ECJ clears way for tax free transfers

Peter Schonewille

In a landmark decision, the European Court of Justice (ECJ) has ruled against Belgium for taxing transfers of pension capital to pension funds elsewhere in the European Economic Area (EEA), where such transfers within Belgium are tax exempt.

The ruling is important because it is the first ever on tax obstacles to the cross-border transfer of pension capital. Companies setting up pan-European pension funds will want to centralise the pension capital accumulated in their various local pension funds, to maximise economies of scale. Such centralisation is not feasible if it is taxed and this ruling eliminates discriminatory taxation of capital transfers.

Belgian income tax law provided that the transfer of occupational pension capital from a pension fund or insurance undertaking to another is not taxable. However, the law also explicitly provided that this exemption did not apply to transfers to pension funds or insurance undertakings abroad.

The European Commission did not accept this discriminatory treatment and took Belgium to the ECJ, under the infringement procedure of Article 226 of the EC Treaty. The Commission claimed that the taxation of outbound transfers was an obstacle to the freedom to provide services. The Commission also claimed that the taxation of outbound transfers was a forbidden restriction of the freedom of movement of workers, self-employed persons, and persons who are not economically active.

The ECJ ruled on 5 July 2007 and agreed with the Commission on all accounts. It needed very few words for its judgment and was probably assisted by the fact that Belgium did not defend itself.

In fact, Belgium had already extended the tax exemption to transfers to pension funds and insurance undertakings established elsewhere in the European Economic Area (EEA) per 1 January 2007. This may have had something to do with the Belgian ambition to be the preferred location for pan-European pension funds. It would be ironic to call for pan-European pension funds to come to Belgium while at the same time discriminating against capital transfers to such funds in other EU member states.

The ruling therefore has no direct effect on Belgian law. It may, however, be a clear signal to other member states who have similar laws that the time has now come either to amend them to eliminate discrimination or to face a showdown in the ECJ. Logic would have it that member states, after adopting the pension fund directive (Directive 2003/41/EC), which establishes the possibility to set up pan-European pension funds, should follow by eliminating the tax obstacles to the functioning of the same funds that they brought to life by adopting the directive.

It should be noted that the ruling only has consequences for those member states that currently exempt domestic transfers and tax outbound transfers. Member states that do not allow domestic transfers can continue to forbid outbound transfers. In the same way, member states that currently tax domestic transfers can continue to tax outbound transfers, provided the rate is the same.

In theory, member states that currently discriminate against outbound transfers by taxing them could repair their infringement by introducing the same tax on domestic transfers. Under EC law they would be free to do so. However, for political reasons they may not wish to choose this route, as it goes against the interests of employees and employers, and would introduce an obstacle to labour mobility in their national markets.

There may be member states that do allow domestic transfers, tax free or not, but which prohibit outbound transfers. That situation is not covered by this ruling, but it seems likely that the ECJ would rule that such a restriction on outbound transfers, since domestic transfers are allowed, runs against the EC Treaty articles on the freedom of movement of workers in the same way as taxing outbound transfers while exempting domestic transfers.

There are no other requests for preliminary rulings on the transfer of pension capital pending with the ECJ, nor has the Commission reported any such pending infringement cases.

In April 2005 the European Federation for Retirement Provision and PricewaterhouseCoopers issued a press release saying that they were to undertake a joint EU-wide study of potential infringements concerning the cross-border transfer of pension capital. But the study was never followed up by complaints to the Commission, which investigates every complaint that it receives.

It may be clear that any complaint along the lines of the restrictions described above would have a large chance of resulting in the opening of a formal infringement procedure on the basis of Article 226 of the EC Treaty.

The ECJ has also ruled against Belgium for not granting tax relief for employer and employee pension contributions paid to pension providers in other member states in the same way as pension contributions paid to Belgian providers. This part of the ruling was completely in line with its earlier ruling on Commission vs Denmark, Case C-150/04 of 30 January 2007, on which this writer reported in the March issue of IPE.

ECJ ruled that Belgium's tax law was obstructing the freedom to provide services

It also covered the cross-border payment of life insurance contributions, which should receive the same tax relief as payments to domestic providers. The ruling confirms that EU law guarantees life insurance companies that they can sell their services without tax discrimination to clients in member states without having an establishment there.

The ECJ did not differentiate between transfers by mobile individuals and transfers by non-mobile individuals. The Commission made this distinction in its Pension Taxation Communication of April 2001 (COM (2001) 214).

Its reasoning was that mobile persons should be allowed to transfer their pension capital without discriminatory taxation to pension funds in other member states, even if the other member states pension rules are different from the pension rules of the state of origin of the person.

Since pension rules are not harmonised, each member state has its own conditions for pensions that can benefit from tax relief, in terms of, for example, the retirement age and the part of the pension that can be paid as lump sum.

On the contrary, for non-mobile workers who wish to transfer their pension capital to a fund in another member state, the Commission is of the opinion that the state of origin can require that all national conditions are fulfilled. If this were otherwise it would mean the end of national pension rules.

EU citizens would be able to transfer their pension capital to the member state with the most favourable rules. The same is, *mutatis mutandis*, true for mobile workers who claim tax relief for contributions paid to the pension fund in their state of origin and non-mobile workers who wish to take out a pension from a provider in another member state.

Finally, the ECJ also ruled against Belgium for requiring foreign insurers to appoint a fiscal representative in Belgium before being able to do business in there. Belgium required this representative to assure the payment of the annual tax on insurance contracts. On this point Belgium did defend itself, but the ECJ ruled that the requirement to appoint a fiscal representative was disproportionate for three reasons.

First, Belgium could get any information that it needed to assess tax from other member states' authorities on the basis of the Mutual Assistance Directive (Directive 77/799/EC). Second, where necessary it could collect the tax from the insured person himself. Third, it could count on the other member states' authorities to help it to collect the tax on the basis of the Recovery Directive (Directive 76/308/EC).

These arguments are generally applicable to each member state that still requires insurance companies to appoint a fiscal representative. The ruling seems to signal the end of fiscal representatives. It thereby makes a significant contribution to lowering the costs for insurance companies that wish to do business in another member state without establishing themselves there since the appointment of a fiscal representative could be quite expensive.

Peter Schonewille works in the unit dealing with direct tax infringement cases at the Directorate General Taxation and Customs Union of the European Commission in Brussels and at the CompetenceCentre for Pension Research of Tilburg University in the Netherlands. His article is written on a personal basis. Email: peter.schonewille@ec.europa.int