

PORTUGUESE DIVIDENDS PAID TO EUROPEAN C.I.V.'S – LOCAL LAW VS. E.U. FUNDAMENTAL FREEDOMS

Author

António Gaspar Schwalbach

Tags

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INTRODUCTION

The taxation of dividends paid by Portuguese resident companies to nonresident Collective Investment Vehicles (“C.I.V.’s”) has, over the past decade, become one of the most litigated and structurally significant issues in Portuguese tax law. What began as a technical discussion concerning the scope of a domestic tax exemption has evolved into a consolidated body of caselaw confirming a structural incompatibility between Portuguese tax legislation and European Union law, in particular the principle of free movement of capital enshrined in Article 63 of the Treaty on the Functioning of the European Union (“T.F.E.U.”).

This article revisits the Portuguese tax regime applicable to dividends distributed to C.I.V.’s, analyses the landmark judgment of the Court of Justice of the European Union (“C.J.E.U.”) in *AllianzGI-Fonds AEVN* (Case C545/19), and examines the decisive role played by the Portuguese Supreme Administrative Court in transforming a challenged legal position into settled caselaw. It further addresses the practical consequences for nonresident funds, asset managers, and custodians, including the recovery of withholding tax and indemnity interest, and reflects on the continued absence of legislative amendment despite consistent judicial intervention.

THE PORTUGUESE DOMESTIC FRAMEWORK

Under Portuguese tax law, dividends distributed by resident companies are, as a rule, subject to Corporate Income Tax (“C.I.T.”) withholding at source. In practice, however, this rule is only residually applied in a domestic context, as most corporate shareholders benefit from a full participation exemption under Article 51 of the Portuguese C.I.T. Code. For cross-border situations, article 14 of the same Code, which transposes the E.U. Parent-Subsidiary Directive into Portuguese law, provides for a full exemption from withholding tax on qualifying dividend distributions, subject to several conditions. The corporate recipient must (i) hold a minimum direct or indirect shareholding of 10%, (ii) have held the shareholding for a period of at least one year, and (iii) be subject to C.I.T. or a comparable tax.

In cross border situations falling outside the scope of Article 14, withholding tax on dividends paid to nonresident corporate shareholders may be mitigated pursuant to applicable double tax treaties. C.I.V.’s, however, are generally excluded from the participation exemption regime, which led the Portuguese legislator to introduce a specific exemption for resident funds under Article 22 of the Tax Benefits Statute. Article 22 establishes a broad exemption from C.I.T. on income obtained by C.I.V.’s, including dividends, interest, rents and capital gains, provided that such vehicles are incorporated and operate under Portuguese law. Dividends paid by Portuguese companies to resident funds are therefore not subject to withholding tax. By contrast,

António Gaspar Schwalbach is the founder of Spear Legal, a Lisbon-based boutique law firm. His practice focuses on tax advisory and tax litigation.

C.I.V.'s established under the laws of other Member States or other countries fall outside the scope of this exemption

THE ORIGIN AND DISCRIMINATORY EFFECTS OF ARTICLE 22 OF THE TAX BENEFITS STATUTE

Article 22 of the Portuguese Tax Benefits Statute, as substantially reformed in 2015, was introduced as part of a broader overhaul of C.I.V. taxation. That reform sought to move away from taxation at fund level and to adopt an exit-based taxation model, with the stated aim of enhancing the international competitiveness of Portuguese investment funds and aligning the domestic regime with those of other European jurisdictions.

However, the manner in which the new regime was drafted resulted in the exemption being expressly limited to C.I.V.'s incorporated and operating under Portuguese law. Consequently, while resident funds benefit from a full exemption from C.I.T. on dividends received from Portuguese companies, nonresident C.I.V.'s are excluded from the scope of Article 22.

In practical terms, this legislative choice means that dividends paid by Portuguese companies to foreign investment funds remain subject to the general withholding tax rules of the Portuguese C.I.T. Code. Nonresident C.I.V.'s are, therefore, taxed at source on dividend income, typically at a 25% rate, subject only to potential mitigation under applicable double tax treaties.

This outcome gives rise to a clear case of discriminatory treatment. Resident and nonresident C.I.V.'s operate in an economically and functionally equivalent manner. In both cases, funds pool capital from multiple investors, invest in comparable financial instruments, and receive dividends generated by Portuguese companies. The place of establishment of the fund does not affect the nature of its activities, the source of the income received, or the underlying economic reality of the investment.

Despite this objective comparability, Portuguese tax law subjects nonresident C.I.V.'s to a materially less favorable tax treatment solely on the basis of residence. The decisive criterion for access to the exemption under Article 22 is not the functional characteristics of the vehicle, but its incorporation under Portuguese law. The resulting difference in treatment distorts capital allocation, increases the effective tax burden on foreign funds, and undermines tax neutrality.

THE FREE MOVEMENT OF CAPITAL UNDER EUROPEAN UNION LAW

The discriminatory effects arising from the Portuguese tax regime applicable to dividends paid to nonresident C.I.V.'s must be assessed in light of the principle of free movement of capital, enshrined in Article 63 of the T.F.E.U. That provision prohibits all restrictions on the movement of capital not only between Member States, but also between Member States and third countries, thereby conferring a particularly broad scope of protection in the field of cross border portfolio investment. This extended territorial reach distinguishes the free movement of capital from other fundamental freedoms and is of central relevance in the context of internationally diversified investment funds.

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Unlike freedoms such as (i) establishment or (ii) the provision of services, the free movement of capital explicitly applies to investments made from or into jurisdictions outside the internal market. As a result, national tax measures may fall within the scope of Article 63 T.F.E.U. even where they affect investments made through funds established outside the European Union, including funds incorporated, for instance, under the laws of the United States, China, or Brazil which invest in Portuguese companies alongside funds established in the internal market. The application of Article 63 T.F.E.U. to third country situations has been consistently confirmed by the C.J.E.U. and significantly widens the potential reach of nondiscrimination claims in the area of withholding taxation.

As consistently held by the C.J.E.U., a national tax measure constitutes a restriction on the free movement of capital where it is liable to deter nonresidents from making investments in a Member State or to discourage residents from investing capital abroad. This assessment focuses on the effects of the measure rather than its formal classification, and a restriction may exist even where the legislation does not explicitly discriminate on grounds of nationality. Differential tax treatment based on residence, when applied to objectively comparable situations, is sufficient to trigger a violation of the prohibition laid down in Article 63 T.F.E.U.

In the specific field of dividend taxation, the C.J.E.U. has repeatedly held that dividends distributed by companies resident in a Member State to resident and nonresident recipients are derived from the same source and must, therefore, be assessed under comparable conditions. Where a Member State grants an exemption from taxation on dividends paid to resident entities while subjecting dividends paid to nonresident entities to withholding tax, that regime is, in principle, capable of restricting the free movement of capital. This is particularly so where the tax burden imposed on nonresident investors cannot be offset by a credit or refund mechanism in their State of residence.

A restriction of this nature may only be justified if it pursues an overriding reason in the public interest recognized by the C.J.E.U., such as (i) the need to ensure the coherence of the tax system, (ii) to safeguard the balanced allocation of taxing powers, or (iii) to prevent tax avoidance. Even where such an objective is invoked, the measure must be appropriate to achieve that objective and must not go beyond what is necessary. In practice, the C.J.E.U. has applied these justifications strictly, particularly in cases where the Member State itself has chosen to exempt resident taxpayers from taxation on the same income.

It is against this legal and jurisprudential framework that the Portuguese exemption regime applicable to C.I.V.'s was examined. The limitation of the exemption under Article 22 of the Tax Benefits Statute to funds incorporated under Portuguese law, combined with the taxation of dividends paid to nonresident funds, squarely raises the question of compatibility with Article 63 T.F.E.U. and sets the stage for judicial scrutiny at the European level.

THE ALLIANZ-GI FONDS AEVN JUDGMENT

The compatibility of the Portuguese withholding tax regime with Article 63 T.F.E.U. was definitively addressed by the C.J.E.U. in its judgment of March 17, 2022 in (Case C545/19). That decision constitutes the cornerstone of the legal analysis in

this area and provided the interpretative framework subsequently adopted by Portuguese arbitration tribunals and courts.

The case arose from a request for a preliminary ruling submitted by a Portuguese tax arbitration tribunal in proceedings brought by a German regulated investment fund. The fund received dividends from Portuguese resident companies which were subject to withholding tax at source. On the other hand, dividends paid to Portuguese resident C.I.V.'s would have benefited from a full exemption under Article 22 of the Tax Benefits Statute. The fund challenged the withholding tax on the grounds that this difference in treatment infringed the free movement of capital guaranteed by Article 63 T.F.E.U.

In its analysis, the C.J.E.U. began by addressing the issue of comparability. It held that resident and nonresident C.I.V.'S are placed in objectively comparable situations with regard to the taxation of dividends received from Portuguese companies, as those dividends derive from the same source and are subject to tax by the same Member State. The C.J.E.U. expressly rejected the argument that differences in the tax treatment of investors, or the existence of other taxes applicable to resident funds, could affect the comparability analysis. The assessment must be carried out at the level of the fund itself, which is the direct recipient of the income and the taxpayer subject to withholding tax.

The C.J.E.U. further held that a tax regime under which dividends paid to resident C.I.V.'s are exempt from taxation, while dividends paid to nonresident C.I.V.'s are subject to withholding tax, constitutes a restriction on the free movement of capital. Such a regime can reasonably be expected to deter nonresident funds from investing in Portuguese companies and, conversely, to limit the access of Portuguese companies to foreign capital. The restrictive effect arises even if the withholding tax rate applicable to nonresident funds may be reduced under a double tax treaty.

Portugal argued that the difference in treatment could be justified by the need to preserve the coherence of the tax system and by the existence of alternative forms of taxation applicable to resident funds, such as Stamp Duty levied on net asset value. The C.J.E.U. rejected these arguments, noting that there was no direct link between the exemption granted to resident funds and any corresponding tax burden imposed on those same funds. The existence of other taxes of a different nature could not justify a residence-based exclusion from an exemption applicable to dividend income.

The C.J.E.U. also dismissed arguments based on the balanced allocation of taxing powers, emphasizing that Portugal chose to exempt resident funds from taxation on dividends and could not rely on that legislative choice to justify less favorable treatment of nonresident funds. The fact that the fund at stake was established in another Member State was sufficient to bring the situation within the scope of Article 63 T.F.E.U. and to trigger a violation of the prohibition of discriminatory treatment.

Although the dispute concerned an E.U. resident fund, the reasoning of the C.J.E.U. is equally applicable to funds established in third countries. Given that Article 63 T.F.E.U. extends to capital movements involving non-E.U. jurisdictions, the principles laid down in *AllianzGI-Fonds AEVN* apply, in principle, to any nonresident C.I.V. investing in Portuguese companies, subject to the limited exceptions recognized by

the C.J.E.U. This broader relevance has been confirmed by subsequent caselaw in other Member States concerning dividend withholding taxes levied on third country investors.

The *AllianzGI-Fonds AEVN* judgment marked a decisive turning point in the challenge to the position of the Portuguese tax authorities. It removed any remaining doubt as to the incompatibility of the Portuguese regime with European Union law and converted what had previously been a challenged doctrinal issue into a clear judicial standard. This standard would soon be internalized by Portuguese courts, paving the way for the consolidation of national caselaw and the systematic refund of withholding tax unduly levied on dividends paid to nonresident C.I.V.'s.

CONSOLIDATION OF PORTUGUESE CASE LAW

Following the *AllianzGI-Fonds AEVN* judgment, Portuguese tax arbitration tribunals and courts consistently applied its principles, declaring unlawful the withholding tax levied on dividends paid to nonresident C.I.V.'s and ordering the refund of tax unduly withheld.

The decisive step towards full legal certainty was taken by the Portuguese Supreme Administrative Court, which confirmed that Article 22 of the Tax Benefits Statute, as reformed in 2015, is incompatible with European Union law insofar as it limits the exemption to funds incorporated under Portuguese law. The Court clarified that comparability must be assessed at fund level and that regulatory or investor level considerations are irrelevant.

As a result, the incompatibility of the Portuguese regime with Article 63 T.F.E.U. ceased to be a matter of doctrinal debate and became a settled point of law within the Portuguese legal system.

PRACTICALITIES: REFUNDS, INDEMNITY INTEREST, AND PROCEDURAL CHOICES

The consolidation of European and national case law has had tangible and increasingly operational consequences for nonresident C.I.V.'s investing in Portuguese companies. In practice, the controversy has shifted from (i) the existence of a substantive right to relief to (ii) the mechanics of enforcement. As right to receive dividends without the imposition of withholding tax is the rule, the choices faced by a non-Portuguese C.I.V. relate to (a) the procedural route selected, (b) the evidentiary package assembled, and (c) the ability of asset managers and custodians to support claims consistently across multiple dividend events and multiple custody chains.

At the substantive level, the claim is typically framed as the recovery of dividend withholding tax levied on a nonresident C.I.V. in circumstances where resident funds benefit from a domestic exemption. The starting point remains the general Portuguese rule that dividends paid to nonresidents are subject to withholding tax at the standard 25% rate (with an increased rate in certain cases), while treaty relief may reduce that rate provided formal requirements are met. This treaty based mitigation, however, does not address the core discrimination problem identified by the

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C.J.E.U. and later internalized by Portuguese courts. In that sense, refund claims based on E.U. law operate on a different level than treaty relief and are designed to restore neutrality rather than merely cap withholding at a maximum treaty rate.

Once the substantive entitlement to restitution is accepted, the economic significance of a claim increasingly depends on indemnity interest. In 2025, the Portuguese Supreme Administrative Court clarified that, when national provisions are set aside due to incompatibility with E.U. law, taxpayers are entitled, not only to a refund of unduly withheld tax, but also to indemnity interest at a 4% yearly rate, accruing from the date of express or tacit rejection of a refund claim. This development matters because it addresses the cash economics of reclaims and reduces uncertainty around interest accrual, which had been treated inconsistently in earlier decisions. The Supreme Administrative Court’s clarification also forces claimants to pay closer attention to the procedural entry point used to challenge the withholding tax, as the starting date for indemnity interest may vary accordingly.

From a procedural standpoint, the choice of route is therefore not merely formal. One pathway is the use of an ordinary administrative claim (*reclamação graciosa*), subject to a two-year limitation period, with indemnity interest accruing from the date of express or tacit rejection of that claim. Another is the extraordinary administrative claim (*pedido de revisão oficiosa*), subject to a four-year limitation period. Under that route, indemnity interest may become due if the refund is not processed within one year from the date the claim was filed, and interest is calculated from that point onwards. In practical terms, these distinctions can materially change the overall recovery profile, particularly in portfolios where dividend distributions are frequent and claims are aggregated over multiple periods.

In this regard, tax arbitration has also become a prominent enforcement channel in Portugal. Under the Portuguese legal regime of tax arbitration, arbitration operates as an alternative jurisdictional mechanism intended to increase the speed of dispute resolution and reduce the burden on administrative and tax courts, with arbitral awards carrying the same legal force as court judgments. The procedural architecture of this regime is explicitly oriented towards speed, including a six-month time limit for the issuance of the arbitral award, subject to limited extensions, and flexible tribunal composition depending on the value of the claim.

Even in a legal environment where the underlying incompatibility of the withholding tax regime with European Union law is firmly established, the effectiveness of a refund claim remains closely linked to its procedural framing and factual substantiation. The existence of settled case law does not, in itself, dispense claimants from complying with domestic procedural rules governing limitation periods, admissibility and proof.

In this context, the evidentiary burden associated with refund claims, while conceptually straightforward, assumes practical relevance. Claimants must be able to demonstrate the receipt of Portuguese source dividends and the withholding tax levied at source, typically through documentation generated within the payment and custody chain rather than at the fund level. Where investments are held through intermediated or multilayer structures, the ability to reconstruct that chain and attribute the withholding to the relevant C.I.V. becomes decisive. Ultimately, the enforceability of rights derived from European Union law depends not only on doctrinal correctness, but also on the claimant’s capacity to translate those rights into procedurally sound and adequately substantiated claims.

In short, the Portuguese dividend withholding tax reclaim debate has matured. The core legal principle is now largely settled at European and national levels, but the practical outcome of any given claim increasingly depends on procedural engineering, documentation and disciplined execution.

CONCLUSION

The Portuguese tax regime applicable to dividends paid to nonresident C.I.V.'s illustrates how well-intentioned legislative reforms may generate unintended incompatibilities with European Union law. The reform of Article 22 in 2015 sought to enhance competitiveness, yet by confining the exemption to domestic funds it introduced a residence based distinction incompatible with the free movement of capital.

It is particularly striking that, despite the volume and consistency of judicial decisions declaring Article 22 incompatible with European Union law, the provision has not yet been amended. As a result, funds adversely affected by the regime continue to be forced to resort to litigation in order to secure the refund of tax unlawfully withheld.

This case once again confirms that nonresident investors should systematically assess whether the taxation of income derived in Portugal, or in any other Member State, withstands scrutiny under the E.U. fundamental freedoms and, where appropriate, take action. From a Portuguese perspective, the experience with Article 22 of the Tax Benefits Statute demonstrates that this provision is unlikely to be an isolated instance. Other domestic tax regimes that confer more favorable treatment on resident entities, in practice, than on comparable nonresident investors may likewise struggle to survive review under the principle of free movement of capital. In this context, asset managers and fund operators cannot adopt a passive stance. A proactive and critical assessment of potentially discriminatory tax treatment has become an essential component of cross border investment governance within the European Union.

Ultimately, the Portuguese case underscores the decisive role of courts in safeguarding the effectiveness of E.U. fundamental freedoms and highlights the importance of neutrality, comparability, and legal certainty in cross border investment.



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