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CJEU decision in the College Pension Plan of British Columbia case

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

On November 13, 2019, the Court of Justice of the European Union (CJEU) rendered its decision 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 Court ruled 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') does not apply 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 Canada-Germany double taxation treaty.

The fund applied for a refund of the withholding tax, arguing that it has received a discriminatory treatment. 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 refunded without any limitation. 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 for that reason 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 CJEU decision

The Court first observed that the German legislation results in the complete or at least partial tax exemption of the dividends paid to resident pension funds in Germany, even though the withholding tax on such dividends is levied at a higher rate (25%) than the one on dividends paid to a Canadian pension scheme (15%). This is due to the combined application of the method used to calculate the corporate income tax base of resident funds and of the corresponding credit mechanism, which allows resident funds to credit the withholding tax paid against their final corporate income tax, and obtain a refund of any excess amount. As a consequence, non-resident pension funds are treated less favourably than resident pension funds, which constitutes a restriction on the free movement of capital.

The Court further noted that resident and non-resident pension funds are in a comparable situation. As regards the application of different procedures for charging tax, the Court noted that the German legislation does not only provide for different tax systems depending on the residence of the fund, but its application may also lead to the full exemption of the dividends paid to resident funds. With respect to the deductibility of technical reserves that take account of the fund's future pension liabilities, the Court concluded that a non-resident pension scheme that allocates the dividends received to its provisions for pensions, whether voluntarily or as a result of regulatory requirements, is in a comparable situation to a German pension fund. However, it is for the referring court to assess whether this is the case in the situation at hand.

Referring to settled case law on this issue, the Court then examined whether the restriction can be justified by overriding reasons in the public interest. The Court considered and rejected possible justifications based on the need to ensure a balanced allocation of taxing rights, the need to safeguard the coherence of the German tax system, and the need to ensure the effectiveness of fiscal supervision.

The Court 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. The Court noted that the German legislation was already in place on December 31, 1993 but has since been amended, and concluded that it will be for the referring court to determine whether the introduction in 2002 of legislation addressing the specific situation of pension funds led to a less advantageous tax treatment of non-resident pension funds. The Court also 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. In these circumstances, the Standstill Clause does not apply.

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

Although the Court does not specifically address the relevance of the “net taxation argument” in this case (i.e. the fact that non-residents cannot deduct expenses directly linked to the collection of dividends), this decision represents a very positive outcome for pension funds (irrespective whether they are based in the EU or not) that filed withholding tax reclaims in the EU on the grounds that resident pensions funds may benefit from a more advantageous tax treatment in the form of a withholding tax refund due to the tax deductibility of their technical reserves.

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



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