The elimination of tax obstacles to pan-European pension funds: An overview

Tax obstacles were always seen as the main barrier to pan-European pension funds. The European Commission worked very hard to eliminate these obstacles. As a result the perspective is changing rapidly. **Peter Schonewille** reports.

In 14 out of the 15 old Member States contributions paid to pension funds by employees and/or employers enjoy some form of tax relief. In many instances this relief was only given for contributions made to domestic pension funds. Contributions to foreign funds had been excluded from the relief. This constitutes an effective barrier to the functioning on pan-European funds: all things being equal, nobody would take out pension insurance from a foreign fund if they do not get the same tax subsidy as when paying to a domestic fund.

Therefore, in April 2001, in parallel with the proposal for the Pension Fund Directive of October 2000, the European Commission issued its "Communication on the elimination of tax obstacles to the cross-border provision of occupational pensions". In the Communication the Commission presented legal analysis concluding that the above discrimination of foreign pension funds is contrary to the EC Treaty and announced that it would monitor national rules, and where necessary, begin legal proceedings before the European Court of Justice in Luxembourg (ECJ). In 2003, following-up its Communication, the Commission decided to refer Denmark to the ECJ; and initiated legal proceedings against seven other Member States for alleged discrimination against foreign pension funds. Below is an overview of the state of play.

<u>Belgium</u>

The Commission has sent Belgium a letter of formal notice and a reasoned opinion (these are, respectively, the first and second steps in the infringement procedure, under Article 226 of the EC Treaty, whereby the Commission can call on the ECJ to rule that a Member State has failed to fulfil a treaty obligation. The third step is the actual referral to the ECJ). It is not yet known whether Belgium will comply with the Commission's request.

<u>Denmark</u>

Denmark also received a letter of formal notice and a reasoned opinion, but has indicated that it does not want to change its law. The Commission has therefore referred Denmark to the ECJ (Case C-150/04, referred on 23 March 2004).

<u>Germany</u>

Germany operates various systems to provide occupational pensions. Some follow the TEE approach (contributions <u>T</u>axed, fund <u>E</u>xempt, benefits <u>E</u>xempt), others follow the EET approach. When applying EET, Germany does not appear to discriminate against foreign pension funds.

Greece

The situation in Greece is not entirely clear, although the European Commission has not announced the opening of any infringement procedure against Greece.

Spain

Spain also received a formal notice and a reasoned opinion from the Commission. It has replied that it will change its legislation before 23 September 2005 - the deadline for the implementation of the Pension Fund Directive. The Commission, however, estimated that this timetable was not sufficient and has sent Spain a reasoned opinion.

France

France also received a formal notice and a reasoned opinion from the Commission. It, too, has replied that it will change its legislation.

Ireland

So far, Ireland has only received a letter of formal notice. There are signals from tax practitioners that sometimes, it may already be possible to get tax relief for contributions paid from Ireland to foreign pension funds, although the proper legal basis for such relief does not yet seem to exist. Therefore, in principle, Ireland does not appear to have any major objections to providing tax relief for cross-border contributions, and it may be willing to adapt its legislation to put matters beyond doubt.

Italy

To date, Italy has also only received a letter of formal notice. It is not yet clear whether, and if so, when the Commission would move to the next step of the infringement procedure. It is equally possible that Italy will comply with the demands of the Commission.

Luxembourg

Luxembourg is the only old Member State which has the TEE system for all its occupational pensions. It applies this system to contributions to both domestic and foreign funds. Its system is therefore not discriminatory.

Netherlands

The Netherlands allows a tax deduction for contributions paid to foreign funds. As such the Dutch system is not discriminatory. However, the Dutch anti-abuse rules, when applied to cross-border contributions, may go further than is strictly necessary, especially in the light of a recent ECJ ruling on French exit taxes (Case C-9/02, de Lasteyrie du Saillant, of 11 March 2004).

Austria

Austria appears to treat contributions paid to foreign funds in the same way as contributions to domestic funds. Accordingly, its system does not give rise to concern.

Portugal

Portugal has received a letter of formal notice and a reasoned opinion from the Commission. It is not yet known whether Portugal will comply with the Commission's request and adopt legislation that will end discrimination against foreign funds.

Finland

Finland has rules discriminating against foreign funds, but lost its case in the ECJ (Case C-136/00 *Danner* of 3 October 2002, a request for a preliminary ruling by the ECJ from a Finnish judge). Pending the necessary changes of its tax law, Finland is already allowing tax deduction for contributions to foreign funds, as it does for domestic funds.

Sweden

Sweden is in the process of implementing the ruling by the ECJ in the *Skandia/Ramstedt* case (Case C-422/01) of 26 June 2003. At the moment when this article was written (31 March 2004) it was not yet clear how Sweden would do that. A challenge for Sweden is that is has the ETT system, under which a tax is levied not only on the benefits, but also from the investment results and capital gains of the pension fund, the so-called yield tax. One solution for Sweden might be to conclude contracts with the foreign pension funds, allowing tax deduction for contributions paid to them, on condition that they would pay the yield tax to Sweden, just as Swedish pension funds would do. Advocate-General Jacobs of the ECJ seemed to support this solution, in his opinion on the *Danner* case against Finland.

United Kingdom

The United Kingdom is in the middle of a major reform of its pension system. The Commission has sent it a letter of formal notice. The new tax legislation needed in the framework of the broader reform seems a good opportunity to end any discrimination, but at the time of writing, it was not yet clear what the UK government intended to do with contributions paid to foreign funds.

New Member States

At present, no overview exists of the pension taxation systems in the new Member States, nor of any potentially discriminatory features that they might possess. The Pensions Forum, run by the European Commission's Directorate-General Employment and Social Affairs is examining whether it can establish such an overview. The new Member States need to comply with the rules of the Single Market in the same way as the old Member States. It may, therefore, be necessary that the Commission starts legal proceedings against some of the new Member States, just as it did with the old Member States.

Overview

It follows from the above that three Member States, Germany, The Netherlands and Austria, were already allowing cross-border deductions before the Commission issued its Communication of April 2001. Finland started to do so, on the basis on an ECJ ruling against it, and two Member States, Spain and France have announced that they will comply with the request of the Commission to end the discrimination against foreign funds. A number of Member States, Belgium, Ireland, Greece, Italy, Portugal, Sweden and the United Kingdom have not yet decided what to do, or their legal situation is unclear, but some of them can be expected to comply in the not-too-distant future.

Denmark is the only Member State which has persisted in refusing to comply with the Commission's request to end the different treatment of contributions paid to foreign funds. It will, therefore, be the next case in the area of pension taxation to be decided by the ECJ, and it is difficult to see how its rules could possibly be upheld. Denmark's main defence is expected to be that the coherence of its tax system would collapse if it were to extend national treatment to contributions paid to foreign funds. However, this argument can easily be rejected by referring to the large number of Member States that already allow cross-border deduction or have announced that they will do so in the near future, apparently without any risk for the coherence of their tax systems.

Conclusion

The main tax obstacle to the functioning of pan-European pension funds is the exclusion from tax relief of cross-border contributions. Many Member States have eliminated this obstacle or have announced that they will do this soon. The few Member States which may wish to continue the discrimination against foreign funds may find it very difficult to explain to the ECJ why they cannot do what so many other Member States already have. The conclusion of this article is, therefore, that for most situations, the main tax obstacle for pan-European pension funds will have been eliminated by the implementation date of the Pension Fund Directive, that is by 23 September 2005.

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