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European Litigation on Taxes on Cross-Border Pension Investment – Should Your Plan Look for Refunds?

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Many countries impose withholding on dividends and interest and impose other taxes on payments made to nonresidents. The US has treaties with many countries that reduce (in some cases to zero) such withholding on dividends and interest paid by the other state to US pension funds. But US pension funds may still pay some withholding on dividends and interest, or may not be exempt from some other foreign taxes on investment.

For the last several years, there has been an ongoing effort by the European Commission (EC) and European plan sponsors to have various taxes imposed by European states on cross-border pension investment in Europe declared in violation of various provisions of the Treaty on European Union (TEU), Treaty on the Functioning of the European Union (TFEU, the Treaty of Rome), and bilateral tax treaties, including those based on the OECD model treaty. This has resulted in a number of cases before the European Court of Justice (ECJ) regarding whether various withholding taxes on dividends and other taxes have violated such nondiscrimination provisions insofar as they result in higher taxes on foreign investors, including pension funds, versus local country investors and pension funds.

It is particularly worth noting that some European tax advisors believe there may be a basis for a claim that taxes by EU countries that discriminate against non-EU (such as US) pension funds compared to local funds may be impermissible as well. One reason is that many of these cases concern Article 56 of the TFEU, which provides that, subject to that article, "all restrictions on the movement of capital between Member States *and between Member States and third countries* shall be prohibited." [Emphasis added.] As a result, US plans with EU investments may wish to consider filing claims for refund of taxes on the basis of such nondiscrimination laws, which are known as "Fokus Bank" claims based on an early decision in the area back in 2004. At least one case to date, holding that the French tax withholding on dividends paid to "undertakings for collective investments in transferable securities funds", known as UCITS, was discriminatory, involved US pension fund investors. See, Santander Asset Management SGIIC SA, et al. v. Ministre du Budget. ECJ, May 10, 2012, Cases C-338/11 to C-347/11. In an earlier decision, Paris Appeal Court 6-12-2007 / Conseil d'Etat 13-2-2009, a French court had held that French taxes imposed on a Netherlands pension fund, including withholding on capital gain on French real property and on dividend income, was discriminatory under the France/Netherlands tax treaty where similar French pension entities were not subject to such withholding.

Since that time, the EC has been understood to be taking various actions involving taxes in the Czech Republic, Spain, Estonia, Latvia, the Netherlands, Poland, Portugal, Slovakia, Finland, Germany, Austria, Denmark, Italy and Sweden. In each case, the taxes involved and the nondiscrimination issues tend to be unique and complex.

In one recent case decided on November 8, 2012, the ECJ decided that certain Finnish taxes paid on dividends to nonresident pension funds was applied in a discriminatory manner. In European Commission v. Finland (C-342/10), the court examined Finnish legislation under which Finnish resident pension funds are taxed on Finnish dividend payments at a rate of 18.38%. The ECJ found that dividends received by resident pension funds were, in practice, exempt or at least partially exempt from income tax as a result of certain provisions of the tax, so that dividends paid to nonresident pension funds were treated less favorably on a gross basis. The court held that this constituted a restriction on the free movement of capital prohibited by the TFEU and other agreements.

In another recent case decided on November 22, 2012, COM vs. Germany (C-600/10), the ECJ decided that certain taxes on dividends of foreign pension funds were permissible. In that case, according to German tax law, dividends received by foreign pension funds are subject to a withholding tax on the gross amount, whereas domestic pension funds could set off business expenses and certain amounts used to build up funding technical reserves against such taxes. The EC since 2009 had challenged that tax though an infringement procedure against Germany, but only with respect to the lack of offset for business expenses, generally bank fees and transaction fees. The court found it had not been shown that a foreign plan would incur these expenses. The decision does not, however, address whether the German taxation of dividends received by foreign pension funds complies with EU law in all respects, and a separate issue appears to remain over whether it is permissible that amounts to build up technical reserves, required for most pension plans, are deductible for purposes of the withholding tax only for German pension funds.

With the EC continuing to litigate over discrimination in taxation between domestic and foreign pension funds, this is an area that pension funds that invest across borders in Europe, including US plans investing in Europe, may wish to monitor and consider filing claims for refund in some cases to safeguard their rights.

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