AG Opinion in the College Pension Plan of British Columbia case

Dividend Withholding Tax – Net Taxation - Third Country - Free Movement of Capital – Pension Fund – Germany

On June 5, 2019, Advocate General (AG) Pikamäe of the Court of Justice of the European Union (CJEU) rendered his Opinion in the College Pension Plan of British Columbia case (C-641/17) concerning the compatibility with EU law of the German withholding tax on dividends paid to a Canadian pension scheme. The AG concluded that the German legislation constitutes an unjustified restriction to the free movement of capital and noted that the derogation from the prohibition on restrictions to the free movement of capital with non-EU countries (also referred to as the 'Standstill Clause") is not applicable to the case at hand..

Background

The College Pension Plan of British Columbia is a tax-exempt Canadian resident pension fund in the legal form of a common law trust. During the years 2007 through 2010, the pension fund received dividends from German stock corporations, which were subject to a 15% withholding tax pursuant to the Canadian-German double taxation treaty.

The fund applied for a refund of the withholding tax, arguing that such treatment is discriminatory. Under German law, a German pension fund would be allowed to deduct technical reserves taking account of its future pension liabilities. This means that only the net income is subject to corporate income tax at the rate of 15%. In addition, the German withholding tax that a German pension fund suffers during a fiscal year is credited against its final corporate income tax, and any excess amount is reimbursed. As a result, German pension funds are exempt or practically exempt from tax, thereby putting non-resident funds at a disadvantage.

The German tax authorities denied the refund and the Canadian pension fund appealed the decision before the Fiscal Court of Munich. In October 2017 the Fiscal Court requested a preliminary ruling from the CJEU on whether the German dividend withholding tax is compatible with the free movement of capital.

The AG Opinion

Observing that the dividends received by the Canadian pension fund stem from portfolio investments, the AG first noted that the German legislation must be examined in light of the free movement of capital. He then considered whether a restriction exists, analysing in turn whether such restriction results from the fact that German pension funds are taxed on their net income or from the fact that they can credit the withholding tax paid against their final corporate income tax, and obtain a refund of any excess amount. The AG noted that it is for the referring court to analyse whether non-resident pension funds are subject to a higher effective tax burden than German funds, and calculated that there is a less advantageous tax treatment of dividends received by non-resident pension funds irrespective of the amount of provisions that may be deducted by the German funds. He therefore concluded that a restriction on the free movement of capital exists only as a result of the withholding tax credit mechanism.

Referring to settled case law in this respect, he further noted that resident and non-resident pension funds are in a comparable situation in light of the presumed objectives of the German tax system. However, he also explained that taxing resident funds on a net basis does not constitute a restriction to the free movement of capital, as there is no direct link between the dividend income received by a pension fund and its technical reserves. Finally, the restriction resulting from the withholding tax credit mechanism cannot be justified by overriding reasons in the public interest.

The AG then established that the Standstill Clause does not apply. This clause allows a derogation from the prohibition on all restrictions existing on December 31, 1993 to the free movement of capital between Member States and third countries, where such capital movements involve direct investment, establishment, the provision of financial services or the admission of securities to capital markets. Although the German legislation was already in place on December 31, 1993 and has not been significantly amended since, he nonetheless noted that portfolio investments do not fall within the material scope of the clause, as they do not qualify as direct investments. Nor does the present case qualify as the provision of financial services.

As a consequence, the German legislation constitutes an unjustified restriction to the free movement of capital that does not fall within the scope of the Standstill Clause.

EU Tax Centre comment

This case will hopefully provide more clarification about the recent CJEU case on the discriminatory taxation of pension funds, in particular on the net taxation argument. Although the AG's Opinion is relatively disappointing in this respect, it remains to be seen whether the CJEU will follow it.

Should you have any queries, please do not hesitate to contact KPMG's EU Tax Centre, or, as appropriate, your local KPMG tax advisor.

Robert van der Jagt
Chairman, KPMG's EU Tax Centre and
Partner,
Meijburg & Co

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