

Could there be tax rebates for foreign pension funds operating in France?

Foreign pension funds operating in France are taxed on all dividend income originating from listed French companies. This tax is withheld at source at 25% and significantly reduces the yield from such investments. In view of recent French and EC case law, this could be about to change, creating the potential for large rebate claims by foreign pension funds.

The French rules

The case in question concerned a pension fund incorporated in a country outside of the European Union but which has a double taxation treaty with France. It operated as a private company on a not for profit basis, investing money to fund its clients' pensions.

In terms of Article 206-1 of the French Tax Code (hereafter 'the Code'), pension funds operating on a not for profit basis are not subject to corporation tax associated with their not-for-profit objective. Dividends paid to them by French companies are exempt from any French tax and are not subject to any withholding tax.

It is in the area of tax withheld at source that foreign pension funds suffer. When French pension funds receive dividends from French companies, no tax is deducted at source as per Article 119 bis 2 of the Code.¹ However, non resident companies have been deemed not to benefit from this exemption.

The legal basis for distinguishing between French and foreign pension funds can be challenged by application of the principles of non-discrimination and the free circulation of capital.

1. Double Tax Treaties

Certain double tax treaties entered into by France provide that "nationals" of one treaty State, irrespective of their State of residence, may not be subject to more onerous taxation, in equivalent situations, than the nationals of the other State.

By way of example, the double tax treaty between France and Country X is stated to apply to all taxes on businesses, including deductions at source and taxes paid in advance.² It states that;

'The nationals of one state, whether or not they are residents of one or other of the states...shall not be subjected to any obligation or imposition in the other state which is different or more onerous than that which the nationals of the other state would be subject to in the same situation'.³

In the above example the treaty provides as follows;

¹ Note 21 juillet 1966 no 5 : BOCD 1966-II-3424 ; D adm. 4 H-6112 no 42, 12 juillet 1997).

² *Double Taxation Treaty between France and Country X*, 19th June 1979, Article 2-1.

³ *Ibid*, at Article 24-1.

‘In terms of the present treaty and in so far as the context does not give rise to a different interpretation, the term “national” refers to “all legal entities, partnerships and associations in accordance with the law in force in the country”’.

It is therefore clear that in terms of this treaty, there is no justification for a foreign company being subject to a greater tax burden than that to which a French company would be subject in France. The treaty applies to ‘nationals’ of one of the states, which Article 3-1 clearly states as including legal persons. As a foreign-registered company, the pension fund qualifies as a national of a foreign country. As highlighted by Bruno Gouthière⁴, the Conseil d’Etat has clarified that it makes no distinction between the terms ‘residence’ and ‘nationality’⁵ so that it does not matter where the company is operating provided it is registered in one of the two countries.

The French Tax Authorities have argued that not-for profit pension funds which are not liable for corporation tax are public bodies and for this reason the double taxation treaty does not apply to them. However in this particular case it is clear that this argument is weak, as pension funds qualifying as ‘nationals’ in terms of the tax treaty can benefit from the non-discrimination clause.

In any event it has been decided by the European court of Justice that neither the internal nor the treaty law of one of the members can contravene the four fundamental liberties, (including the free circulation of capital) provided for in the European Community Treaty.

2. EC law – the Free Movement of Capital

In terms of Article 56 of the European Community Treaty, restrictions on the movement of capital and payments between member states themselves *and* between member states and third party states are not permitted. There are at least three cases which are of particular relevance in this area.

In *Amutra SGPS*⁶ it was held that member states could not tax at source dividends from one company paid to a company in another member state if it did not impose the same tax on dividends paid to a company domiciled in its own country.

Further, in the case (105/05, RJF 3/08 no 378), the ECJ affirmed that the Articles also applied to movements of capital between a member state and a third party state.

The case of *Centro di Musicologia Walter Stauffer*⁷ discussed the applicability of these provisions to different entities and concluded that these Articles could be applied to not-for-profit organisations, such as pension funds. There is a double economic imposition in the case of the payment of a dividend by a French company to a foreign company.

These precedents demonstrate that the current French regulations dissuade pension funds, whether organised in other EC countries or elsewhere, from investing in French companies and consequently prevent French companies from securing capital from these third countries.

⁴ Fiscal, *Plus-values immobilières des non-résidents*, Editons Francis Lefebvre 2008.

⁵ CE 17 janvier 1996, no 120646, 8e et 9e s.-s, SA Nike, RJF 3/96, no 322.

⁶ C-379/05

⁷ ECJ 386/04

Finally, in the past year, the European Commission has placed various member states on notice (which is the second phase of the infringement procedure provided for by Article 226 of the EC Treaty) regarding their tax treatment of European pension funds.⁸ This action was judged on the basis that pension funds from other member states receive harsher tax treatment than those of the member state itself. This therefore demonstrates the Commission's willingness to uphold the terms of Article 56 of the Treaty and indicates that it would adopt a similarly robust approach concerning discrimination against a pension fund from a third party state.

What does this mean for foreign pension funds?

Clearly the consequences could be wide ranging. There are undoubtedly many foreign-based pension funds investing in France which have been subjected to the 25% withholding of tax at source on their dividend income. On the basis of the above, such companies may be able to obtain tax rebates which may be of significant amounts.

This could have a significant impact on the revenue generated by their investments.

July 30, 2008
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⁸ See letters of notice to The Czech Republic, Denmark, Spain, Lithuania, Netherlands, Portugal, Slovenia, Sweden *IP/07/616* of 7th May 2007, to Italy and Finland *IP/07/1152* of 23rd July 2007, to Germany and Estonia *IP/08/143* of 31st January 2008, to Spain and Portugal *IP/08/712* of 6th May 2008.