PensionsEurope position paper on the withholding tax refund barriers to cross-border investment in the EU

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About PensionsEurope

PensionsEurope represents national associations of pension funds and similar institutions for workplace pensions. Some members operate purely individual pension schemes. PensionsEurope Members are large institutional investors representing the **buy-side** on the financial markets.

PensionsEurope has **24 member associations** in EU Member States and other European countries with significant – in size and relevance – workplace pension systems[1].

PensionsEurope member organisations cover the workplace pensions of about **70 million European citizens.** Through its Member Associations PensionsEurope represents more than **€ 3.5 trillion of assets** managed for future pension payments.

PensionsEurope also has **27 Corporate and Supporter Members** which are various service providers and stakeholders that work with IORPs.

PensionsEurope has established a **Central & Eastern European Countries Forum (CEEC Forum)** to discuss issues common to pension systems in that region.

PensionsEurope has established a **Multinational Advisory Group (MAG)** which delivers advice on pension issues to PensionsEurope. It provides a collective voice and information sharing for the expertise and opinions of multinationals.

Contact:
Mr Matti LEPPÄLÄ, *Secretary General/CEO*
Koningsstraat 97, rue Royale – 1000 Brussels
Belgium
Tel: +32 (0)2 289 14 14 – Fax: +32 (0) 289 14 15
matti.leppala@pensionseurope.eu
www.pensionseurope.eu

[1] EU Member States: Austria, Belgium, Bulgaria, Croatia, Estonia, Finland, France, Germany, Hungary, Ireland, Italy, Lithuania, Luxembourg, Netherlands, Portugal, Romania, Spain, Sweden, UK. Non-EU Member States: Iceland, Norway, Switzerland.

Introduction

In the summer of 2005, PensionsEurope[2] and professional services firm PricewaterhouseCoopers submitted complaints against 19 EU Member States to the European Commission (EC). They claimed that the EU Member States shall stop discriminating foreign pension funds and acknowledge their right for withholding tax (WHT) refunds. Since then, progress has been made to facilitate the WHT refunds.

In particular, PensionsEurope welcomes (i) the EC Recommendation of 19 October 2009 on the Withholding Tax Procedures[3], (ii) the accomplishments of the Tax Barriers Business Advisory Group of the EC (which followed up to the EC's Recommendation and has examined the state of withholding tax relief and refund procedures in the EU Member States with respect to double tax conventions and domestic law), and (iii) the EC's Capital Markets Union (CMU) Action Plan[4] in which the EC notes that in order *"to encourage Member States to adopt systems of relief-at-source from withholding taxes and to establish quick and standardised refund procedures, the Commission will promote best practice and develop a code of conduct with Member States on withholding tax relief principles".*

Such initiatives are steps in the right direction to remove tax related barriers to cross-border investment and they are aligned with the EU Treaties which also address the need for harmonisation of domestic provisions on indirect taxation because of their potential distorting effect on the single market. The harmonisation of all major elements of value added taxation originates from 1967[5] and harmonisation of excise duties[6] from the early 1970s. PensionsEurope believes that establishing a cross-border investment-friendly tax environment by removing unfair tax treatment, mainly in the withholding tax area, and introducing tax incentives are essential to boost institutional investments in the EU and ultimately to build the CMU.

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[2] At the time the ''European Federation for Retirement Provision'' (EFRP)
[3] http://eur-lex.europa.eu/legal-content/EN/ALL/?uri=CELEX:32009H0784
[4] http://ec.europa.eu/finance/capital-markets-union/docs/building-cmu-action-plan_en.pdf
[5] Turnover taxes were covered by EC provisions as early as 1967 (multi-stage but non-cumulative turnover tax, Council Directive 67/557/EC), and a common system of value added taxes was set up with the 6th directive (Council Directive 77/388/EEC), recast in 2006 (Directive 2006/112/EC)
[6] See DG TAXUD web page on excise duties.

Indeed, much remains to be done. Unfortunately pension funds are still often penalised when they are investing in other EU Member States, because foreign countries do not reciprocally recognise their “pension fund” status, and therefore, their right for the WHT refunds. Furthermore, the complexity of the WHT procedures and different national approaches pose significant and expensive burdens to pension funds. This paper provides several examples of the fiscal barriers and it also calls on the policymakers to take concrete actions in order to remove them.

Lack of reciprocal recognition of pension funds

In some EU Member States there are no clear rules confirming the non-commercial status and the tax exemption of pension funds, irrespective of the character of their investments. If the rules were clear, the capital that currently has to be invested through foreign investment vehicles could be invested directly. Furthermore, the pension funds could reduce their spending on consulting, tax-advisory, legal services etc. A more efficient and effective allocation of capital (i.e. pension savings) would benefit pension funds’ beneficiaries directly through higher returns and indirectly through investments in the real economy.

In general, the tax exemptions are based on a clear assignment or mapping to the statutory categories in each Member State, such as the term “pension fund” (or a comparable term), or the categories such as “statutory” or “public body” (in the context of the public sector pension institutions). According to different Member States’ laws, a clear qualification of either pension fund or public body can indisputably be made. However, often the respective qualifications in the home country’s legislation are different, or the resident/home country distinction is unclear. These problems often arise because statutory terms and categories vary in national legislations.

In order to increase the economies of scale (share investment risks and pool expert knowledge) pension funds typically use third party funds or other vehicles. It is important to ensure a tax-neutral treatment of pension funds, as their investment income is tax-exempt in those Member States with an EET-taxation model (Exempt contributions, Exempt investment income and capital gains, Taxed benefits). Double taxation would arise if both the pay-out phase to beneficiaries and the investment phase were taxed. For instance, under the Dutch tax law, the tax provisions are designed in such a way that the tax burden is the same for the situation of a direct investment by an investor, an investment through a tax transparent fund, or an investment through an opaque fund. If the tax burden is much higher when using a pooled investment vehicle, the use of such funds is not interesting for investors.

Obstacles with the WHT refund processes

"Fokus Bank" - reclaim of dividend withholding tax[7]

In 2004, the Court of European Free Trade Association (EFTA) ruled that it is discriminatory for Norway to withhold tax on dividends to UK and German investors while effectively exempting Norwegian investors from the same taxation.

A large number of practical problems with the WHT refund processes still exist in spite of the EFTA judgment "Fokus Bank" (2004) and the case law of the Court of Justice of the European Union (CJEU) i.e. "Denkavit" (2006), "Amurta" (2007), "Aberdeen" (2009), and "Santander" (2012). The above-mentioned cases have shown that the WHT practices in many EU Member States are discriminatory with respect to dividends earned by foreign funds, and therefore, contradicting European law.

There are also many other practical problems with the WHT refund processes. They are too complex, expensive and long-lasting e.g. because of the costly tax advice in foreign languages. Usually the refund processes take for a long time (up to 10 years in many cases). As the refund processes are often expensive (between 10.000 and 100.000 EUR for actions in one country for each fund, which often means up to 50% of expected refunds) and the outcomes are uncertain (given that the legal recourse involves several levels of jurisdiction), often pension funds do not assert their justified reclaims.

[7] See the Judgment of the Court: Fokus Bank ASA and The Norwegian State on the interpretation of the rules of free movement of capital within the EEA.

Examples

In **Spain** the standard refunding process is elaborate and laborious and tax advice is strictly needed. In many cases reclaims of pension funds and their investment vehicles in the first level of jurisdiction are not successful, leading to long lasting and even more expensive processes with uncertain outcomes.

In the **Netherlands** the standard refunding process is also elaborate and laborious. The Dutch tax authorities ask for extensive documents and questions that are hard to come by, including expert opinions regarding the comparability of the German "Spezial-AIF"[8] and investment structures according to Dutch law, without giving an indication of granting the refund. In many cases the reclaims of pension funds and their investment vehicles in the first level of jurisdiction are not successful. This often leads to long-lasting and even more expensive processes with uncertain outcomes. Currently, there is a model lawsuit ongoing with respect to the reclaim of WHT on Dutch dividends to a German Spezial-AIF[9]. Pension funds and their Spezial-AIF can engage in costly legal action to preserve their reclaims.

In **France** there is no WHT on dividends for domestic investment funds, while foreign funds have to pay the WHT from the French dividends. Since 2000 there are still many unresolved reclaim cases that have not yet been resolved. On 9 November 2015, the French Administrative Supreme Court rendered two decisions (No. 370054 and No. 371132) ruling that a person, such as a pension fund, that is exempt from tax in a contracting state, by reason of its status or activity, cannot be considered as liable to taxation within the meaning of the articles of the Double Taxation Treaty (DTT), respectively Article 2(1)(4)(a) of the France-Germany Income and Capital Tax Treaty (1959) as amended through 2001 (The

[8] In all the examples the investment fund is eligible to the WHT refunds and as this "special AIF" according to German investment law "Kapitalanlagegesetzbuch" is solely owned by the pension fund, 100% of the tax rebate belongs to the pension fund. Secondly, the examples and problems described in this section do not only apply to German pension funds, but to some other EU pension funds as well. Thirdly, the problems described in this section do not only occur in the Member States mentioned in the examples, but also when making claims in many other EU Member States.

[9] Usually German pension funds do not invest directly in foreign equity but via specialised investment funds called "Special-AIF" (regulated by the German investment law "Kapitalanlagegesetzbuch"). Foreign dividends earned by these funds are generally taxed at source at a rate of 25% instead of being taxed at a rate of 15%, as would be in accordance with most double taxation treaties. Thus, the funds have a general claim on relief / refunding of the difference.

Treaty)[10] and Article 4(1) of the France-Spain Income and Capital Taxation Treaty (1995) (The Treaty). As a consequence, such persons cannot be considered as residents of the contracting state under the Treaty and the Court denied double taxation benefits (15% WHT instead of 25% on French dividends) to the German pension fund (Landesärztekammer Hessen Versorgungswerk). As the pension fund is exempt from the tax in the contracting state by reason of its status or activity, it cannot be considered liable to taxation within the meaning of article 2(1)(4)(a) of the Treaty. Consequently, such a person is not a resident of the contracting state under the Treaty.

In **Italy** it often takes 10 years or more to get a refund, as many bureaucratic obstacles are involved; such as ensuring that the fund's board members get personal Italian tax IDs, etc. In Italy dividends paid to domestic pension funds are exempt from the WHT but they are included in the pension fund taxable income subject to a 20% alternative tax rate. The WHT is applied on dividends paid to foreign pension funds at a 11% tax rate if the pension fund is established in the EU or in the EEA countries, or at a rate of 26% if it is established in other countries. No WHT is applied on Italian source dividends paid to domestic investment funds, while foreign funds are subject to the WHT at a rate of 26%.

[10] France-Germany Income and Capital Tax Treaty (1959) as amended through 2001 (The Treaty)

Examples of the obstacles with the WHT refund processes

Country in which pension fund has invested	Country in which pension fund is established/ resident	Outstanding reclaims	Estimated costs: the first phase + other phases	Current status
Denmark	The Netherlands	2002-2008: 1 million EUR	First phase: 60000 EUR Litigation: 350000 EUR (up to the ECJ)	Litigation for many years. Litigation has been ended by the pension fund after the EC ended their investigation whether the Danish law at that time was in breach of EU law.
Denmark	The Netherlands	2010-2013: 2.8 million EUR	First phase: 55000 EUR Litigation: 350000 EUR (up to the ECJ)	No reaction received from the Danish tax authorities so far. Litigation to be started.
France	Germany	2003-04: 46000 EUR	• The cost for refunding request already incurred. - For the appeal a French tax advisor is necessary, estimated cost for up to 4 levels of jurisdictions: • Fees for the 1st and the 2nd instance: 1000–2000 EUR per fund, each instance. • Fees for the 3rd and the 4th instance: 12000–20000 EUR per fund, each instance. • In addition, 11% of fees for performance fee, and other expenses (excluding translation cost). • For the fund manager: 500-750 EUR per fund each instance.	The French tax authority rejected the reclaim in 2010. Estimated maximal length of the legal procedures: up to 14 years (The 1st: 4 years; the 2nd: 6-7 years; the 3rd: 2-3 years; the 4th: 3-6 months).
Germany	The Netherlands	2004-2009: 7.9 million EUR	First phase: 45000 EUR Litigation: 100000-150000 EUR	No reaction received from the German tax authorities so far. Litigation to be started.
Germany	The Netherlands	2010-2011: 510000 EUR	Claims: 15000 EUR Litigation: 100000-150000 EUR	No reaction received from the German tax authorities so far. Litigation to be started.
Italy	The Netherlands	2002-2009: 9.1 million EUR	Claims: 30000 EUR Litigation: 100000-150000 EUR	Claims filed in period 2008-2013. No reaction received from the Italian tax authorities so far. Litigation to be started.
Italy	The Netherlands	2010-2012: 320000 EUR	First phase: 50000 EUR Litigation: 100000-150000 EUR	Claims filed in period 2014-2015. No reaction received from the Italian tax authorities so far. Litigation to be started.
Netherlands	Germany	2002-2011: 191000 EUR	• The 1st option: 30000-60000 EUR[11] • The 2nd option: 6000 EUR[12]	On-going
	Germany	2008–2011: 50000 EUR	• The cost for the first level of jurisdiction already incurred • Remaining option: 3000 EUR[13]	The Dutch tax authority rejected the reclaim in 2015.

[11] The expert opinions regarding the comparability of the German "Spezial-AIFs" to the Dutch law, attesting notary, translation, and labour costs of a fund manager.

[12] If the so-called "minimalistic approach" is applied which consist in preserving claims via a tax advisor until the outcome of the model lawsuit is clear.

Country in which pension fund has invested	Country in which pension fund is established/ resident	Outstanding reclaims	Estimated costs: the first phase + other phases	Current status
Portugal	The Netherlands	2003-2010: 2.2 million EUR	First phase: 40000 EUR Litigation: 50000-100000 EUR	On-going litigation for many years.
Portugal	The Netherlands	2011-2013: 610000 EUR	First phase: 40000 EUR Litigation: 50000-100000 EUR	On-going litigation since 2013-2015.
Spain	Germany	2012-2014: 23000 EUR	12000 EUR[14]	On-going: Low likelihood of success in the first phase/level of jurisdiction; additional cost for orderly courts/phase 2 to get refunding.
Spain	Germany	2012-2014: 20000 EUR	8000 EUR	On-going: Low likelihood of success in the first phase/level of jurisdiction; additional cost for orderly courts/phase 2 to get refunding.
Spain	The Netherlands	2002-2005: 7.3 million EUR	150000 EUR	On-going litigation for many years.
Sweden	The Netherlands	2000-2008: 4.1 million EUR	First phase: 35000 EUR Litigation: 100000-150000 EUR	On-going litigation for many years.
Sweden	The Netherlands	2009-2010: 580000 EUR	First phase: 15000 EUR Litigation: 100000-150000 EUR	No reaction received from the Swedish tax authorities so far. Litigation to be started.

[13] If the so-called "minimalistic approach" is applied which consist in preserving claims via a tax advisor until the outcome of the model lawsuit is clear.
[14] The Spanish tax advisor, custodian, certificate for payment of WHT, attesting notary, translation, and labour costs of a fund manager.

Conclusions

This paper provided several examples of the lack of reciprocal recognition of pension funds and the problems with the WHT refund processes. It showed that the WHT refund processes can be very complex, expensive, and long-lasting. In order to remove these barriers, PensionsEurope calls on the policymakers, especially the EC and the EU Member States, to:

- Ensure that the EU Member States reciprocally and automatically recognize pension funds in a feasible way in order to reduce the effort and costs for pension funds to prove their status in the host country. If a pension fund according to the law of its home country qualifies as a pension fund (or other privileged entity or tax exempt investor), it shall automatically get recognition as a pension fund according to statutory terms or categories in the host country;
- The EU Member States shall respect the case-law of the Court of Justice of the European Union (CJEU). If a Member States fail to comply with the EU law, the EC shall resolve the underlying problems with the Member State concerned by means of a structured dialogue. If the Member State does not agree with the EC or fails to implement a solution to rectify the suspected violation of the EU law, the EC shall launch a formal infringement procedure, as it has done in the past;
- Ensure simple, transparent, and inexpensive WHT refund procedures. This could be achieved for example through:
    - the EU-wide acceptance of national non-assessment certificates;
    - the EU-wide accepted non-assessment certificate (similar to the EU-passport for the funds);
- Update the inadequate double taxation Treaties and include enough provisions for the mutual recognition.