JUDGMENT OF THE COURT (First Chamber)

6 October 2011 (*)

(Failure of a Member State to fulfil obligations – Article 63 TFEU and Article 40 of the EEA Agreement – Free movement of capital – Foreign and national pension funds – Corporation tax – Dividends – Exemption – Difference in treatment)

In Case C?493/09,

ACTION under Article 258 TFEU for failure to fulfil obligations, brought on 1 December 2009,

European Commission, represented by R. Lyal and M. Afonso, acting as Agents, with an address for service in Luxembourg,

applicant,

v

Portuguese Republic, represented by L. Inez Fernandes and H. Ferreira, acting as Agents,

defendant,

THE COURT (First Chamber),

composed of A. Tizzano, President of the Chamber, J.-J. Kasel, A. Borg Barthet, E. Levits (Rapporteur) and M. Safjan, Judges,

Advocate General: P. Mengozzi,

Registrar: M. Ferreira, Principal Administrator,

having regard to the written procedure and further to the hearing on 24 March 2011,

after hearing the Opinion of the Advocate General at the sitting on 25 May 2011,

gives the following

Judgment

1 By its action the European Commission seeks a declaration from the Court that, by taxing dividends received by non-resident pension funds at a higher rate than dividends received by pension funds resident in Portuguese territory, the Portuguese Republic has failed to fulfil its obligations under Article 63 TFEU and Article 40 of the Agreement on the European Economic Area of 2 May 1992 (OJ 1994 L 1, p. 3, 'the EEA Agreement').

Legal context

2 Under Article 16(1) of the scheme applicable to tax advantages (Estatuto dos Beneficios Fiscais, ‘the EBF’), income earned by those pension funds and entities assimilated to them that are established and operate in accordance with Portuguese law are exempt from corporation tax (Imposto sobre o Rendimento das Pessoas Colectivas, ‘the IRC’).

3 Article 16(4) of the EBF provides that, in the event of non-compliance with the conditions laid down in Article 16(1), enjoyment of the advantage provided for in Article 16(1) is not to apply in respect of the year concerned, the companies managing the pension fund and assimilated entities, including mutual associations, being liable as principals for taxes owed on the funds or assets for whose management they are responsible and being liable to pay the tax due within the period provided for in Article 120(1) of Code on Corporation Tax (Código do Imposto sobre o Rendimento das Pessoas Colectivas, the ‘CIRC’).

4 Article 4(2) of the CIRC provides that legal persons and other entities that have neither their headquarters nor their actual management in Portuguese territory remain subject to the IRC only in respect of income obtained in Portuguese territory. Article 80(4)(c) of the CIRC specifies that the rate of the IRC is 20%, without prejudice to the provisions of double taxation agreements.

5 Under Article 4(3)(c), paragraph 3, of the CIRC, income from the investment of capital owed by a person having its domicile, headquarters or actual management on Portuguese territory, or payment of which is attributable to a permanent establishment situated on Portuguese territory, forms part of the income of non-residents that is taxable in Portugal.

6 Under Article 88(1)(c), (3)(b) and (5) of the CIRC, the IRC is levied at source as definitive tax.

7 Article 88(11) of the CIRC states:

‘A tax rate of 20% shall be imposed on profits distributed by entities subject to the IRC to entities qualifying for total or partial exemption, including, in this case, income on capital, where the securities giving entitlement to the profits have not remained in the continuous ownership of the same taxable person throughout the year preceding the date of acquisition have not been retained for the time necessary to complete that period.’

8 Article 88(12) of the CIRC provides:

‘Any tax deducted at source shall be deducted from the amount of the tax determined in accordance with the provisions of paragraph 11. Tax deducted at source may not then be deducted under Article 90(2).’

Pre-litigation procedure

9 On 23 March 2007 the Commission sent a letter of formal notice to the Portuguese Republic, in which it claimed that Portuguese tax provisions relating to the treatment of dividends and interest received by pension funds not resident in Portuguese territory were incompatible with Article 63 TFEU and Article 40 of the EEA Agreement.

10 As it was not satisfied with the Portuguese Republic’s response of 18 June 2007, on 8 May 2008 the Commission sent a reasoned opinion to that Member State, calling upon it to adopt the measures necessary to comply therewith within two months of receipt.

11 In its reply of 14 August 2008, the Portuguese Republic acknowledged that the tax scheme in question constituted a restriction on the free movement of capital but submitted that such a

restriction was justified under European Union (‘EU’) law. In particular, it submitted that the more favourable tax scheme reserved for pension funds resident in Portugal offsets the specific statutory duties imposed on them.

12 Since it was not satisfied by those explanations, the Commission decided to bring these proceedings for failure to fulfil obligations.

Procedure before the Court

13 By application lodged at the Registry of the Court on 8 April 2010 under the third subparagraph of Article 40 of the Statute of the Court of Justice of the European Union and Article 93 of the latter’s Rules of Procedure, the EFTA Surveillance Authority applied to intervene in this case in support of the form of order sought by the Commission.

14 By order of 15 July 2010, the President of the Court rejected that request.

The action

Arguments of the parties

15 The Commission submits that the Portuguese tax system applicable to pension funds establishes a difference in treatment on the basis of the place of residence of those funds. Thus, dividends paid to pension funds established and operating in accordance with Portuguese law are entirely exempt from the IRC, whereas similar dividends paid to non-resident pension funds are subject to it.

16 The Commission considers that that difference in treatment constitutes a restriction on the free movement of capital, insofar as investment by non-resident pension funds in Portuguese companies is made less attractive.

17 At the outset, the Portuguese Republic states that, according to Article 88(11) of the CIRC, there is no difference in treatment between resident and non-resident pension funds where the distributed dividends arise from shares held by the beneficiary fund for a period of less than a year, as those profits are, in both cases, liable to the IRC.

18 In other cases, the Portuguese Republic acknowledges the existence of a restriction on the free movement of capital but submits that it is justified in two respects.

19 Firstly, the tax scheme applicable to pension funds is justified for the purpose of preserving the coherence of the tax system. Thus, the exemption from tax of the income of resident pension funds is offset by the taxing of pensions paid to beneficiaries resident in Portugal by means of tax on the income of natural persons. In the context of pensions, a broad interpretation of that overriding reason relating to the public interest is necessary in order to eliminate any risk of interference with the financial balance of the social security system.

20 Secondly, the Portuguese Republic submits that the limitation of the IRC exemption to resident pension funds is based on requirements linked to effective fiscal supervision. Thus, the statutory requirements giving rise to the entitlement to benefit from the IRC exemption require it to be possible for the funds wishing to avail themselves of that exemption to be directly supervised by the Portuguese tax authorities.

21 Thus, pension funds resident in Portugal are subject not only to prudential requirements and particularly strict investor protection arising from Directive 2003/41/EC of the European Parliament and of the Council of 3 June 2003 on the activities and supervision of institutions for occupational

retirement provision (OJ 2003 L 235, p. 10), but also to additional conditions specific to Portuguese law, in particular with regard to financial responsibility. Thus, Article 16(4) of the EBF provides, inter alia, that pension fund management companies are primarily responsible for tax debts of the funds or assets they are responsible for managing.

22 Supervision of those matters is particularly complex and requires the Portuguese tax authorities to be able to communicate directly with the pension fund qualifying for the IRC exemption. In particular, in the event of non-compliance with the requirements of Portuguese law relating to the IRC exemption, direct surveillance of the funds is essential to ensure repayment of the amounts due by way of IRC. Such control would be impossible with regard to pension funds resident in another Member State and, a fortiori, to those resident in a third State party to the EEA Agreement, since the provisions of EU law on cooperation in tax matters are not applicable in this context.

23 In response to those arguments, the Commission submits, firstly, that the justification relating to the coherence of the tax system cannot be upheld in relation to the restriction on the free movement of capital caused by the Portuguese pension funds tax system.

24 Thus, on the one hand, the IRC levied on the income of non-resident pension funds does not constitute a direct source of finance for the social security system. On the other hand, the offsetting of the loss of tax revenue resulting from the IRC exemption by taxing pension funds is effective only in cases where the beneficiaries of those pensions reside in Portugal.

25 Secondly, the Commission states that the restriction at issue is not justified by considerations linked to effective fiscal supervision either.

26 Indeed, on the one hand, the alleged competitive advantage, from which non-resident pension funds benefit in relation to the conditions to be fulfilled, cannot justify less favourable tax treatments being applied to them.

27 On the other hand, the tax treatment reserved for non-resident pension funds cannot be regarded as seeking to protect the companies in which they invest as well as the individuals residing in Portugal. It simply restricts the benefit of the IRC exemption to resident pension funds, without allowing non-resident pension funds the chance to prove that they offer guarantees equivalent to those offered by resident funds. Therefore, to secure the attainment of the objectives set out by the Portuguese Republic, it would be sufficient to request non-resident pension funds to provide evidence of their status and of the statutory framework in which they operate, where the cooperation and mutual assistance mechanisms provided for by EU law, but also by multilateral and bilateral agreements with regard to third States party to the EEA Agreement, enable the Portuguese authorities to carry out the necessary checks and even to recover tax debts owed.

Findings of the Court

The existence of a restriction on the free movement of capital

28 It follows from settled case-law that the measures prohibited by Article 63(1) TFEU, as restrictions on the movement of capital, include those that are such as to discourage non-residents from making investments in a Member State or to discourage that Member State’s residents from doing so in other States (Joined Cases C?436/08 and C?437/08 *Haribo Lakritzen Hans Riegel and Österreichische Salinen* [2011] ECR I?0000, paragraph 50).

29 In relation to whether the national law at issue constitutes a restriction on the free movement of capital, it must be noted that in order for them not to be liable to the IRC, dividends distributed to

pension funds by companies established in Portuguese territory must fulfil two conditions. On the one hand, they must be paid to pension funds established and operating in accordance with Portuguese law. On the other hand, those dividends must be distributed in respect of shares that have been in the continuous ownership of the same pension fund for a minimum period corresponding to one year preceding the date of their availability and retained for the time necessary to complete that period.

30 It follows that, due to the first condition provided for by the national law at issue, investment that may be made in a Portuguese company by a non-resident pension fund is less attractive than an investment that may be made by a resident pension fund. Indeed, in the first case only dividends distributed by the Portuguese company are subject to a rate of 20% in respect of the IRC even if they arise from shares that have been in the continuous ownership of that pension fund for a minimum period corresponding to one year preceding the date of their availability. That difference in treatment has the effect of dissuading non-resident pension funds from investing in Portuguese companies and savers resident in Portugal from investing in such pension funds.

31 That difference in treatment however does not exist where the dividends paid by a resident company arise from shares that have not been in the continuous ownership of the same taxable person during the year preceding the date of their availability. Indeed, under Article 88(11) of the CIRC, the exemption provided for in Article 16(1) of the EBF is not applicable in those conditions, so that those dividends are subject to corporation tax whatever the place of residence of the pension fund to which they are paid.

32 In those circumstances, it must be concluded that, in relation to the taxation of dividends distributed by companies established in Portuguese territory in respect of shares owned by a pension fund for longer than one year, the disputed law constitutes a restriction on the free movement of capital that is prohibited, in principle, by Article 63 TFEU.

Reasons that may justify the law at issue

33 As is apparent from settled case-law, national measures restricting the free movement of capital may be justified on the grounds set out in Article 63 TFEU or by overriding reasons relating to the public interest provided that they are appropriate to secure the attainment of the objective which they pursue and do not go beyond what is necessary in order to attain it (see Case C?233/09 *Dijkman and Dijkman-Lavaleije* [2010] ECR I?0000, paragraph 49 and the case-law cited).

34 In the Portuguese Republic’s view, the law at issue is justified by reasons relating to the necessity of preserving, on the one hand, the coherence of the tax system and, on the other hand, the effective supervision of the requirements which pension funds must meet in order to benefit from the exemption from the corporation tax in dispute.

– The objective relating to the necessity of preserving the coherence of the tax system.

35 It should be noted that the Court has already acknowledged that the need to maintain the coherence of a tax system can justify a restriction on the exercise of the fundamental freedoms guaranteed by the EC Treaty (see Case C?418/07 *Papillon* [2008] ECR I?8947, paragraph 43, and *Dijkman and Dijkman-Lavaleije*, paragraph 54).

36 For an argument based on such a justification to succeed, the Court requires, however, a direct link to be established between the tax advantage concerned and the offsetting of that advantage by a particular tax levy, with the direct nature of that link falling to be examined in the light of the objective pursued by the rules in question (see *Papillon*, paragraph 44, and *Dijkman and Dijkman-Lavaleije*

, paragraph 55).

37 In that regard, the Portuguese Republic has not satisfactorily shown that such a link exists where it merely submits that the corporation tax exemption offsets the income tax payable by members of pension funds resident in Portugal in respect of the pensions that they receive and thus allows the double taxation of that income to be avoided.

38 Moreover, it must be noted that, on the one hand, it does not follow from the law at issue that income paid to beneficiaries residing in Portugal by non-resident pension funds is not subject to income tax. Therefore, in such circumstances, dividends paid to non-resident funds are subject to corporation tax and the amount paid to resident beneficiaries by those funds is subject to income tax.

39 On the other hand, where a resident fund pays income to a non-resident beneficiary, the dividends it receives are exempt from corporation tax, whatever the tax treatment reserved for the income that those funds pay in the State of residence of the beneficiary of those funds.

40 Moreover, concerning the argument relating to the need to ensure the maintenance of the Portuguese pension system, the Portuguese Republic did not put forward any information making it possible to determine the extent to which not exempting dividends paid to non-resident funds from corporation tax affects the financing of that system.

41 Therefore, having regard to the information it has put forward, the Portuguese Republic cannot rely on the need to preserve the coherence of the tax system in order to justify the restriction on the free movement of capital that arises from the legislation at issue.

– The objective relating to the need to guarantee effective supervision

42 It is settled case-law that the need to guarantee the effectiveness of fiscal supervision constitutes an overriding reason in the public interest capable of justifying a restriction on the exercise of fundamental freedoms guaranteed by the Treaty (see *Dijkman and Dijkman-Lavaleije*, paragraph 58 and the case-law cited).

43 In the Portuguese Republic's view, the exemption from the IRC is consideration for pension funds' satisfying the requirements laid down by Directive 2003/41 and Portuguese law.

44 In particular, the conditions that resident pension funds must fulfil in order to avail themselves of the corporation tax exemption are intended to ensure the maintenance of the Portuguese pension system, by subjecting those funds to particularly strict requirements as concerns management, operation, capitalisation and financial responsibility. The supervision of those requirements is possible only insofar as those funds reside in Portugal.

45 In that regard, it must, however, be noted that the legislation in dispute excludes, in principle, non-resident pension funds from availing themselves of the IRC exemption, without giving them the chance to prove that they meet the requirements set by Portuguese law. Therefore, the Portuguese Republic cannot maintain that the difference noted between the treatment afforded to resident pension funds and that reserved for non-resident pension funds in respect of the IRC exemption is consideration for the first of those funds' satisfying the requirements laid down by that legislation. Non-resident pension funds are in any event excluded from benefiting from that exemption, even if they fulfil the requirements needed to obtain that exemption.

46 National law that absolutely prevents a pension fund from submitting evidence that it

satisfies the requirements that would allow it to benefit from the IRC exemption, if it were resident in Portugal, is not justified in the name of the effectiveness of fiscal supervision. It cannot be excluded, a priori, that pension funds resident in a Member State other than the Portuguese Republic may be able to provide relevant documentary evidence enabling the Portuguese tax authorities to ascertain, clearly and precisely, that they meet equivalent requirements to those laid down by Portuguese law, in their State of residence.

47 Such an assessment applies to EU Member States and Member States of the European Economic Area (‘EEA’) particularly because, as the Advocate General noted at points 57 and 58 of his Opinion, Decree-law No 12/2006 of 20 January 2006, put forward by the Portuguese Government in its defence, is intended to transpose Directive 2003/41, the application of which has been extended to EEA Member States.

48 In any event, the fact that it is absolutely impossible for non-resident pension funds to benefit from the exemption granted to pension funds resident in Portugal cannot be considered to be proportionate with regard to the difficulties pleaded by the Portuguese Republic in relation to the collection of information and recovery of tax debts.

49 Firstly, in relation to funds residing in a Member State other than the Portuguese Republic, Council Directive 77/799/EEC of 19 December 1977 concerning mutual assistance by the competent authorities of the Member States in the field of direct taxation (OJ 1977 L 336, p. 15), and also Council Directive 2008/55/EC of 26 May 2008 on mutual assistance for the recovery of claims relating to certain levies, duties, taxes and other measures (OJ 2008 L 150, p. 28) provide the Portuguese authorities with a cooperation and assistance framework enabling them to obtain the information required by national law, and also the means of recovering possible tax debts from non-resident pension funds.

50 Secondly, in relation to pension funds residing in an EEA Member State, while it is true that the mechanisms described in the preceding paragraph of this judgment are not applicable as things stand, it must be noted, on the one hand, that the law at issue does not make the benefit of the exemption from corporation tax subject to a bilateral assistance agreement between the Portuguese Republic and the EEA Member States which enables cooperation and assistance equivalent to that put in place between the EU Member States. On the other hand, as the Advocate General noted at point 70 of his Opinion, measures less restrictive of the free movement of capital than those in the law at issue could be envisaged to ensure the recovery of tax debts, such as the obligation to provide, a priori, the necessary financial guarantees for the payment of those debts.

51 It follows that the restriction on the free movement of capital arising from the law in dispute cannot be justified on the grounds relied upon by the Portuguese Republic.

52 Accordingly, it must be held that, by reserving the benefit of the corporation tax exemption to pension funds resident in Portuguese territory alone, the Portuguese Republic has failed to fulfil its obligations under Article 63 TFEU and Article 40 of the EEA Agreement.

Costs

53 Under Article 69(2) of the Rules of Procedure, the unsuccessful party is to be ordered to pay the costs if they have been applied for in the successful party’s pleadings. As the Commission has applied for a costs order against the Portuguese Republic and the latter has been unsuccessful, the Portuguese Republic must be ordered to pay the costs.

On those grounds, the Court (First Chamber) hereby:

1. **Declares that, by reserving the benefit of the corporation tax exemption to pension funds resident in Portuguese territory alone, the Portuguese Republic has failed to fulfil its obligations under Article 63 TFEU and Article 40 of the Agreement on the European Economic Area of 2 May 1992;**

2. **Orders the Portuguese Republic to pay the costs.**

[Signatures]

* Language of the case: Portuguese.