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Finnish Tax on Dividends Violates EC Treaty, AG Says

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COUNTRY DIGEST

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Advocate General Jan Mazak of the European Court of Justice on December 19 issued an opinion in *Aberdeen Property Fininvest Alpha* (C-303/07), finding that Finland should not tax dividends paid by a Finnish company to a Luxembourg collective investment fund (SICAV) that owns 100 percent of the Finnish company's stock.

Under Finnish law, the dividends paid to the Luxembourg fund are subject to Finnish withholding tax. The Luxembourg fund does not qualify for the dividend withholding tax exemption granted under the EU parent-subsidiary directive because it is not organized according to one of the corporate forms enumerated in the directive and is not subject to corporate tax in Luxembourg. Dividends paid to a Finnish company or investment fund, however, are exempt from withholding tax to eliminate double taxation of corporate profits.

Mazak took the position that the Finnish withholding tax violates the EC treaty. According to the advocate general, the EC Treaty applies even to intercompany dividends that fall outside the scope of the EU parent-subsidiary directive. The treaty principles of freedom of establishment and free movement of capital prohibit member states from taxing outbound dividends in a less favorable manner than domestic dividends. The position of a Luxembourg SICAV is comparable to that of a domestic company or fund, even though the SICAV is not subject to tax in Luxembourg, Mazak said.

The opinion is not binding on the ECJ, although it tends to rule in accordance with the advocate general's opinion in most cases. If the ECJ accepts the advocate general's opinion, its judgment would be a major step toward the elimination of dividend withholding tax in the EU.

Implications Under Italian Law

Domestic dividends paid to corporate shareholders are not subject to withholding tax in Italy, and 95 percent of the dividend is exempt in the hands of the recipient company, leading to an effective tax of 1.375 percent (taking into account the 27 percent corporate tax rate).

Dividends paid to domestic investment funds are not subject to withholding tax, but are subject to a 12.5 percent tax on the net increase of their asset value at the end of the tax year.

The ordinary withholding tax on outbound dividends is 27 percent, but the withholding tax on intercompany dividends paid to treaty partners generally is reduced to 5 percent.

Dividends paid to EU companies that are subject to corporate tax in the residence state are subject to a 1.375 percent withholding tax, regardless of the amount of stock owned in the Italian distributing company. This equalizes the treatment of outbound and domestic dividends for corporate shareholders.

Intercompany dividends paid to an EU parent company are exempt from withholding under the EU parent-subsidiary directive.

The advocate general's opinion in *Aberdeen Property Fininvest Alpha* implies that an EU investment fund not subject to tax in its own country of organization could still claim the dividend withholding tax exemption that is granted to Italian investment funds, or the reduced 1.375 dividend withholding tax granted to other EU companies, instead of the ordinary 27 percent dividend withholding tax on dividend income received from Italian companies. ◆

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