

## Asset Management 14 May 2007

**Commission begins formal enquiries on discriminatory taxation of dividends and interest paid to foreign pension funds**

On 7 May 2007 the European Commission (EC) announced its decision to send letters of formal notice to the Czech Republic, Denmark, Spain, Lithuania, the Netherlands, Poland, Portugal, Slovenia and Sweden. A letter of formal notice is the first step of the infringement procedure of Article 226 of the EC Treaty.

The Commission has expressed concerns that those nine Member States tax dividend and/or interest payments to foreign pension funds (outbound payments) more heavily than dividend and/or interest payments to domestic pension funds (domestic payments). The Commission has stated that it doubts whether such higher taxation is compatible with the EC Treaty and with the European Economic Area (EEA) Agreement, as it may restrict the free movement of capital. The Member States involved have been asked to reply within two months.

### Background

For many years EU pension schemes may have been subject to discriminatory treatment when making cross border investments in other EU Member States. This is because Member States often grant more favourable tax treatment to domestic pension schemes than to other EU pension schemes.

For example UK pension schemes investing cross- border in Europe often incur withholding taxes on investment income not incurred by local schemes.

### Legal developments

There have been a number of cases in the European courts that indicate that the levying of withholding taxes on outbound payments in cross border situations is discriminatory, where such taxes are not levied in connection with domestic payments. The most recent case is the Denkvit case, where the European Court of Justice ruled that the imposition of dividend withholding tax by France only on dividends paid to non-resident companies is contrary to Article 43 of the EC Treaty.

In the light of such developments, the Netherlands has already changed its laws. With effect from 1 January 2007, non-resident EU pension schemes as well as Dutch pension schemes have been entitled to lodge claims to recover all withholding tax suffered on Dutch dividends.

### Why did the Commission act?

The Commission referred to the Denkvit case in the announcement of 7 May, noting that the case appeared to confirm that higher taxation of outbound payments compared with domestic payments is not in conformity with the EC treaty freedoms.

The Commission also referred to complaints lodged in December 2005, which named 18 member states that discriminate against pension schemes on cross border dividends and interest. The EU Taxation and Customs Commissioner László Kovács commented, "The European pension industry has complained about higher taxation

of pension funds if they exercise their rights under the EC Treaty to invest across the border. The Commission is taking these complaints seriously and has decided to start formal enquiries".

As well as starting formal enquiries against the nine member states named in the May 2007 announcement, the Commission is still examining the situation in relation to other Member States. This would explain why countries such as Germany, France, Italy and Austria have not been sent a formal notice. In due course, further infringement proceedings may follow.

## What action should be taken and how can PwC help?

For a number of years, PwC has used its wide network of investment management and EU tax specialists to assist EU pension schemes to file EU protective withholding tax claims.

PwC has also assisted fund managers and insurance companies to file protective EU withholding tax claims in respect of their UCITS funds and life companies.

Although the EC press release refers to pension schemes, the underlying treaty freedoms to which it refers are equally applicable to life companies with pensions business and UCITS funds such as open ended investment companies, authorised unit trusts and SICAVs. Therefore these entities should also urgently consider filing protective claims in respect of their investment funds.

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