Disappearing Tax Obstacles

The European Court of Justice has delivered two favourable rulings and the European Commission is working hard to eliminate the remaining tax obstacles to the cross-border provision of occupational pensions, reports Peter Schonewille

Commissioner Bolkestein is determined to create a Single Market for occupational pensions. Now that the Pension Fund Directive has been adopted, the pressure on the remaining tax obstacles has increased. This article discusses current developments in the pension taxation area.

Almost all Member States tax occupational pensions according to the EET or ETT principle. That means that the contributions by both employer and employee are tax deductible, that the investment results of the pension fund are exempt, or taxed (that is the case only in Denmark, Italy and Sweden) and that the benefits are taxed. The main reason for Member States to have such a system of deferred taxation is to encourage their citizens to save for their old age. A side-effect is that it will help Member States to deal with the demographic time-bomb, as a State will receive tax revenues at the time when the demographic dependency ratio will be much more unfavourable.

Many Member States do not allow tax deduction for pension contributions paid to a pension fund in another Member State. This effectively seals off their national markets from competition from other Member States, makes it impossible for multinationals to run pan-European funds and constitutes a major obstacle to the free movement of workers.

To deal with this problem the European Commission issued a Communication on the elimination of tax obstacles to the cross-border provision of occupational pensions, on 19 April 2001. The Communication concluded, on the basis of the EC Treaty and the case-law of the European Court of Justice in Luxembourg (ECJ), that Member States were not allowed to restrict the freedom to provide services and the free movement of workers by refusing tax deductibility for pension contributions paid to pension funds in other Member States.

Since the Communication the ECJ has ruled on two cases concerning the deduction of contributions paid to foreign funds - the Danner case (Case C-136/00) on 3 October 2002, and the Skandia/Ramstedt case (Case C-422/01) on 26 June 2003. Both cases were referred to the ECJ by national courts. In both cases the ECJ struck down the national restrictions.

The Danner case concerned a German doctor who moved to Finland and continued to contribute to his German pension scheme. Finland refused the deduction. The ECJ ruled that Article 49 on the EC Treaty (on the freedom to provide services) precluded Finland from disallowing the deductibility if it did not at the same time preclude the taxation of the benefits paid by foreign pension providers.
The Skandia/Ramstedt case is a test case, whereby Skandia offered its director Mr Ramstedt pension policies from Skandia UK, Skandia Denmark and Skandia Germany, the only difference between those policies and a policy with Skandia Sweden being the location of the pension provider. Sweden refused deduction for the contributions paid to the foreign pension providers. The ECJ ruled unambiguously that this ran against Article 49 of the EC Treaty.

The Skandia/Ramstedt ruling seems to be generally applicable to all Member States which still refuse cross-border deduction on the sole ground that the pension provider is located outside their territory. It is interesting to note that the ECJ used little time to reach its verdict. The hearing was on 30 January 2003, Advocate-General Léger issued his opinion on 30 April 2003, and the ECJ ruled on 26 June 2003.

On 5 February 2003, following up to the Pension Taxation Communication the Commission launched five new infringement procedures, against Belgium, Spain, France, Italy and Portugal, and continued one old procedure against Denmark. All these Member States refuse any cross-border deduction for pension contributions, for both mobile workers and non-mobile workers. The five first-mentioned states received letters of formal notice, the first step in an infringement procedure, and Denmark received a reasoned opinion, the second step in an infringement procedure. If Denmark does not change its legislation, the Commission may refer it to the ECJ quite soon, to be the next pension taxation case decided by the ECJ after Danner and Skandia/Ramstedt.

At the same time the United Kingdom is in the middle of a major overhaul of its pension taxation rules. So far, the UK has not indicated in which direction it wishes to move regarding contributions paid to foreign pension funds. The first consultation document remained silent on the matter. An indication of what the UK will be doing may be provided by the upcoming decision by the Inland Revenue in the Pepgo (Pan-European Pensions Group) case. In this case a group of multinationals have filed a request with the Inland Revenue to get tax deductions for contributions paid from the UK to a Dutch pension fund for a non-mobile worker who is working and residing in the UK.

Member States usually claim that allowing tax deduction of pension contributions paid to foreign funds would lead to losses of tax revenue. Apart from the fact that the ECJ has consistently dismissed this argument, this fear seems unwarranted. Member States may be able to develop arrangements to prevent such loss of tax revenue. As Advocate-General Jacobs pointed out in his opinion on the Danner case, in line with what the Commission had said in its Pension Taxation Communication, a Member State has three ways of safeguarding the taxation of pension benefits paid out to its residents by foreign pension funds. Firstly, it can require the necessary information from the taxpayer. Secondly, it can call on the help from the Member State where the fund is located, on the basis of the Mutual Assistance Directive of 1977. Thirdly, it can conclude a contract with the pension provider, stating that the pension provider shall provide the Member State with all the information that it needs in order to tax the future benefits. Pension providers are strongly regulated. They are meant to stay, even after our death. They should be reliable contract partners. And in case they would breach the contract the Member State would be carrying a big stick: it could refuse any future deductions of contributions paid to the institution, thereby effectively putting it out of business. Member States should therefore not worry that allowing foreign pension institutions to provide services on their market would undermine their future tax revenues.
In conclusion, it is clear that the pension taxation landscape in Europe is changing. The two recent rulings by the ECJ and the six pending infringement cases bear witness to this. With the Skandia/Ramstedt ruling, taxpayers may claim deduction for their pension contributions paid to, for example, pan-European funds located in other Member States. If the foreign fund fulfils the same conditions as domestic funds, the Member State does not have the right to refuse the tax deduction. The Commission will be able to make good use of the Skandia/Ramstedt ruling in its discussions with Member States on the pending infringement cases. We seem now closer than ever to pan-European pension funds, providing their services across borders without being hampered by tax obstacles.

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