

France and Spain end tax discrimination of foreign pension funds

France and Spain have announced that they will change their tax legislation and comply with the European Commission's request to give pension contributions paid to pension funds located in other Member States the same tax treatment as contributions to domestic funds, reports **Peter Schonewille**

The announcement by France and Spain can be considered as a major breakthrough in the battle to achieve an Internal Market for occupational pensions. It increases the pressure on the Member States whose tax legislation still discriminates against foreign pension funds (Finland and Sweden (but see below), Belgium, Portugal, Ireland, Italy, the United Kingdom and Denmark).

The announcements came in reaction to so-called "letters of formal notice" that the European Commission sent to these two countries in February 2003. A letter of formal notice is the first step in the infringement procedure under Article 226 of the EC Treaty whereby the Commission can call on the European Court of Justice (ECJ) in Luxembourg to rule that a Member State has failed to fulfil an obligation under the Treaty.

Although France and Spain indicated following receipt of the letter of formal notice that they would change their legislation, the Commission nevertheless sent them a "reasoned opinion", the second step of the infringement procedure, in December 2003. Spain had said that it would change its legislation before 23 September 2005, which is the deadline for the implementation of the Pension fund directive. France had not provided a timetable. The Commission found the Spanish timetable and the lack of a French timetable insufficient (press release IP/03/1756 of 17 December 2003).

Although the timing may still be an issue, the important thing is that both France and Spain have decided to open their markets for foreign pension providers without awaiting a ruling by the ECJ. It seems that they are convinced by the legal reasoning of the Commission which claimed that the Internal Market principles of the free movement of workers and the freedom to provide services require Member States to stop discriminating against foreign pension providers. Another contributing factor may have been that the Commission's reasoning was confirmed in two recent rulings by the ECJ on the deduction of contributions paid to foreign funds - the Danner case (C-136/00) and the Skandia case (C-422/01), on which I reported in the August/September issue of IPE of last year (that article is also on this website).

France and Spain will thus end the discrimination against foreign funds. Finland and Sweden are expected to do the same in reaction to the rulings in the Danner and Skandia cases. Germany, Austria and the Netherlands already allow tax relief for contributions paid to foreign funds. This makes it very difficult for the other EU Member States which do not yet extend their domestic relief to contributions paid to foreign funds to claim that doing otherwise would make the coherence of their tax system collapse; if so many

Member States can allow tax deductions for cross-border contributions without endangering the coherence of their tax systems, why can other Member States not do the same?

This argument is likely to be tested for the first time in the Commission's forthcoming case against Denmark. Already back in February 2003 the Commission decided to refer Denmark to the ECJ for discriminating against foreign funds. Cases may follow against Belgium and Portugal. On 17 December 2003 the Commission also announced that it had sent reasoned opinions to these two States. Belgium had not given a definitive reply to the letter of formal notice it had received on 5 February 2003 and Portugal had responded arguing that its legislation was coherent in that there is a link between tax deductibility of contributions and taxation of pensions in case of Portuguese pension funds and between the non-tax deductibility of contributions and the non-taxation of pensions in case of foreign pension funds.

As far as Belgium is concerned the Commission's press release mentions that the Commission finds it unacceptable that the transfer of pension capital to a foreign pension fund provokes a special taxation in Belgium. It would be interesting to see how the ECJ would rule on such tax, since if a Belgian employee changes jobs and transfers pension capital from one pension fund to another within Belgium he can do so tax free. It would indeed seem that the freedoms of the EC Treaty would oblige a Member State with such a system to allow the tax free transfer to foreign pension funds also, if an employee takes up a job in another Member State. If Belgium does not comply with the reasoned opinion the Belgian case may well be the first on the cross-border transfer of pension capital to be decided by the ECJ.

In the meantime it will be interesting to see what Ireland, Italy and the United Kingdom will do. The Commission has not reported on their reactions to the letters of formal notice they too received. The United Kingdom is still in the middle of a major reform of its occupational pension system. It has not yet announced how it intends to deal with contributions paid to foreign pension providers, but it seems logical that if it wishes to do something, this would be announced in its Budget 2004 of April this year, in the framework of the expected broader proposals for reform of its tax rules on occupational pensions.

In conclusion, the announcement by France and Spain brings a true Internal Market for occupational pensions closer. It may well weaken any remaining resistance from those Member States whose tax rules still discriminate against foreign pension providers. Other Member States may be expected to follow the example set by France and Spain, to the benefit of European workers, businesses and pension providers.

Peter Schonewille is Principal Administrator at the Direct Taxation Unit of DG Taxation and Customs Union of the European Commission in Brussels. His article is written on a personal basis and does not necessarily reflect the opinion of the European Commission. It appeared earlier in *Investment & Pensions Europe* of February 2004.