

ANALYSIS



Tax

CJEU requires actual neutralisation of tax discrimination against non-resident collective investment schemes or, where there is tax transparency, against their unitholders

The Court of Justice of the European Union confirms that the mere possibility of applying double taxation avoidance mechanisms under a double taxation treaty does not neutralise the restriction on the free movement of capital. The deduction of taxes paid in the source country must be actually made in full, either by the collective investment scheme itself or, in cases of tax transparency, by its unitholders.

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1. Introduction

On reference for a preliminary ruling from the Supreme Court by decision of 11 February 2025 (cassation appeal no. 8746/2025), the Judgment of the Court (First Chamber) of 17 September 2026, Case C-139/25, *Administración General del Estado v. Ishares Europe ETF*, has confirmed that the application to (open-ended) non-resident collective investment schemes ('IIC') of a more onerous tax scheme than that applicable to resident funds constitutes a restriction on the free movement of capital. Although the Court acknowledged that such a restriction may be neutralised by a double taxation treaty in line with its previous case law, the mere theoretical existence of a tax credit or a potential deduction is not sufficient to rule out a breach of European Union law. The neutralisation of the restriction on this fundamental freedom requires proof that investors can actually benefit from a mechanism that fully eliminates the excess taxation they bear.

2. Background

The origin of this judgment lies in the dispute between a U.S. collective investment scheme (iShares Europe ETF) and the Spanish tax authorities regarding the difference in tax rates between the 1% rate applicable to collective investment schemes resident in Spain (Art. 29(4) of the Corporate Income Tax Act 27/2014 of 27 November — a reduced tax rate that also existed under the previous legislation) and the 15% withheld from Ishares during the fiscal years 2007 through 2010 pursuant to Article 10(2)(b) of the 1990 double taxation treaty between Spain and the U.S.

iShares made a number of applications seeking a refund of the difference between the amount withheld, corresponding to the tax rate of 15%, and the amount corresponding to the tax rate of 1% calculated on the gross dividend amount. Those applications were rejected in the Central Tax Tribunal on the grounds that the situation of Ishares' situation was not objectively comparable to that of Spanish collective investment schemes, and that, in any event, the restriction on free movement resulting from the contested taxes had been neutralised, since both the double taxation treaty and U.S. legislation allowed iShares to neutralise in full the difference in tax treatment in Spain, by attributing the income which it had received to its shareholders or unitholders and by transferring to them the tax credit corresponding to the withholding tax levied in Spain, it being irrelevant whether or not neutralisation takes place from the point of view of the unitholders.

It should be noted that iShares, in its capacity as a Regulated Investment Company (RIC) within the meaning of the Investment Company Act of 1940, opted to avail itself of the special tax transparency scheme provided for in U.S. legislation, under which it is not taxed on the dividends received and transfers to its unitholders those dividends and the tax credit corresponding to the amount withheld on those dividends.

The *Audiencia Nacional's* Judicial Review Division, by judgment of 12 September 2022 (app. no. 1325/2017), allowed, by a majority, the appeal lodged by Ishares and found that Ishares was entitled to a refund of the amounts claimed, together with interest from the date on which the with-

holding tax had been levied. That court identified a violation of European Union law, acknowledged the objective comparability of the situations (the fact that Ishares had opted to apply the special tax transparency scheme being irrelevant to that analysis) and held that it had not been established that the additional tax borne by Ishares had been neutralised; the fact that Ishares had elected to transfer to the shareholders or unitholders the right to apply in the U.S. the tax credit corresponding to the withholding tax levied in Spain did not support the assertion that the tax authority had succeeded in demonstrating complete neutralisation.

After the State Attorney's Office lodged an appeal, the Supreme Court's Judicial Review Division decided to stay the procee-

the State where such dividends are generated.

3. Analysis of the judgment

The Court of Justice finds, first, that dividends paid to non-resident collective investment schemes are subject to less favourable tax treatment compared to dividends paid to schemes resident in Spain, and confirms that the Spanish legislation constitutes a restriction on the free movement of capital, prohibited by Article 63 of the Treaty on the Functioning of the European Union ('TFEU') (para. 36). Contrary to the Spanish Government's line of argument, the Court of Justice notes that the fact that the non-resident collective investment scheme is not subject to taxation in its State of residence or that it passes

on the tax burden in respect of the dividends which it receives to its unitholders under the special tax transparency scheme, has no bearing on the finding that the dividends received by that collective investment scheme are subject to a higher tax burden than dividends distributed to resident

schemes, merely because Spain has exercised its tax jurisdiction (para. 33).

The Court then notes that differences in treatment permitted under Article 65(1) (a) TFEU as a derogation from the fundamental principle of the free movement of capital must not constitute either a means of arbitrary discrimination or a disguised restriction. Consequently, such differences in treatment are permitted only when they concern situations which are not objectively comparable or, otherwise, when they are justified by an overriding reason in the public interest. While it is for the re-

The higher tax burden arises from the exercise of Spain's taxing powers

dings and to refer to the Court of Justice of the European Union (the 'Court of Justice' or 'CJEU') for a preliminary ruling on whether any restriction on the free movement of capital can be considered neutralised by the fact that the applicable double taxation treaty and the domestic legislation of the country of residence of a non-resident entity equivalent to resident harmonised investment funds allow it to benefit from a tax transparency scheme under which it is not taxed on the dividends it receives and passes on to its unitholders those dividends and the tax credit corresponding to the withholding tax borne in

ferring court to assess the comparability of the situations of resident and non-resident collective investment schemes, taking into account the objective and the content of the applicable national legislation, the Court of Justice notes that “as soon as a Member State, whether unilaterally or by way of a convention, subjects not only resident collective investment undertakings but also non-resident collective investment undertakings to tax on the income which they receive from a resident company, the situation of those non-resident collective investment undertakings becomes comparable to that of the resident collective investment undertakings” (para. 43).

The Court of Justice then acknowledges that the mechanisms for eliminating double taxation provided for in a tax treaty may constitute valid mechanisms for neutralizing the restriction on the free movement of capital, provided that their application enables the effects of the difference in treatment under national legislation to be compensated for in full. Although it is for the referring court to determine whether the application of the double taxation treaty between Spain and the U.S. allows such a deduction in full, the Court of Justice makes two very important clarifications:

- It expressly rejects the notion that the mere theoretical possibility of a deduction for the collective investment scheme is sufficient to consider the restriction neutralised (para. 55), since “it cannot be claimed that a Member State has succeeded in ensuring compliance with its obligations by concluding a bilateral tax convention for the avoidance of double taxation where a non-resident collective investment

undertaking, which has opted for a tax regime provided for by the legislation of its State of residence and which is not alleged to have done so in an abusive or fraudulent manner, cannot, on account of that tax regime, even though that regime was not imposed on that non-resident collective investment undertaking but was elected by it, enjoy the protection of that convention” (para. 56).

- It acknowledges the possibility that the applicable double taxation treaty (Art. 24(2)(a)) may be interpreted as providing for the possibility for Ishares’ unitholders to benefit from the deduction or the tax credit corresponding to the withholding tax levied in Spain on the dividends (para. 61). In this regard, in order to be able to find that that difference in treatment is neutralised by the application of that double taxation treaty in favour of the unitholders, the referring court must satisfy itself that those unitholders can actually benefit from that application and that that application allows those unitholders to deduct in full from the tax which they must pay in their State of residence the amount corresponding to the difference between the tax rates of 15% and 1% (para. 64).

On the basis of the foregoing, the Court of Justice answers the question referred for a preliminary ruling as follows: “Article 63 TFEU must be interpreted as meaning that a restriction on the free movement of capital may be considered to be neutralised by the application of a bilateral tax convention for the avoidance of double taxation, concluded between the State of residence of a collective investment un-

undertaking and the Member State in which dividends are paid, where that collective investment undertaking benefits, in its State of residence, from a tax transparency regime under which it is not taxed on the dividends received and transfers to its unit-holders those dividends and the tax credit corresponding to the withholding tax levied in the Member State in which those dividends are paid, provided that those unit-holders can actually benefit from such an application, inasmuch as that application allows them to deduct in full from the tax payable by them in their State of residence the amount corresponding to

tually and fully be implemented, including at the level of the unitholders.

Although the ruling does not address the burden of proof, it confirms that the transfer of the tax credit to the investment fund's unitholders is not sufficient to conclude that such neutralisation has occurred; rather, it must be proven that neutralisation has actually and fully taken place at this second level.

Undoubtedly, this ruling will have a significant impact on administrative and judicial proceedings for the refund of withholding taxes borne by non-resident investors, where the issue is likely to shift to proving or establishing whether or not the actual deduction has occurred in full at the level of the fund's unitholders, which may create difficulties —particularly, we believe, for the tax authorities — in cases involving open-end investment funds due to the broad, diverse, and changing nature of their investors.

It is not enough for the possibility of a deduction to exist merely in theory

the difference between, on the one hand, the tax rate applied in the Member State in which the dividends are paid to dividends paid to non-resident collective investment undertakings and, on the other, the tax rate applied to dividends paid to resident collective investment undertakings”.

4. Final thoughts on the burden of proof regarding neutralisations

The judgment under discussion limits the tax authorities' general reliance on the existence of double taxation relief mechanisms in the applicable bilateral tax treaty to consider discriminatory taxation that restricts the free movement of capital to be neutralised. Neutralisation must not be a merely theoretical possibility but must ac-

And, in light of the foregoing, the key issue will be to determine who will bear the burden of proof in the event of alleged discrimination: the taxpayer or the tax authority. With regard to the evidence, the aforementioned judgment by the *Audien-cia Nacional* dated 12 September 2022, held that the burden of proving the neutralisation at the level of the unitholders' tax status (since the collective investment scheme is a transparent entity) should rest with the Spanish tax authority, based on the principle of ease of proof, on the understanding that the information necessary to verify the right to a refund would be protected by the principle of confiden-

tiality, and on the Court of Justice's own case law (judgments of 16 June 2022, C-572/2020, *Silicones*, and of 17 March 2022, C-545/19, *Allianz GI Fonds AEVN*), as the *Audiencia Nacional* considered it "more reasonable to require the tax authority to provide proof, since it can request information from other tax authorities". In its view, this line of reasoning was confirmed by the case law of the Supreme Court [judgments of 17 December 2020 (case no. 5855/2018), 21 January 2021 (appeals nos. 5086/2018 and 6760/2018), 29 January 2021 (appeal no. 4492/2018), and 14 April 2021 (appeal no. 6317/2018)].

For its part, the most recent case law of the Supreme Court — albeit in relation to proving compliance with the comparability requirements between resident and non-resident investment funds — provides that "[t]he burden of proof that the comparability requirements set out above are met rests with the non-resident FIL [free investment scheme], although in the absence of specific Spanish national legislation determining the exact means of proof it must provide, the FIL may not be required to submit evidence or certificates that are strictly identical to those required of FILs resident in Spain or that are disproportionate or extraordinarily difficult to obtain. When the Spanish administrative authority has reasonable grounds to doubt the adequacy of the evidence provided, it

must actively exercise the powers to obtain information available to it under the double taxation treaty or similar agreement signed with the country of origin or residence of the non-resident FIL, as well as the mechanisms for the automatic and mandatory exchange of information in the field of taxation provided for under European Union law, in particular Council Directive 2011/16/EU of 15 February 2011 on administrative cooperation in the field of taxation. The unjustified failure to use these information exchange mechanisms available to the authorities must be taken into account in determining the allocation of the burden of proof and, where appropriate, will allow the evidence provided to be considered sufficient" (Judgment of 5 April 2023, appeal no. 7260/2021, reiterated, among others, in the Judgment of 25 April 2023, appeal no. 8494/2021).

Close attention must be paid to how the Supreme Court applies the criteria set out in the *Ishares* case ruling and, in particular, to how those criteria affect the burden of proof regarding tax neutralisation for the investor or unitholder, which will serve as a guide in resolving other pending cases. In any event, it is important to have solid evidence of the transfer by the collective investment scheme to its investors or unitholders of both the income earned and the corresponding tax credits.