ECJ rules on refund of German WHT on dividends paid to foreign pension funds

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On November 13, 2019, the European Court of Justice held in a landmark ruling that pension funds from non-EU states must not be treated less favorably for corporate income tax purposes than German pension funds (C-641/17 – College Pension Plan of British Columbia vs. Finanzamt München III).

Taxation of German pension funds

Dividends received are generally subject to withholding tax at a rate of 25% of the gross dividend. As part of the assessment procedure, taxes withheld on dividends are fully creditable against the corporate income tax liability of the German resident pension fund. If the taxes withheld on the dividend are higher than the determined corporate income tax, the surplus is refunded.

In addition, in the determination of the German pension funds’ taxable profits, dividend income is fully deductible to the extent it is used to cover increases in the technical reserves in the year in which the dividend was received. In practice, 90% of the dividends received from shares held to cover technical reserves are generally tax deductible. Consequently, the dividend received is almost completely exempt from tax in practice.

German Taxation of foreign pension funds
A foreign pension fund which has neither its management nor its registered office in Germany is also subject to withholding tax on the gross dividend paid to it by German resident corporations at the above-mentioned rate. Pursuant to Section 44a (9) German Income Tax Act (EStG), two fifths of the withheld and paid tax is refunded upon application of the foreign pension fund. However, the remaining 15% withholding tax on dividends has a final effect due to Section 32 (1) no. 2 German Corporation Tax Act (KStG). Thus it is not possible to credit any withholding tax against corporate income tax liability. Moreover, the increases in technical reserves of the foreign pension fund could not be taken into account as operating expenses in determining the taxable profit of a foreign pension fund.

**ECJ decision C-641/17**

With the decision of the ECJ of November 13, 2019 (C-641/17 – College Pension Plan of British Columbia vs. Finanzamt München III) it was determined that an unequal treatment as described above is contrary to the free movement of capital.

The ECJ did not follow the argument of the defendant (the German Inland Revenue Office) that there is a connection between dividend income and allocation to technical reserves, which justifies unequal treatment according to the settled case law of the ECJ (judgment of May 21, 2015, Wagner-Raith (C-560/13)). An objectively comparable situation – which is the responsibility of the national court to examine – exists insofar as a non-resident pension fund allocates the dividends received voluntarily or under the rules of mandatory law in its state of domicile to its technical reserves.

It is also not possible for the Member State (i.e. Germany in the present case) to justify discriminatory treatment in the public interest, as Germany has decided to practically exempt dividend received completely or almost completely from taxation.

**DLA Piper comment**

This ruling of the European Court of Justice has a fundamental effect beyond the individual case. Pension funds resident in other EU Member States – as well as those resident elsewhere, provided that they are sufficiently comparable to German taxable pension funds (Pensionsfonds) – should be entitled to a refund of withholding tax on dividends paid to them by German resident corporations to the extent that such dividends are used to fund allocations to technical reserves set up to cover their liabilities towards their respective beneficiaries. It still needs to be decided by the German tax courts how these pension funds should provide evidence for such allocations.

Generally, German taxable pension funds (Pensionsfonds) are subject to the same corporate income tax regime as corporate life insurers. As such, the arguments of the case will arguably also apply to German withholding taxes on dividends paid by German resident corporations to foreign life insurance companies.

Foreign pension funds and life insurers should therefore review their investment portfolio for dividend payments by German corporations and apply for a corresponding refund of WHT with the German tax authorities.

To learn more, please contact the authors.

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