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Euro Tax Flash from KPMG's EU Tax Centre

CJEU decides that Swedish withholding tax on foreign public pension institutions is contrary to EU law

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Key Summary:

On July 29, 2024, the CJEU gave its decision in case C-39/23 concerning the compatibility with EU law of the Swedish withholding tax levied on dividends paid by Swedish companies to foreign public pension funds.

The main findings of the CJEU are summarized below:

- The CJEU the CJEU concluded that the Swedish legislation, including a different tax treatment between the dividends paid to non-resident public pension funds and dividends paid to Swedish public pension funds, constitutes a restriction on the free movement of capital.
- With this decision the CJEU provided new insights on the characteristics of public institutions that can serve as relevant distinguishing criteria for the comparability assessment.

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TWO-WORD SUMMARY

CJEU – Sweden – Free movement of capital – withholding tax on dividends – foreign public pension funds – comparability

On July 29, 2024, the Court of Justice of the European Union (CJEU or the Court) gave its decision in case C-39/23. The case concerns the compatibility with EU law of the Swedish withholding tax levied on dividends paid by Swedish companies to three Finnish public pension funds.

In line with the opinion of the Advocate General ('AG'), the Court concluded that the Swedish legislation under dispute is contrary to the free movement of capital.

Background

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The plaintiffs are three Finnish public sector pension institutions claiming a refund of the dividend withholding tax charged in Sweden.

Under current Swedish law, Swedish public pension funds are treated as state agencies and are exempt from tax on dividend income, whereas non-Swedish pension funds are subject to a 30 percent dividend withholding tax (which can be reduced to 15 percent under the double tax treaty concluded between Sweden and Finland). The plaintiffs argued that the Finnish pension funds are in a comparable situation to Swedish resident pension funds and consequently suffered from a differentiated treatment that represents a breach of EU law[1]. The Swedish tax authorities and administrative courts had previously rejected similar claims. However, the Swedish Supreme Administrative Court referred the case to the CJEU for a preliminary ruling (for more information, please refer to E-News Issue 170).

On March 21, 2024, AG Collins recommended the CJEU to decide that the Swedish withholding tax treatment of foreign public sector pension institutions constitutes, in principle, a restriction of the free movement of capital, subject to the referring court's verification of whether the Finnish public pension funds are objectively comparable to a Swedish public pension fund. The AG also concluded that the restriction can not be justified by overriding reasons in public interest. the AG noted that the criteria to be taken into account when assessing whether a foreign public pension institution is in a situation that is objectively comparable to that of the source State and its general pension funds must include their respective purposes, functions and core tasks, the regulatory frameworks in which they operate and the characteristics of their organizations. For more details on the AG opinion, please refer to E-new Issue 193.

The CJEU decision

The CJEU decision

First, the Court observed that, based on settled case law, measures that are likely to dissuade non-residents from making investments in a Member State or to dissuade residents from making investments in other States, restrict the free movement of capital. The CJEU also recalled that, based on settled case law, the free movement of capital does not make a distinction between private undertakings and public undertakings, i.e., that public undertakings also fall under the scope of the free movement of capital.

The Court noted that the difference in tax treatment between Swedish public pension institutions and foreign public pension institutions leads to a disadvantageous treatment of dividends paid to non-resident public pension institutions and may dissuade non-resident such entities from investing in Swedish companies. Based on these considerations, and in line with the opinion of the AG, the CJEU concluded that the legislation under dispute constitutes a restriction on the free movement of capital.

The Court then noted that a different treatment could be permitted under the free movement of capital if it relates to situations that are not objectively comparable or where the restriction can be justified by an overriding reason relating to the public interest.

As regards the comparability analysis, the CJEU reiterated that based on settled case law the comparability of a cross-border situation with a domestic situation should be assessed based on (1) the objective pursued by the national legislation at stake and the purpose and content of the relevant provisions, and (2) that only the relevant distinguishing criteria included in the national legislation should be taken into account when assessing whether there is a different tax treatment related to a situation that is objectively comparable.

[1] Article 63 of the Treaty on the Functioning of the European Union (TFEU).

In that regard, the Court noted that the Swedish dividend withholding tax exemption for public pension funds aims to avoid a circular flow of public resources of the Swedish State. The CJEU noted, however, that the fact that such a pension fund is part of the Swedish State does not necessarily place it in a different situation compared to that of a non-resident pension institution governed by public law. In the Court's view, such objective could also be achieved whilst exempting foreign pension institutions from dividend taxes. Moreover, the Court held that both the Swedish and Finnish pension funds have the same social objective, the same tasks, and the same type of legal organization. As regards in particular the argument of the Swedish Government that non-resident pension institutions governed by public law are not intended to promote the financial stability and viability of the Swedish social security system, unlike resident pension funds governed by public law, the Court upheld the AG's view that, although, by definition, the objective of each fund is to protect the stability and viability of a separate national pension system, that does not in and of itself vitiate the cross-border comparison of pension funds.

The Court acknowledged that there are differences between resident and non-resident pension funds in terms of, *inter alia*, the collection of pension contributions, the payment of pensions, the legal form of the funds compared. In the Court's view, however, and subject to the verifications of the referring court, these specifics do not appear to have a direct link with the tax treatment of the dividends received from Sweden. The Court concluded that, in the case under dispute, the only distinguishing criterion between Swedish public pension funds and non-resident public pension funds is the place of residence of the funds (i.e., that foreign public pension funds can not apply the exemption because they are not a tax resident in Sweden).

In light of the above, the CJEU held that the different tax treatment relates to situations that are objectively comparable.

Lastly, the Court examined whether the difference in treatment can be justified by the overriding reasons in the public interest put forward by the Swedish government, namely (i) the need to safeguard the objective pursued by Swedish social policy and its financing and (ii) the principle of territoriality combined with the need to preserve a balanced allocation of the powers between the Member States.

As regards the first justification, the Court acknowledged the Swedish government's plea that the dividend tax exemption aims to avoid an unnecessarily costly circular flow of public resources and to guarantee the autonomous status of Swedish pension scheme. The Court noted, however, that administrative disadvantages are not alone sufficient to justify a restriction.

The Court noted that the justification based on the balanced allocation on the power of taxation between Member States may be accepted where the scheme at issue intends to prevent activities which may jeopardize the right of the Member State to exercise its taxing powers in relation to activities carried out within its territory. Nevertheless, in the Court's view, in cases such as the one under dispute, where the Member State has chosen not to tax its own funds, that justification can not be successfully used.

In light of the considerations above, the CJEU concluded that the Swedish legislation constitutes a restriction on the free movement of capital, which is precluded under Article 63 TFEU and can not be justified by an overriding reason in the public interest.

ETC Comment:

The CJEU decision is broadly in line with its previous case law on the taxation of dividends paid to foreign pension funds. However, the decision provided new insights on the characteristics of public institutions that can serve as relevant distinguishing criteria for the comparability assessment.

The Swedish Supreme Administrative Court will now decide the case based on the judgment of the European Court of Justice.

Additional relevant links

- Tax alert KPMG Sweden
- Report prepared by KPMG Sweden

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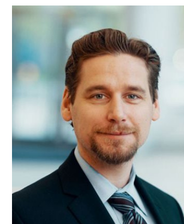

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