Reports of Cases

OPINION OF ADVOCATE GENERAL
SHARPSTON
delivered on 19 July 2012 [1]

Case C-342/10

European Commission
v

Republic of Finland

(Free movement of capital — Discriminatory taxation of dividends distributed to non-resident pension funds)

1. In the present infringement proceedings the issue before the Court is whether Finland taxes dividends paid to non-resident funded pension plans ('non-resident pension plans') [2] in a discriminatory manner.

2. Pension plans of the kind at issue typically receive, from and/or on behalf of participants, contributions with which they purchase investments to provide income through dividend payments. Some of that income will be used to cover operating costs, but a significant proportion will be transferred to reserves out of which pensions will be paid to beneficiaries. In some cases the organisation that runs the plan may also make a profit.

3. Pension plans established in Finland ('resident pension plans') are, in principle, taxed there on dividend payments at a rate of 19.5%. [3] However, any part of that income which is transferred to reserves is treated as if it were expenditure, and can thus be deducted from taxable income. Consequently, such investment income is, in effect, not taxed at all at that stage. However, it is taxable as income in the hands of beneficiaries when it is paid out to them pursuant to contracts of assurance.

4. In relation to non-resident pension plans, Finland can only tax dividend payments that arise within its territory. Thus, non-resident pension plans are treated differently inasmuch as such dividend payments are subject to a withholding tax which is levied at the rate of 19.5%. [4] There is, however, no mechanism corresponding to that for resident pension plans, whereby income transferred to reserves benefits from a tax advantage under the national system.

5. The Commission claims that such a difference in treatment is discriminatory.

1 — Original language: English.
2 — See point 25 below.
3 — See point 16 below.
4 — See point 19 below.

Legislation

The FEU Treaty and the EEA Agreement

The Treaty

6. Article 63 TFEU prohibits all restrictions on the movement of capital between Member States and third countries.

7. Article 65(1)(a) TFEU provides that Article 63 TFEU is without prejudice to the right of Member States 'to apply the relevant provisions of their tax law which distinguish between taxpayers who are not in the same situation with regard to their place of residence or with regard to the place where their capital is invested'.

8. Article 65(3) TFEU states the measures and procedures referred to in paragraph 1 '… shall not constitute a means of arbitrary discrimination or a disguised restriction on the free movement of capital and payments as defined in Article 63'.

9. Article 40 of the EEA Agreement [5] in effect extends the prohibition in Article 63 TFEU to the European Economic Area ('the EEA').

10. Article 6 of the EEA Agreement states that the provisions of the EEA Agreement, in so far as they are identical in substance to corresponding rules of what were at that time the EEC and ECSC Treaties (and to acts adopted in application thereof), are to be interpreted in conformity with the case-law of the Court at the time that the EEA Agreement was signed. [6] The Court of Justice has jurisdiction to interpret the EEA Agreement with regard to the territory of the European Union. [7]

11. Thus the rules in the EEA Agreement prohibiting restrictions on the free movement of capital must likewise, as far as possible, be interpreted in the same way as Articles 63 and 65 TFEU.

Directive 77/799/EEC

12. Directive 77/799/EEC [8] governs the exchange of information between Member States necessary to enable them to effect a correct assessment of taxes on income and capital. That directive is not in issue in the present proceedings; but it is relevant in so far as the Commission explains that the declaration it is seeking only concerns those EEA States to which Directive 77/799/EEC applies. [9]

5 — The Agreement on the European Economic Area of 2 May 1992 (OJ 1994 L 1, p. 3) ('the EEA Agreement').

6 — Case C-345/05 *Commission* v *Portugal* [2006] ECR I-10633, paragraph 39, and Case C-471/04 *Keller Holding* [2006] ECR I-2107, paragraph 48; see also the case-law cited therein.

7 — Opinion of Advocate General Geelhoed in Case C-452/01 *Ospelt and Schlössle Weissenberg* [2003] ECR I-9743, point 67, and Case C-321/97 *Andersson and Wåkerås-Andersson* [1999] ECR I-3551, paragraph 28.

8 — Council Directive 77/799/EEC of 19 December 1977 concerning mutual assistance by the competent authorities of the Member States in the field of direct taxation (OJ 1977 L 336, p. 15). Council Directive 2011/16/EU of 15 February 2011 on administrative cooperation in the field of taxation repeals and replaces Directive 77/799/EEC with effect from 1 January 2013 (OJ 2011 L 64, p. 1).

9 — See point 70 below and footnote 47.

Directive 88/361/EEC

13. Directive 88/361/EEC[10] brought about complete liberalisation of capital movements and to that end Article 1(1) thereof required the Member States to abolish all restrictions on such movements. Following the introduction of Articles 56 and 58 EC (now Articles 63 and 65 TFEU) into the Treaty in 1994,[11] the nomenclature annexed to Directive 88/361/EEC has had an indicative value in any assessment of whether a transaction constitutes a capital movement for the purposes of Article 63 TFEU.[12] Article 40 of the EEA Agreement should be read together with its Annex XII. Those two provisions make specific reference to Directive 88/361/EEC and the manner in which that measure should be interpreted for the purposes of the EEA Agreement.

The parent-subsidiary directive

14. The parent-subsidiary directive[13] is not in issue in the present proceedings. However, it is relevant in so far as it governs the double taxation of dividend distributions. The aim of the parent-subsidiary directive is, by the introduction of a common system of taxation, to eliminate any disadvantage to cooperation between companies of different Member States as compared with cooperation between companies of the same State and thereby to facilitate the grouping together of companies at EU level.[14] The parent-subsidiary directive seeks to ensure that where a parent company receives dividends (referred to as distributed profits in that directive) due to its association with its subsidiary the State of the parent company should either refrain from taxing those profits or, if a charge to tax is imposed, allow the parent company to deduct from the amount of tax due that fraction of corporation tax paid by the subsidiary which relates to those dividend payments.[15] Furthermore, in order to ensure fiscal neutrality the parent-subsidiary directive provides in its Article 5 that: 'Profits which a subsidiary distributes to its parent company shall be exempt from withholding tax.'[16]

National legislation

15. The Laki elinkeinotulon verottamisesta (Law on the taxation of business income, 360/1968) ('the LEV') governs the taxation of dividend payments made to resident pension plans. A combined reading of Paragraphs 6a and 11 of the LEV means that dividends paid to pension plans are taxed as income.

16. Under Paragraph 6a of the LEV read together with Paragraph 2 of the tuloverolaki (law on income tax, 1535/1992), pension plans are charged to tax at a rate of 19.5% on dividend payments.

17. Paragraph 7 of the LEV provides that expenses and losses incurred in order to acquire or to maintain income from an economic activity are deductible for tax purposes.

10 — Council Directive 88/361/EEC of 24 June 1988 for the implementation of Article 67 of the Treaty (OJ 1988 L 178, p. 5).

11 — Articles 56 and 58 EC were introduced with effect from 1 January 1994 by the Treaty of Maastricht (The Treaty on European Union) (OJ 1992 C 191, p. 1).

12 — Case C-174/04 *Commission* v *Italy* [2005] ECR I-4933, paragraph 27.

13 — Council Directive 90/435/EEC of 23 July 1990 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States (OJ 1990 L 225, p. 6). For the purposes of the parent-subsidiary directive the status of a parent company is attributed to any company of a Member State which fulfils the conditions of Article 2 of that directive and has a minimum holding of 10% in the capital of a company of another Member State that fulfils the same conditions: see Article 3(1) of that directive.

14 — Case C-284/06 *Burda* [2008] ECR I-4571, paragraph 51 and the case-law cited there.

15 — See the fourth recital in the preamble and Article 4(1) of the parent-subsidiary directive. See also Case C-138/07 *Cobelfret* [2009] ECR 1-731, paragraphs 29 and 30.

16 — See points 67 to 69 below on the parent-subsidiary directive.

18. Point 10 of the first subparagraph of Paragraph 8 of the LEV provides that deductible expenses for the purposes of Paragraph 7 include statutory transfers made by insurance companies, insurance associations, savings institutions and other similar insurance organisations with a view to meeting their obligations in respect of insurance liabilities together with sums necessary to satisfy those obligations, as well as sums which, in accordance with the principles governing the insurance industry,[17] are necessary to cover liabilities in relation to investments for pensions and other related insurance obligations.[18]

19. Dividend payments made by Finnish companies to non-resident pension plans are subject to a withholding tax pursuant to the lähdeverolaki (Law on taxation at source, 627/1978). Under Articles 3 to 7 of the lähdeverolaki, withholding tax is charged at the rate of 19.5%. That rate is lower where a double taxation convention applies.[19]

Procedural background

20. Following a procedure in conformity with Article 258 TFEU, the Commission asks the Court to declare that, by introducing and maintaining in force a scheme under which dividends distributed to non-resident pension plans are taxed in a discriminatory manner, the Republic of Finland has failed to fulfil its obligations under Article 63 TFEU and Article 40 of the EEA Agreement. The Commission also asks the Court to order the Republic of Finland to pay the costs.

21. The Governments of Denmark, France, the Netherlands, Sweden and the United Kingdom have intervened in support of Finland.

22. The Commission and the Governments of Finland, the Netherlands and Sweden made oral representations at the hearing on 10 May 2012.

Assessment

Preliminary observations

23. First, the Finnish Government submits that the Commission's application is inadmissible. Finland states that the application fails to meet the requirements laid down in Article 38(1)(c) of the Rules of Procedure, in so far as it does not set out the pleas in law in a manner that is sufficiently clear and precise to enable Finland to prepare its defence and the Court to rule.

24. Whilst the Commission's application would have been easier to follow if it had been formulated with greater precision, it is clear from an examination of the Finnish Government's defence that it has understood the Commission's complaint. Furthermore, the application is sufficiently clear to have enabled the governments of five Member States to make submissions responding to the point in issue. I do not consider therefore, that Finland has been prejudiced in preparing its defence.

17 — Funded pension plans (see point 25 below) are obliged to have sufficient assets to cover future liabilities in order to protect those persons with whom they have contracts of assurance. In general, the Member States are responsible for regulating pension provision in their respective territories. However, Directive 2003/41/EC of the European Parliament and of the Council of 3 June 2003 on the activities and supervision of institutions for occupational retirement provision (OJ 2003 L 235 p. 10) lays down certain requirements in order to protect the rights of beneficiaries assured by funded pension plans. These include the requirement that funded pension plans ensure that sufficient assets are set aside to meet a pension plan's liabilities as they arise.

18 — In this Opinion I refer to Paragraph 7 and point 10 of the first subparagraph of Paragraph 8 of the LEV as 'the national legislation at issue'.

19 — See point 70 below.

25. Second, the current proceedings concern 'funded' pension plans. Such pension plans accumulate assets that are used for the payment of benefits to persons with whom they have contracts of assurance. The assets belong to the plan and their use is only permissible for the payment of those benefits.[20] Funded pension plans typically transfer payments generated by their investments to reserves set aside to meet future liabilities.[21] At the hearing Finland explained that the transfers are made pursuant to statutory rules. It is not disputed that non-resident pension plans carry out the same activity in relation to transferring dividend payment to reserves for the same purpose as resident pension plans.

26. Third, dividend payments are usually considered to constitute income (a receipt) rather than an expense.[22] Thus, dividends are generally, in principle, taxed as income.[23] However, under the national legislation at issue pension plans (or other similar organisations that carry out similar insurance activities) are allowed to treat dividend payments that they receive and transfer to reserves as an expense for tax purposes. In calculating liability to tax dividends are therefore, deducted from a pension plan's income in order to establish the amount on which tax is due.

27. Such a facility seems to me to constitute a tax advantage that arises from the nature of the particular obligations and activities of pension plans.

28. Fourth, there is no definition in the Treaty of what constitutes 'capital movements' for the purposes of Article 63 TFEU. Although receipt of dividends is not expressly mentioned as a capital movement in the nomenclature annexed to Directive 88/361/EEC, the right to receive such a payment presupposes participation in new or existing undertakings for the purpose of Heading I(2) of the annex and/or transactions in securities on the capital market as set out in Heading IIIA(1) and (3).[24] The acquisition of assets that generate dividends clearly falls within the annex to the nomenclature, even though dividend payments as such are generally treated as income for tax purposes.

29. Fifth, in non-harmonised matters of direct taxation it is for the Member States to decide whether to exercise their taxing powers. None the less, according to settled case-law, Member States must exercise such competence consistently with EU law and therefore avoid direct or indirect discrimination on grounds of nationality.[25]

Discrimination

30. The Commission contends that, as resident pension plans are entitled to treat dividend payments transferred to reserves as deductible expenses, those pension plans are (practically) exempt from tax. Non-resident pension plans are at a disadvantage because tax on dividend payments made to them is collected at source by means of withholding tax from which no deductions are permitted. The Commission argues that that difference in treatment makes the cross-frontier transfer of capital less attractive by deterring non-resident pension plans from acquiring shares in Finnish companies. In doing so, it prevents pension funds from spreading their investments and maximising their returns which are to be used for the payment of pensions to persons assured.

20 — See Private pensions: OECD classification and glossary, www.oecd.org/dataoecd/49/38356329.pdf. See also the Green Paper published by the European Commission 'Towards adequate, sustainable and safe European pension systems, (COM(2010) 365 final). Such pension plans (which may be occupational or personal) accumulate dedicated assets to cover the plan's future liabilities.

21 — By way of contrast, unfunded pension plans (known as Pay-as-you-go or PAYGO or PAYG) are not obliged to set assets aside – benefits are paid from current workers' contributions and/or taxes.

22 — Dividend payments are classified as income in the OECD Model Tax Convention on income and capital, available at www.oecd-ilibrary.org/taxation/model-tax-convention-on-income-and-on-capital. The most recent version is dated 22 July 2010.

23 — See point 15 above.

24 — See point 13 above.

25 — Case C-487/08 *Commission* v *Spain* [2010] ECR I-4843, paragraph 37 and the case-law cited therein.

31. Finland does not accept that resident pension plans are exempt from tax on dividends they receive. It points out that in principle all pension plans are subject to a charge to tax. That said, it accepts that non-resident pension plans are treated differently to resident pension plans and that in certain cases the facility to treat dividend payments as deductible expenses may lead to no liability to tax.

32. It is clear that the facility under the national legislation in issue is a tax advantage that is not afforded to non-resident pension plans.

33. Pension plans acquire and maintain capital assets in order to generate income over the long-term. Such a difference in the tax treatment of dividends discourages the free movement of capital in so far as it makes investment in Finland less attractive for non-resident pension plans. Consequently, opportunities for Finnish undertakings to raise investment from foreign pension plans are more limited. [26]

34. I therefore consider that, by allowing resident pension plans to treat dividend payments transferred to reserves as deductible expenses but not affording the same advantage to non-resident pension plans, the national legislation at issue constitutes a restriction on the free movement of capital for the purposes of Article 63 TFEU.

Justification

35. Is the difference in treatment of resident and non-resident pension plans justified?

Article 65(1)(a) TFEU

36. Finland, supported by the governments of the intervening Member States, contends that Article 65(1)(a) TFEU allows it to distinguish between pension plans that are not in the same situation with regard to their place of residence and hence to apply the national legislation at issue.

37. In that respect, Article 65(1)(a), which is an exception to the fundamental principle of the free movement of capital, must be interpreted strictly. [27] It should not be construed as meaning that any national measure that distinguishes between taxpayers by reference to their place of residence is automatically compatible with the Treaty. [28]

38. A distinction must be drawn between different treatment that is permitted under Article 65(1)(a) TFEU and arbitrary discrimination which is prohibited under Article 65(3). In order for the national legislation at issue to be capable of being regarded as compatible with the provisions of the Treaty on free movement of capital, Article 63 TFEU, the difference in treatment must concern situations which are not objectively comparable or be justified by an overriding reason relating to the public interest. [29]

26 — See Case C-493/09 *Commission* v *Portugal* [2011] ECR I-9247, paragraphs 28 to 32.

27 — Joined Cases C-338/11 to C-347/11 *Santander Asset Management* [2012] ECR, paragraph 21.

28 — *Commission* v *Spain*, cited in footnote 25 above, paragraph 47.

29 — *Commission* v *Spain*, cited in footnote 25 above, paragraph 47 and the case-law cited therein.

39. That question has been examined by the Court in a number of cases concerning economic double taxation.[30] The general rule is that Member States may introduce measures in order to prevent or mitigate the imposition of a series of charges to tax on, or the economic double taxation of, profits distributed by a resident company, and that resident and non-resident shareholders receiving dividends are not necessarily in a situation that is comparable.[31]

40. However, as soon as a Member State, either unilaterally or by way of a convention, imposes a charge to tax on the income, not only of resident shareholders, but also of non-resident shareholders, from dividends which they receive from a resident company, the situation of those non-resident shareholders becomes comparable to that of resident shareholders.[32]

41. As the Court puts it: 'It is solely because of the exercise by that State of its power of taxation that, irrespective of any taxation in another Member State, a risk of a series of charges to tax or economic double taxation may arise. In such a case, in order for non-resident companies receiving dividends not to be subject to a restriction on the free movement of capital prohibited, in principle, by Article 56 EC, the State in which the company making the distribution is resident is obliged to ensure that, under the procedures laid down by its national law in order to prevent or mitigate a series of liabilities to tax or economic double taxation, non-resident shareholder companies are subject to the same treatment as resident shareholder companies'.[33]

42. In the present proceedings the objective of the national legislation at issue is to take account of the specific purpose of pension plans (and other similar forms of organisation) in accumulating funds transferred to reserves that are eventually used to meet their future assurance liabilities. In allowing those organisations to treat dividends as deductible expenses, any charge to tax is deferred to the point when payment is made under contracts of assurance and the payment is then taxed in the hands of the beneficiary.

43. Although non-resident pension plans carry out the same activities and have the same objectives as resident pension plans in relation to making transfers to reserves, Finland has chosen to tax dividends paid to such plans. Since making transfers to reserves is an essential element of their activities, I consider that non-resident pension plans in receipt of dividends from Finnish companies are in a comparable position to resident pension plans.

44. In those circumstances I consider that, since non-resident pension plans are not permitted to treat dividend payments received from Finnish companies that are transferred to reserves as deductible expenses, the national legislation at issue constitutes a restriction on the free movement of capital that is prohibited under Article 63 TFEU.

30 — Economic double taxation is not defined. It arises where the same income is taxed twice, in the hands of two different taxpayers, for example where corporation tax is charged in respect of profits and those same profits are charged to income tax in the hands of that company's shareholders when distributed to them as dividends. See, for example, Case C-35/98 *Verkooijen* [2000] ECR I-4071.

31 — See Case C-379/05 *Amurta* [2007] ECR I-9569, paragraph 37 and the case-law cited therein.

32 — *Commission* v *Spain*, cited in footnote 25 above, paragraph 51 and the case law cited therein.

33 — *Commission* v *Spain*, paragraph 52 and the case-law cited therein.

Fiscal territoriality

45. Finland and the governments of the intervening Member States contend that the different tax treatment of resident and non-resident pension plans is justified by the principle of fiscal territoriality. They submit that it follows from that principle that non-residents (subject to limited tax liability) are taxed only on income arising in the taxing State (Finland) and expenses directly linked to the activity that generated such income are deductible for tax purposes. [34] However, in the case of residents (who are subject to full tax liability), their worldwide income and expenses constitute the basis of the assessment to tax.

46. The principle of fiscal territoriality in international tax law is not defined, although it has been recognised by the Court. [35] I agree that the powers of the taxing State are exercised according to that principle. [36]

47. None the less, in my view it does not follow that the national legislation at issue automatically falls outside the scope of Article 63 TFEU. Different treatment of resident and non-resident pension plans cannot be brought within the scope of Article 65(1)(a) TFEU by a bare reference to that principle. [37]

48. Finland and the intervening Member States rely on *Gerritse*, [38] they submit that dividend payments that are transferred to reserves do not constitute expenses directly linked to the economic activity (investment of capital in Finland) that generated those dividends. In respect of non-resident pension plans, such transfers cannot be treated as deductible expenses, since it follows from the principle of fiscal territoriality that non-resident pension plans are subject only to limited tax liability in Finland. Accordingly, it is permissible to treat resident pension funds differently because such pension plans are fully taxable in Finland.

49. The Commission also relies on *Gerritse*, it contends that the national legislation at issue should be interpreted as recognising a direct link between the transfers of dividends to reserves and the capital investments in Finland that generate those dividends. Therefore, those transfers should also be treated as tax deductible expenses for non-resident pension plans.

50. In *Gerritse*, [39] the Court held that where the expenses in question are directly linked to the activity that generated taxable income in the taxing State, residents and non-residents are placed in a comparable position and therefore those expenses should be tax deductible.

51. The present matter differs from earlier cases where the Court has examined whether non-resident taxpayers should be afforded the same advantage as resident taxpayers in relation to the deduction of expenses when calculating the basis of assessment to tax. [40]

52. The circumstances are unusual in so far as dividend payments constitute income. They are not expenses. The national legislation at issue operates by creating a legal fiction that allows resident pension plans to treat such distributions as expenses.

34 — See point 50 below.

35 — Case C-446/03 *Marks and Spencer* [2005] ECR I-10837, paragraphs 45 and 46.

36 — See points 70 to 74 below concerning the double taxation of dividend payments.

37 — See the Opinion of Advocate General Jacobs in Case C-39/04 *Laboratoires Fournier* [2005] ECR I-2057, point 12; see also the Opinion of Advocate General Tesauro in Case C-118/96 *Safir* [1998] ECR I-1897, points 20 to 25. See further Case C-319/02 *Manninen* [2004] ECR I-7477, paragraph 39.

38 — Case C-234/01 [2003] ECR 1-5933, paragraph 27.

39 — Cited in footnote 38 above.

40 — Like *Gerritse*, Case C-345/04 *Centro Equestre* [2007] ECR I-1425 and C-290/04 *FKP Scorpio Konzertproduktionen* [2006] ECR I-9461 concerned freedom to provide services and whether operating expenses incurred by the taxpayers concerned were directly linked to the activity that generated taxable income. Case C-265/04 *Bouanich* [2006] ECR I-923 concerned the free movement of capital and the deductibility of the acquisition costs of shares acquired on a repurchase by a shareholder who was not resident in the taxing State.

53. The question is whether that same fiction should apply to non-resident pension plans.

54. In FKP *Scorpio Konzertproduktionen*[41] the Court held in relation to what were at the time Articles 59 and 60 EC (now Articles 56 and 57 TFEU) that those provisions do not preclude the taking into account if appropriate of expenses that are *not* directly linked, within the meaning of the *Gerritse* case-law, to the economic activity that generated the taxable income in question.

55. I conclude that it does not follow automatically from the principle of fiscal territoriality that dividends paid to non-resident pension plans that are transferred to reserves ('expenses' under the national legislation at issue) must be directly linked to the activity that generated the income in order to be treated as tax deductible.

Cohesion of the tax system

56. Finland raises a further, subsidiary argument that the difference in treatment is justified because it is necessary to ensure the cohesion of its system of taxation.

57. Whilst recognising that the need to maintain the cohesion of a national tax system may justify a restriction on fundamental freedoms in the form of differential treatment according to whether a particular event occurs within or outwith the purview of that system, the Court has consistently stressed that such justification depends on there being a direct link between the tax advantage concerned and the offsetting of that advantage by a particular charge to tax.[42]

58. The *Bachmann*[43] case concerned the Belgian system that applied to the taxation of income, in particular whether insurance contributions made in another Member State were deductible for tax purposes. Mr Bachmann had concluded sickness and invalidity insurance contracts, together with a life assurance contract, in Germany (where he then worked) before moving to live and work in Belgium, where he continued to pay the necessary premiums under those contracts. Belgian law did not allow him to deduct the amount of those premiums from his taxable income, as it would have done if the premiums had been paid in Belgium. However, the Belgian Government successfully argued that the exemption of the premiums from taxation was offset by taxation of the pensions, annuities or capital sums paid out by the insurers. The Court considered that the cohesion of the tax system presupposed that, if a State were obliged to allow the deduction of premiums paid in another Member State, it should be able to tax any sums payable by insurers. That could not, however, be guaranteed. Consequently, the cohesion of the tax system could not be ensured by measures less restrictive than the Belgian rules.

59. The Court's judgment in *Bachmann* was based upon the finding that under Belgian law there was a direct link,[44] in relation to the same taxpayer liable to income tax, between the ability to deduct insurance contributions from taxable income and the subsequent taxation of sums paid by insurers. The Belgian legislation in issue also provided that, if payment of contributions was not deducted from an assured person's taxable income, then the benefits paid by the insurance company were not taxed.

60. In the present matter there is no such corresponding link that offsets the tax advantage and the tax liability.

41 — Cited in footnote 40 above.

42 — Case C-204/90 *Bachmann* [1992] ECR I-249 and see also Case C-300/90 *Commission* v *Belgium* [1992] ECR I-305.

43 — Cited in footnote 42 above.

44 — The words 'direct link' are used here in the specific sense explained by the Court in the *Bachmann* case-law. Thus, it means that under the national legislation at issue that there exists a connection between the tax advantage and the tax liability: see paragraphs 21 to 23 of the judgment in *Bachmann*, cited in footnote 42 above.

61. There are three elements to the Finnish system: (i) pension plans are subject to business tax on dividend payments, (ii) those dividend payments that are transferred to reserves are treated as tax deductible expenses and (iii) there is a possibility that tax deferred on the dividend payments can be charged on future payments made to beneficiaries pursuant to contracts of assurance.

62. Those three separate elements might comprise part of an overall scheme of taxation, but there is no evidence of a direct link between them.

63. In relation to the tax advantage for pension plans and the possible subsequent charge to tax on benefits in the hands of the beneficiary, Finland has not shown that the deductions are directly linked to any charge to income tax on the beneficiary upon receipt of benefits under an assurance contract. Moreover pension plans generally invest in different assets and therefore use income from various sources in order to maintain their reserves. Dividends from corporate investments comprise only one such source. In such circumstances, benefits paid by pension plans pursuant to contracts of assurance are not generated solely by dividend payments. Accordingly, there is no direct link between the particular tax treatment of dividend payments under the national legislation at issue and any benefits paid out as pensions to persons assured that might be taxed as income.

64. It therefore seems to me that the difference in treatment cannot be justified on the ground that it is necessary for the cohesion of the tax system.

65. I thus conclude that the national measure at issue is not justified.

Ancillary matters

Double taxation

66. There are two points concerning the issue of double taxation that require clarification.

67. First, under the Finnish tax system, dividend payments made by a Finnish subsidiary to a non-resident pension plan that is also a parent company within Articles 2 and 3(1) of the parent-subsidiary directive are not subject to withholding tax at 19.5% under Articles 3 to 7 of the lähdevrolaki. [45]

68. Under the parent-subsidiary directive, taxation of such dividend payments is a matter for the State where the non-resident pension plan is established. That State is able to choose to refrain from taxing such dividends in the hands of the pension plan (the parent company). Alternatively it may tax the pension plan, but then must allow it to deduct from any amount of tax due that fraction of corporation tax relating to the dividend payment that it has received from its Finnish subsidiary. [46]

69. Therefore, the taxation of dividend payments received by non-resident pension plans that are parent companies for the purposes of the parent-subsidiary directive is a matter for the State where those pension plans are established rather than Finland.

45 — See Article 5 of the parent-subsidiary directive in point 14 above.

46 — See Article 4(1) of the parent subsidiary-directive and see point 14 above.

70. Second, Finland has concluded double taxation agreements with all Member States apart from Cyprus and with the EEA States except Liechtenstein.[47] Under the double taxation conventions the rate of tax on dividend payments is no more than 15%. Finland explained at the hearing that in some cases the rate is nil (as is the case for France, Ireland and the United Kingdom).[48]

71. France contends that the less favourable treatment of non-resident pension plans is mitigated by the double taxation conventions in so far as a lower rate of tax (up to a maximum of 15%) applies than the 19.5% rate which applies to resident pension plans.

72. Although the Court has held that a Member State may ensure compliance with its obligations under the Treaty by concluding a double tax convention with other Member States,[49] it is necessary that the application of such a convention allows the effects of the difference in treatment under national legislation to be compensated for.[50]

73. In order to neutralise the difference in treatment under the national legislation at issue, Finland would have to demonstrate that the more onerous tax treatment of non-resident pension plans in comparison to resident pension plans could not be attributed to its tax system.[51] It is true that, if a nil rate of tax applied to dividends paid to non-resident pension plans (as is the case for France, Ireland and the United Kingdom) any dividends would be taxed in the State of establishment rather than Finland.

74. However, Finland accepts that the practical effect of the tax advantage afforded to resident pension plans is that dividend payments made to them are often subject to little or no business tax. It seems to me that where a rate of tax of not more than 15% is charged to non-resident pension plans under a double taxation convention, the unfavourable treatment is not compensated for by such an agreement (save in cases where the tax rate is likewise at, or close to, nil under that double tax convention). I do not consider therefore that those conventions compensate fully for the difference in treatment under the national legislation at issue.

Withholding tax

75. Finally I wish to make certain observations relating to the concerns of Denmark, the Netherlands and Sweden regarding withholding taxes.[52]

76. Those governments contend that it follows from the principle of fiscal territoriality that Member States in exercising their powers of taxation should be able to charge tax on dividends paid to non-resident taxpayers on the basis of the gross amount received rather than the net sum (dividend payments less any deductions of, for example, expenses).

47 — The Commission confirmed in its reply that its application concerns all Member States and EEA States with which Finland has concluded a double taxation convention and/or are covered by Directive 77/799/EEC. Liechtenstein is therefore outside the scope of the present proceedings because it is not covered by that directive and it does not have a double taxation agreement with Finland. Directive 77/799/EEC applies to Cyprus; therefore that Member State is covered by the Commission's application.

48 — The double taxation conventions are based on the OECD's Model Tax Convention on income and on capital mentioned in footnote 22 above. That Convention introduces a mechanism for administrative assistance and the exchange of information in tax matters and sets a maximum rate of 15% for charging tax on dividend payments made to taxpayers who are resident in a State different to that of the company making the distribution.

49 — *Commission* v *Spain*, cited in footnote 25 above, paragraph 58.

50 — *Commission* v *Spain*, paragraph 59.

51 — *Commission* v *Spain*, paragraph 60.

52 — Member States commonly impose taxes on the distribution of profits by companies, that is, on dividends paid to shareholders. Such taxes normally take the form of withholding tax collected at source by the paying company on behalf of the tax authorities. Withholding taxes are often used in a domestic context to ensure compliance and to simplify collection; and the tax withheld generally meets, or is set against, the liability of recipients who are resident taxpayers. Withholding taxes on cross-border dividends represent the imposition of an extra tax by the taxing State on non-residents for which the latter may not obtain relief in their State of residence. See, for example, the Opinion of Advocate General Jacobs in Joined Cases C-283/94, C-291/94 and C-292/94 *Denkavit and Others* [1996] ECR I-5063, point 7.

77. In *Truck Centre*[53] the Court held that the collection of tax by means of a withholding tax reflects the situation that only resident taxpayers are directly subject to the supervision of the tax authorities of the State where the payment is made and those authorities can ensure the compulsory recovery of tax. That is not the case for non-resident taxpayers, where collection of tax requires the assistance and cooperation of the tax authorities of another Member State[54] EU law thus recognises that different tax arrangements for residents and non-residents are permissible where the situations of the two categories of taxpayer are not considered to be comparable in relation to the administration and collection of tax.

78. Accordingly, I would agree that it falls within the Member States' discretion when exercising their powers of taxation to choose to apply withholding taxes to collect tax on dividend payments made to non-residents. However, my conclusion in point 34 above concerns a difference in treatment relating to a particular fiscal advantage, rather than the application of withholding taxes.

Conclusion

79. For the reasons set out above, I consider that the national legislation at issue infringes Article 63 TFEU and Article 40 of the EEA Agreement. I therefore recommend that the Court should make the declaration sought by the Commission and, as requested by the Commission and in accordance with Article 69(2) of the Rules of Procedure, order the Republic of Finland to pay the costs.

53 — Case C-282/07 [2008] ECR I-10767, paragraphs 38 to 41.

54 — *Truck Centre*, paragraph 41.