdf.
106. J. Lamotte & J. Wantz, *Luxembourg*, in *Investment Funds,* IFA Cahiers 104B, p. 549 (IFA 2019).
107. Art. 159 LITL.
108. Art. 173(1) UCI Law.
109. Arts. 173 and 174 UCI Law.
110. Lamotte & Wantz pointed out that the practical difficulties of allocating these investments to individual investors before distribution explain a tolerance adopted by the Luxembourg tax authorities, which accept that those earnings are only taxed at the level of individual investors when distributed, *see* Lamotte & Wantz, *supra* n. 106, at p. 562.

income received can reach 45.78% marginal effective rate for individuals[111] and up to 24.94% for corporate investors.[112] However, as described below, the unit holdings can be partially or totally exempt.

Distributions made by transparent investment funds to resident investors are not by definition subject to withholding tax. If we shift the perspective and look at dividends received by a transparent investment fund, the general rules applicable to dividends are to be considered. Under Luxembourg law, dividend distributions are subject to a 15% withholding tax unless an exemption applies.[113]

Corporate investors (unit holders) can (i) be reimbursed from this withholding tax where a tax has been wrongly withheld because the necessary proof of an exemption has not been provided in time for it to be applied; (ii) credit this tax withheld when calculating CIT; (iii) be exempt from that withholding levied on when they hold a qualifying participation (at least EUR 1.2 million or 10% of the company's capital) for at least 12 months.[114,115]

Income and gains earned by corporate investors eligible for the participation exemption regime (participation for at least 12 months of at least 10% of the company's capital or EUR 1.2 million, or EUR 6 million in case of capital gains)[116] as a result of an investment made by the fund which is tax transparent in a fully taxable company are exempt from income tax at the corporate investor level. If the participation exemption regime does not apply, 50% of dividends are exempt from CIT.[117]

In respect of individual investors: they can benefit from a 50% exemption on dividends paid by a fully taxable company to investment funds;[118] capital gains of individual investors are exempt if the investor does not hold substantial participation (more than 10% of the company's share capital or equity at any time in the 5 years preceding the date of transfer of ownership) and the sale is carried out after 6 months of the date of purchase; capital gains from substantial participations are taxed but if the sale occurs after 6 months the individual investor is entitled to a reduction of half of the applicable rates on capital gains;[119] finally, short-term capital gains (participation sold within 6 months from the purchase date) are fully taxable.

Non-resident investors are also subject to withholding tax at the rate of 15% on distributions made by Luxembourg established companies to Luxembourg resident transparent funds, except if the foreign investor fulfils the criteria for an exemption.[120,121] Income arising from payments made by transparent funds to non-resident investors is not subject to Luxembourg

111. Progressive income tax scale (top rate 42% above EUR 200,004 income, *see* art. 118 LITL), increased by 7% or 9% of a solidarity surcharge (*contribution au fonds pour l'emploi*).
112. Since 2019, the general corporate income tax rate is 17% for earnings above EUR 200,000. In addition to this rate, there is also a solidarity surcharge of 7% and, in the case of the city of Luxembourg, a municipal business tax of 6.75%, which results in a combined corporate tax rate of 24.94%. In 2015, the general corporate income tax rate was 21% for income above EUR 15,000.
113. Lamotte & Wantz, *supra* n. 106, at p. 561.
114. Art. 147 LITL.
115. Lamotte & Wantz, *supra* n. 106, at p. 562.
116. Art. 147 LITL.
117. C. Bardini, *Luxembourg – Corporate Investment Income* p. 2, Country Tax Guides (accessed 30 May 2023).
118. Art. 115 LITL.
119. Art. 100 LITL.
120. Art. 147 LITL.
121. Lamotte & Wantz, *supra* n. 106, at pp. 561-562.

income taxation,[122] except where the investors have a permanent establishment, a permanent representative or a fixed place of business in Luxembourg. Likewise, income accrued to non-resident investors due to the sale or disposal of investments in the fund are, as a rule, not subject to income tax in Luxembourg, and may be taxed only in exceptional situations.

6.2.3. Taxation of investors in opaque funds

Dividends received by opaque investment funds are subject to a 15% withholding tax, except where an exemption is applicable.[123] Regarding the taxation regime applicable to investors in opaque funds, that is, those established under a corporate form, the income paid by these funds to resident investors in Luxembourg is not subject to withholding tax. However, they are fully subject to the aforementioned ordinary income tax rates.[124]

Gains from the disposal of unit holdings in these UCITS earned by individual investors are not subject to income tax, provided that requirements related to the investment maintenance period and the percentage of participation in the fund are fulfilled. Otherwise, capital gains arising from the disposal of this substantial participation hold for at least 6 months are subject to taxation at half the ordinary rate.[125] Resident corporate investors, on the other hand, are subject to tax on dividends and gains, regardless of whether they meet the requirements benefitting individuals.

In the case of non-resident investors, dividends paid to them are not subject to withholding tax and these investors are not subject to income tax in Luxembourg, except when they have a permanent establishment, a permanent representative, or a fixed place of business in Luxembourg, as is also the case with tax transparent funds.[126]

Finally, an exemption regime is also applicable to gains obtained on the disposal or sale of investments in these funds by non-resident investors. Thus, they are subject to income tax when the disposal of the units takes place within 6 months of the investment acquisition date and exempt when disposed of after that period.[127]

7. Economic implications

7.1. Methodology

In the following simulation study, we assess the impact of the differing tax treatment of investment funds in Portugal, Germany and Luxembourg before and after the *Allianzgi-Fonds* case decision. Hence, we build on the well-established methodology put forward by Devereux & Griffith (1999, 2003).[128] Therefore, we calculate the effective tax levels for different scenarios (*see* Figure 1) including the key parameters, effective average tax rate (EATR) and cost of capital (CoC). Overall, the methodology goes beyond the pure consideration of the statutory tax rate as it includes further tax parameters, like country-specific regulations

122. Art. 173(1) UCI Law.
123. Participation for at least 12 months of at least 10% of the company's capital or EUR 1.2 million. *See* art. 147 LITL.
124. Lamotte & Wantz, *supra* n. 106, at p. 560.
125. Fisch, Goebel & Trouiller, *supra* n. 21, at p. 53.
126. Id., at p. 54.
127. Art. 156(7) LITL. Luxembourg will often not be able to exercise tax jurisdiction over any such gains due to the tax treaty rule in art. 13(5) OECD MC; there is also an additional (anti-avoidance) rule, under which non-resident investors remain taxable on gains from significant participations beyond 6 months, if they have become non-residents less than 5 years ago after being residents for more than 15 years.
128. Devereux & Griffith (1999), *supra* n. 17; Devereux & Griffith (2003), *supra* n. 17.

Table 3. Luxembourg tax regimes on investment funds and unit holders

Types of investment funds	Taxation of investment funds	Taxation of unit holders
Tax transparent funds	– 15% withholding tax on income paid to the fund (dividends may be exempt in case of corporate unit holder that meets requirements) – Income tax: not subject to income tax – Annual subscription tax: 0.05% (reduced to 0.01% in special situations)	Residents – individuals: – income must be included in taxable income and subject to tax rates which can reach 45.78% – dividends: partially exemption regime (50% on dividends) in case of substantial participation – capital gains: taxation at half of the ordinary income tax rates in case of substantial participation – corporate: – income must be included in taxable income and subject to tax rates which can reach 24.94% – participation exemption regime applicable on capital gains and dividends – can be reimbursed or credited from the 15% withholding tax on dividends
		Non-residents – dividends not subject to Luxembourg income taxation – except when investors have a permanent establishment, permanent representative or a fixed place of business in Luxembourg
Opaque funds	– 15% withholding tax on income paid to the fund – Income tax: considered a tax resident company subject to income tax but exempt under special legislation – Annual subscription tax: 0.05% (reduced to 0.01% in special situations)	Residents – individuals: – income must be included in taxable income and subject to tax rates which can reach 45.78% – gains from disposal are not subject to tax if the investment maintenance period is greater than 6 months and the percentage of participation is less than 10%. Otherwise, if the participation is greater than 10% gains are subject to taxation at 50% ordinary rates – corporate: – income must be included in taxable income and subject to tax rates which can reach 24.94% – participation exemption regime applicable on capital gains and dividends – can be reimbursed, credited or exempt from the 15% withholding tax
		Non-residents – dividends not subject to withholding tax and income tax in Luxembourg – except when investors have a permanent establishment, permanent representative or a fixed place of business in Luxembourg – participation exemption applicable to gains on disposal

Notes: This table summarizes the Luxembourg tax regimes on investment funds and unit holders, presenting the main characteristics of the tax regimes applicable depending on whether the investment fund is classified as a tax transparent fund or an opaque fund. For each type of fund, the tax rules applicable to the investment fund itself and its unit holders are presented. Regarding unit holders, the table highlights rules applicable to residents, non-residents, individuals or corporations.
Source: Own illustration.

on tax systems, tax base, and tax rates on company and shareholder level.[129] For the purpose of this article, the term company corresponds to investment fund, and the term sharehold-

129. ZEW, *Effective Tax Level Using the Devereux/Griffith Methodology – Final Report 2021* (2022).

er corresponds to unit holder. The impact of these tax parameters is measured in terms of after-tax returns of corporate investments. For the country-specific tax information, we rely on ZEW (2022),[130] and our own additional research. Regarding our calculations, we apply key economic assumptions displayed in Table 4.

Table 4. Economic assumptions of Devereux & Griffith methodology

Assumptions on types of taxes and tax bases	
Company level (incl. investment fund)	Corporate income tax including surcharges, local business taxes, non-profit taxes
Shareholder level (incl. unit holder)	Tax on dividend income (i.e. personal income tax including surcharges, withholding tax)
Type of asset	Financial asset (100%)
Assumptions on inflation, interest rate and pre-tax rate of return	
Inflation rate (π)	2%
Real interest rate (r)	5%
Nominal interest rate (i)	7.1%
Pre-tax rate of return (p)	20%

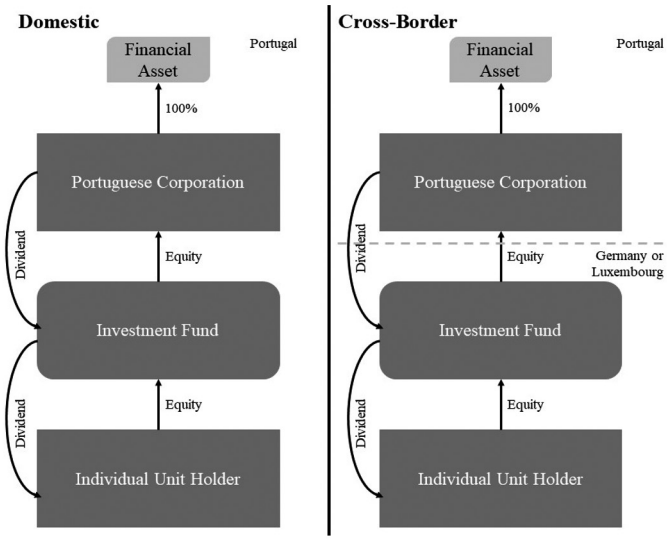
Source: Own illustration based on C. Spengel, *Internationale Unternehmensbesteuerung in der Europäischen Union: Steuerwirkungsanalyse – Empirische Befunde – Reformüberlegungen*, p. 88 (IDW 2003).

Generally spoken, the Devereux & Griffith methodology builds on the neoclassical investment theory considering a discrete, hypothetical investment regarding an (at least) marginal investment of a profit-maximizing company. The company continues investing until the incremental investment's marginal return covers its marginal expenditures. The EATR is the measure for a profitable investment, i.e. a positive pre-tax return rate, indicating the preference regarding the investment location decision.[131] Moreover, the methodology allows to compute the effective tax levels on marginal investments that yield a minimum required return (relevant measure: CoC). The CoC assesses the impact of taxation on the scale of investment. Within our simulation study, both measures are considered.

To evaluate the distortions caused by Portuguese discriminatory fund taxation, we assess domestic and cross-border scenarios in different tax years. The considered period spans from 2015 until 2022, whereby we focus on specific years (i.e. 2015, 2018, 2022) representing major changes in the tax regulations for funds. In our simulation study, we assume an individual shareholder (as unit holder) who undertakes an investment in an investment fund. As locations of the investment fund,[132] we consider either Portugal, Germany, or Luxembourg. The investment fund, which can be domestic (i.e. Portugal fund) or foreign (i.e. German and Luxembourg fund), decides to invest the additional capital in a Portuguese corporation.[133] The Portuguese corporation invests solely in a financial asset. As we consider the taxation of dividend payments, we assume new equity as financing source at all levels. The structure of the considered scenarios is displayed in Figure 1.

130. Id.
131. Devereux & Griffith (2003), *supra* n. 17; M. P. Devereux & R. Griffith, *Taxes and the Location of Production: Evidence from a Panel of US Multinationals*, 68 Journal of Public Economics 3, p. 337 et seq. (1998).
132. Due to methodological restrictions, we do not apply the total net asset value as tax base. However, the tax base effects do not significantly distort the results.
133. We exclude the option of an investment split.

Figure 1. Structure of considered investment scenarios



Source: Own illustration.

Overall, we distinguish the tax treatment of domestic and cross-border investments before and after the *Allianzgi-Fonds* case. Thus, the Portuguese regime only changes after the judgment. For one cross-border investment with respect to a German investment fund, we analyse two different regimes before and after 2018. Between 2015 and 2017 the investment fund has been considered as transparent entity. In 2018 and afterwards, the investment fund has been treated as a corporation for tax matters. However, the individual unit holder can hold the participation in the investment fund either as a business asset or a private asset, leading to different tax treatments. For the other cross-border investment, we include Luxembourg and distinguish between the taxation of transparent investment funds and opaque funds.

7.2. Results

In the following, we display and interpret the effective tax levels regarding the fund taxation before and after the *Allianzgi-Fonds* case decision. In the setting, we consider 2015 and 2018 to demonstrate the effect of the German tax reform and 2022 to represent the CJEU decision. As our modelling shall express especially the influence of the taxation of funds, we, therefore, assume full new equity financing of the investment fund and the Portuguese corporation. Moreover, the corporations invest solely in financial assets. We distinguish between the shareholder and the fund level. For the investment unit holder, we consider a top-rate qualified shareholder, who is charged with the Portuguese withholding tax and the respective domestic dividend tax.

In the following, we consider the EATR as an indicator to compare the location attractiveness. Thus, our interest is in assessing the effect on whether to carry out a domestic or foreign investment. Hence, we aim to display tax distortions between these investments due to the discriminating Portuguese tax regulations. Therefore, we consider not only the EATR at the corporate (investment fund) level but also at the shareholder (unit holder) level. In

addition, we also include the CoC as an indicator of the scale of investment. For our analysis the EATR, which is influenced by tax rate changes, is the primary indicator.

Germany treated investment funds before 2018 as transparent entities, and therefore, only levied taxes at the unit holder level. Since 2018, the tax systems distinguish the tax treatment based on the qualification of the units as private or business assets. For private assets, a 30% exemption is applicable from the maximum flat tax rate (approximately 26.375%), resulting in a reduced income tax rate of 18.4625% (= 70% from 26.375%) at the unit holder level. Regarding business assets, despite maintaining the same maximum flat tax rate, 60% of the income is exempted, resulting in a stylized income tax rate of 10.55% (= 40% from 26.375%). Notably, after the German reform, no CIT is levied: neither at the level of the investment fund nor on the Portuguese corporation.

Luxembourg presents a contrasting tax environment characterized by higher taxation at both shareholder and corporate levels.[134] Luxembourg imposes an additional withholding tax on investment funds, irrespective of being treated as transparent or non-transparent (opaque). Regarding the opaque funds, an additional 0.05% subscription tax is levied. Unit holders face a substantial 45.78% personal income tax burden, compounded by Portuguese withholding tax obligations.

Overall, under the discriminatory Portuguese fund taxation of foreign investment funds and unit holders, for the domestic setting lower EATR and CoC are determined compared to a foreign investment (*see* Table 5). This is driven through the additional levy of the 25% withholding tax by the Portuguese system for cross-border investments. This effect becomes especially obvious when comparing the effective tax levels for the foreign German investment and the domestic investment. Both the Portuguese and German tax regimes are comparable in tax rates levels, whereas through the additional withholding tax levied on the investment of a German unit holder through a German investment fund, the EATR and CoC for the Portuguese-German setting are higher compared to the domestic Portuguese scenario. The lower EATR signals a higher location attractiveness regarding profitable investments in a Portuguese investment fund that invests in a Portuguese corporation. In addition, the lower CoC represents a positive effect on the scale of investment for the described domestic scenario compared to the cross-border scenario. Thus, the effective tax levels confirm the domestic investment bias due to the discriminatory regulation in Portugal. Regarding Luxembourg, the high level of the EATR is especially driven from the shareholder taxation. Compared to the German setting, Luxembourg is less attractive from tax considerations.

To consider the impact of the *Allianzgi-Fonds* case decision, we compare the EATR and CoC (*see* Table 6) before and after the CJEU decision. After the CJEU decision, the abolishment of the Portuguese withholding tax impacts the effective tax levels regarding foreign investment funds. Due to the absence of newer available data, we use the tax system structures of 2022; however, it is important to note that the expected impact of the alterations

134. Despite having high ordinary income tax rates compared to other jurisdictions, the combination of the various characteristics of the tax regime in force in Luxembourg, especially the general exemption of capital gains for individual investors after 6 months and the extension of the participation regime to holdings less than 10% (through the alternative threshold of 1.2 million acquisition cost) but also partial exemptions, non-withholding taxes and credits received in some situations can all contribute to the jurisdiction being considered a low tax jurisdiction.

Table 5. Effective tax levels in 2015 and 2018

	Shareholder		Corporate	
	EATR (%)	**CoC (%)**	**EATR (%)**	**CoC (%)**
2015				
PT	20.66	5.01	0.11	5.01
LU (transparent)	78.87	23.12	16.47	6.23
LU (opaque)	78.88	23.14	16.53	6.23
DE	45.19	8.22	32.39	7.91
2018				
PT	18.96	4.86	0.05	5.00
LU (transparent)	75.57	20.46	16.47	6.23
LU (opaque)	75.59	20.47	16.53	6.23
DE (business asset)	32.39	6.85	0.00	5.00
DE (private asset)	41.13	8.08	0.00	5.00

Notes: The table displays the EATR and CoC in 2015 and 2018 regarding the taxation of funds (Corporate) and individual unit holders (Shareholder). For Portugal a domestic investment is assumed. Regarding Luxembourg and Germany, we assume a cross-border investment in a Portuguese corporation. Moreover, for Luxembourg we distinguish between the transparent fund and the non-transparent opaque fund. For Germany we consider the policy change leading to the distinguishment between private and business asset in 2018.
Source: Own illustration.

in the general tax system remains marginal as we rather focus on the parameters which are primarily influenced by specific regulations set for fund taxation. Overall, after the abolishment of the discriminatory withholding tax in Portugal, the EATR and the CoC for the cross-border scenarios decrease. For the German setting, the abolishment results in a decrease of 0.28 percentage points (pp.) for the EATR at the shareholder level (unit holder), both for the business asset and private asset case. The decrease in CoC is only marginal and amounts to 0.19 pp. for business asset and 0.03 pp. for private asset. For both scenarios in Luxembourg, a decrease of the EATR by 0.23 pp. and the CoC by 0.10 pp. is given. All changes occur at the shareholder level (unit holder). Considering the overall EATRs, Germany as location for the investment fund (corporate) and the unit holder (shareholder) is much more attractive than the domestic Portuguese setting. The EATRs are 0.10 pp. lower under the private asset scenario, whereas the consideration of the units as business assets results in the EATR being 0.19 pp. lower.

8. Conclusion

Overall, we are able to confirm that the abolishment of the discriminatory withholding tax can considerably reduce the effective tax levels for cross-border investments. Moreover, the abolishment also diminishes the domestic investment bias. Nonetheless, the results do not confirm the achievement of neutrality. In our specific modelling scenario, the German cross-border investment becomes more tax-beneficial compared to the domestic Portuguese investment. Thus, the abolishment of the discriminatory tax does not automatically lead to neutrality due to the interaction of different domestic tax regulations.

Therefore, in line with previous research we conclude that a comprehensive harmonization of Member States' tax rules on investment funds by means of a Directive (positive

integration) seems necessary to implement an internal market without tax distortions to investment. In face of the results, it is also legitimate to ask whether the CJEU should restrain itself from a formal interpretation of discrimination and restriction – at least, when the CJEU, in complex cases such as the one we examined in this article, is not sure of the results that such formal interpretation will lead to.

Table 6. Effective tax levels before and after Allianzgi-Fonds case

	PT		LU (Transparent)		LU (Opaque)		DE (Business asset)		DE (Private asset)	
	EATR (%)	CoC (%)	EATR (%)	CoC (%)	EATR (%)	CoC (%)	EATR (%)	CoC (%)	EATR (%)	CoC (%)
Before *Allianzgi-Fonds* case decision										
Corporate	0.05	5.00	16.47	6.23	16.53	6.23	0.00	5.00	0.00	5.00
Shareholder	20.62	5.00	75.57	20.46	75.59	20.47	29.57	5.99	38.31	7.10
After *Allianzgi-Fonds* case decision										
Corporate	0.05	5.00	16.47	6.23	16.53	6.23	0.00	5.00	0.00	5.00
Shareholder	20.62	5.00	52.14	10.12	52.17	10.13	1.95	3.77	10.69	4.32

Notes: The table displays the EATR and CoC before and after the *Allianzgi-Fonds* case decision regarding the taxation of funds. For Portugal a domestic investment is assumed. Regarding Luxembourg and Germany, we assume a cross-border investment in a Portuguese corporation. Moreover, for Luxembourg we distinguish between the transparent fund and the non-transparent opaque fund. For Germany we consider the EATR and CoC for the private asset and business asset scenario.
Source: Own illustration.