

Publications

Continued European Litigation Over Disparate Tax Treatment of Non-EU and EU Pension Funds

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Another development has arisen in the ongoing concerns regarding whether local tax rules in EU countries unfairly favor investment by local pension funds over those established outside the EU. The general theory is that Articles 63, 64, and 65 of the Treaty on the Functioning of the European Union (“TFEU”), to the extent they prohibit restrictions on the free movement of capital by reason of the effective tax burden, require comparable tax treatment of pension funds not only among EU countries but also with countries outside the EU. (Article 63 provides in part that “all restrictions on the movement of capital between Member States *and between Member States and third countries* shall be prohibited.”) Some large non-EU pension funds with sizable investments in some EU countries have found it worthwhile to litigate in this area to recover taxes they have paid. A recent case has involved the College Pension Plan of British Columbia.

To greatly oversimplify, under German tax law, German pension funds, though subject to tax on their investment income, are able to reduce their taxable profit by in deducting the amounts reserved to meet their pension payment obligations, these amounts are referred to as technical provisions, and German resident funds are also allowed to credit withholding tax paid against their final income tax, with the ability to obtain refunds of excess amounts. The view is that this effectively permits German funds to pay less than 15% tax on dividends received. Dividends paid to the College Pension Plan by German payors, however, had been subject to withholding at the 15% rate provided under the Canada-Germany tax treaty. The Canadian plan had applied for a refund, and after the refund was denied, appealed to a German tax court, the Finanzgericht München (Finance Court, Munich). There, the Finance Court, Munich, first requested that the European Court of Justice (“ECJ”) consider two interpretative questions of EU law to be answered. In 2019, the ECJ essentially answered those two questions by holding that the College Pension Plan is objectively comparable to a German pension fund, and also that the German dividend withholding tax levied from the Canadian plan would violate the free movement of capital provision of the TFEU if, like German pension funds, the College Pension Plan uses the dividend income

received for its pension liability technical provisions (*i.e.* adds the dividend income to the pension liability reserve). Whether it does so

was a question of fact which the ECJ then referred back to the Finance Court, Munich. Thus, the initial ECJ decision, College Pension Plan of British Columbia, C-641/17, was favorable to the Canadian plan.

However, the Finance Court, Munich, issued its decision on the referral in December 2021, and it is not favorable to the Canadian plan. The Finance Court, Munich's decision on referral examined the College Pension Plan's financial statements and held that the pension fund did not allocate dividends received to make technical provisions for pensions which it will have to pay in the future. Thus, the claims for refund were dismissed. The College Pension Plan is understood to be appealing to the Federal Fiscal Court. One question the decision raises may be the extent to which it is difficult to transpose German civil law pension concepts such as technical provisions with Canadian common law trust concepts. In any event, non-EU pension funds have received a setback for now on refund claims based on the free movement of capital provisions of the TFEU, at least in Germany.

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