JUDGMENT OF THE COURT (Fourth Chamber)

8 November 2012 (*)

(Failure of a Member State to fulfil obligations – Free movement of capital – Article 63 TFEU – EEA Agreement – Article 40 – Taxation of dividends paid to non-resident pension funds)

In Case C?342/10,

ACTION under Article 258 TFEU for failure to fulfil obligations, brought on 7 July 2010,

European Commission, represented by R. Lyal and I. Koskinen, acting as Agents, with an address for service in Luxembourg,

applicant,

v

Republic of Finland, represented by J. Heliskoski, acting as Agent,

defendant,

supported by

Kingdom of Denmark, represented by C. Vang, acting as Agent,

French Republic, represented by G. de Bergues and N. Rouam, acting as Agents,

Kingdom of the Netherlands, represented by C. Wissels and M. Noort, acting as Agents,

Kingdom of Sweden, represented by A. Falk and S. Johannesson, acting as Agents,

United Kingdom of Great Britain and Northern Ireland, represented by H. Walker, acting as Agent, and G. Facenna, Barrister,

interveners,

THE COURT (Fourth Chamber),

composed of L. Bay Larsen, acting as President of the Fourth Chamber, J.?C. Bonichot, C. Toader, A. Prechal (Rapporteur) and E. Jaraši?nas, Judges,

Advocate General: E. Sharpston,

Registrar: C. Strömholm, Administrator,

having regard to the written procedure and further to the hearing on 10 May 2012,

after hearing the Opinion of the Advocate General at the sitting on 19 July 2012,

gives the following

Judgment

1 By its application, the European Commission seeks a declaration that, by introducing and maintaining in force a scheme under which dividends paid to foreign pension funds 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 Agreement on the European Economic Area of 2 May 1992 (OJ 1994 L 1, p. 3) (the 'EEA Agreement').

2 By order of the President of the Court of 22 November 2010, the Kingdom of Denmark, the French Republic, the Kingdom of the Netherlands, the Kingdom of Sweden and the United Kingdom of Great Britain and Northern Ireland were granted leave to intervene in support of the form of order sought by the Republic of Finland.

Finnish law

3 As regards resident pension funds, it is clear from Paragraph 6 of Law 360/1968 on the taxation of income from economic activities (laki elinkeinontulon verottamisesta (360/1968), the 'LEV'), read in combination with Paragraph 124(2) of Law 1535/1992 on income tax (tuloverolaki 1535/1992) of 30 December 1992, that the dividends received by those pension funds are, in principle, taxed at an effective rate of 19.5%.

4 Article 7 of the LEV provides:

'Expenses and losses incurred in order to acquire or to maintain income from an economic activity are deductible for tax purposes.'

5 The first subparagraph Paragraph 8 of the LEV provides:

'Deductible expenses within the meaning of Paragraph 7 are inter alia:

…

(10) The 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, are necessary to cover liabilities in relation to investments for pensions and other related insurance obligations ...'

6 The Finnish sourced dividends received by non-resident pension funds are taxed in accordance with Law 627/1987 on the taxation of income and property of limited taxpayers (lähdeverolaki 621/1978).

7 Under Paragraph 3 and point 3 of the first subparagraph of Paragraph 7 of that law, a withholding tax of 19.5% is charged, except in the cases based in particular on the application of 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), on dividends that a non-resident pension fund receives in Finland. That rate varies between 15% and 0% where a double taxation convention applies. The Republic of Finland has concluded such conventions with all the Member States of the European Union and the European Economic Area (EEA), with the exception of the Republic of Cyprus and the Principality of Liechtenstein.

The pre-litigation procedure

8 Taking the view that the Finnish tax system is discriminatory as regards the dividends paid to non-resident pension funds and, therefore, as being contrary to Article 63 TFEU and Article 40 of the EEA Agreement, on 19 July 2007 the Commission sent the Republic of Finland a letter of formal notice to which the latter replied by letter of 19 September 2007.

9 On 23 September 2008, the Commission sent to that Member State an additional letter of formal notice to which the Republic of Finland replied by letter of 20 November 2008.

10 On 26 June 2009, the Commission sent a reasoned opinion to which the Republic of Finland replied on 25 August 2009.

11 Since it was not satisfied with the explanations provided by that Member State, the Commission decided to bring the present action.

Consideration of the request to reopen the oral procedure

12 By document lodged at the Court Registry on 3 September 2012, the Republic of Finland requested the Court to order that the oral procedure be reopened pursuant to Article 61 of the Rules of Procedure. According to that Member State, the Advocate General's Opinion contains a number of incorrect assertions as regards the content of the Finnish legislation which is the subject of the present action for failure to fulfil obligations.

13 It is clear from the case?law that the Court may of its own motion, or on a proposal from the Advocate General, or at the request of the parties, order the reopening of the oral procedure, in accordance with Article 61 of the Rules of Procedure, if it considers that it lacks sufficient information or that the case must be dealt with on the basis of an argument which has not been debated between the parties (see, inter alia, Case C?210/06 *Cartesio* [2008] ECR I?9641, paragraph 46).

14 The content of the Finnish legislation which is the subject-matter of the present action for failure to fulfil obligations has been sufficiently debated before the Court by the parties, in both the written procedure and at the hearing. In those circumstances, the Court considers that it has all the information necessary in order to rule on the action before it.

15 Moreover, it is not claimed that this case must be dealt with on the basis of an argument which has not been debated before the Court.

16 The Court, after hearing the Advocate General, accordingly considers it appropriate to reject the request to reopen the oral procedure.

The action

Admissibility

17 Referring to the judgment in Case C?195/04 *Commission* v *Finland* [2007] ECR I?3351, the Republic of Finland submits that the essential points of fact and law on which an action is based must be indicated coherently and intelligibly in the application itself. That is not so in the present case, since the precise subject-matter of the application cannot be ascertained from its text.

18 However, that Member States takes the view, in its defence, that the application concerns tax discrimination due to the fact that the national pension funds may deduct distributed profits from the amounts referred to in Paragraph 7 and point 10 of the first subparagraph of Paragraph 8 of the LEV, that is undertakings made with respect to pension matters, whereas it is prohibited for

pension funds established in other Member States or in the EEA member of the European Free Trade Association (EFTA) from making such deductions on profits imputable to their establishments in Finland.

19 It does not appear from the application or the Commission's pleadings that the subject-matter of the application differs from that described by the Republic of Finland.

20 It is true that, the Commission submits, in the alternative, that in the context of withholding tax, non-resident pension funds are taxed on the gross amount of dividends received and that even the expenses which are undeniably related to the income concerned are not deductible in Finland by those pension funds.

21 As the Republic of Finland observes, without being challenged by the Commission, the subject-matter of the action concerns only that related to undertakings made regarding pensions, laid down in Paragraph 7 and point 10 of the first subparagraph of Paragraph 8 of the LEV.

22 In those circumstances, the Republic of Finland's argument that the subject-matter of the dispute has not been defined with sufficient precision by the Commission cannot be accepted.

23 It follows that the action is admissible.

Substance

24 The Commission acknowledges that its action concerns only pension funds established in the Member State of the European Union or in countries which belong to EFTA with which the Republic of Finland has concluded a convention on the exchange of information. It claims that the fact that the Republic of Finland de facto applies a tax exemption to dividends received by resident pension funds, whereas dividends of the same kind paid to non-resident pension funds are taxed, constitutes a restriction on the free movement of capital.

25 The Commission observes that resident pension funds, although as regards the dividends which they have received, subject to a rate of taxation of 19.5%, are in effect authorised to deduct tax, on the basis of Paragraph 7 and point 10 of the first subparagraph of Paragraph 8 of the LEV, the amounts reserved in order to meet their obligations as regards pensions, which, in fact, gives rise to a tax exemption for those dividends.

26 However, the dividends received by the non-resident pension funds are subject to a rate of tax of at least 15% in accordance with the double taxation conventions or a rate of tax of 19.5% in accordance with national tax legislation, without the possibility of their being granted by the Republic of Finland the right to deduct tax from the amounts in reserve, whereas the legislation of that Member State regards those amounts as expenses directly related to the income concerned.

27 The Republic of Finland and the interveners challenge the existence of discrimination against non-resident pension funds, which constitutes an infringement of Article 63 TFEU and Article 40 of the EEA Agreement, essentially on the ground that the difference in the taxation of dividends paid to resident and non-resident pension funds relates to situations which are not objectively comparable.

28 It must be recalled that, according to settled case?law, the measures prohibited by Article 63(1) TFEU as restrictions on the movement of capital, include those that are such as to discourage non-residents from making investments in a Member State or to discourage that Member State's residents from doing so in other States (see, in particular, Joined Cases C?436/08 and C?437/08 *Haribo Lakritzen Hans Riegel and Österreichische Salinen* [2011] ECR I?305,

paragraph 50, and Case C?493/09 *Commission* v *Portugal* [2011] ECR I?9247, paragraph 28).

29 As regards the national legislation at issue, the Commission submits that the possibility, open only to resident pension funds under Paragraph 7 and point 10 of the first subparagraph of Paragraph 8 of the LEV, to deduct the amounts reserved in order to meet their obligations in respect of pensions means that a special tax base is applied to those companies, involving an effective tax exemption solely for resident pension funds. In practice, all the income generated by those pension funds is naturally oriented towards that purpose.

30 The Republic of Finland does not challenge the Commission's assertions, supported by specific examples, according to which the resident pension funds generate hardly any taxable income. However, it expresses doubts as to the fact that that situation arises because resident pension funds are able to deduct tax from the amounts reserved with a view to meeting their obligations in respect of pensions on the basis of Paragraph 7 and point 10 of the first subparagraph of Paragraph 8 of the LEV.

31 However, when questioned at the hearing, the Republic of Finland was unable to demonstrate that the fact that resident pension funds generate almost no taxable income could be explained otherwise than by the fact that those amounts are deductible. In particular, it does not appear that 'all kinds of other deductions' related to their business, to which the Republic of Finland refers without giving any further details, may in themselves give rise to that situation.

32 Therefore, while dividends received by resident pension funds are, in practice, exempt or partially exempt from income tax as a result of the provisions of national law at issue, the dividends received by non-resident pension funds are taxed at 19.5% under the same national legislation, or at 15% or less under double taxation conventions concluded by the Republic of Finland.

33 Treating dividends paid to non-resident pension funds less favourably than dividends paid to resident pension funds is liable to deter companies established in another Member State from investing in the Republic of Finland, and thus constitutes a restriction on the free movement of capital prohibited, in principle, by Article 63 TFEU (see, Case C?379/05 *Amurta* [2007] ECR I?9569, paragraph 28).

34 Contrary to what the French Republic and the United Kingdom suggest, it cannot be held that this unfavourable treatment is offset by the double taxation conventions concluded by the Republic of Finland. It is necessary for that purpose that the application of such a convention should allow the effects of the difference in treatment under national legislation to be compensated for (see, Case C?284/09 *Commission* v *Germany* [2011] ECR I?9879, paragraph 63, and the case?law cited). As is clear from the explanations provided on that point at the hearing by the Republic of Finland, that Member State has concluded only three conventions providing for a rate of taxation on dividends of 0%, most of the other conventions providing for a rate of 15%.

35 In order for such a difference in treatment to be compatible with the provisions of the FEU Treaty on the free movement of capital, it must concern situations which are not objectively comparable or be justified by an overriding reason of public interest (see, in particular, Case C?446/04 *Test Claimants in the FII Group Litigation* [2006] ECR I?11753, paragraph 167, and Case C?436/06 *Grønfeldt* [2007] ECR I?12357, paragraph 16).

36 As regards the question whether the situations at issue are objectively comparable, it must be recalled that the comparability of a cross-border situation with an internal situation must be examined having regard to the aim pursued by the national provisions at issue (see, Case C?337/08 *X Holding* [2010] ECR I?1215, paragraph 22, and Case C?18/11 *Philips Electronics UK*

[2012] ECR, paragraph 17).

37 Furthermore, it is settled case?law that, in relation to expenses, such as business expenses which are directly linked to an activity which has generated taxable income in a Member State, residents and non-residents of that State are in a comparable situation, with the result that legislation of that State which denies non-residents, in matters of taxation, the right to deduct such expenses, while, on the other hand, allowing residents to do so, risks operating mainly to the detriment of nationals of other Member States and therefore constitutes indirect discrimination on grounds of nationality (Case C?450/09 *Schröder* [2011] ECR I?2497, paragraph 40 and the case?law cited).

38 According to the Republic of Finland, supported on that point by the interveners, that is not the case, since the deduction of their obligations as regards pensions, provided for in Paragraph 7 and point 10 of the first subparagraph of Paragraph 8 of the LEV, does not concern expenses directly related to an activity which generated taxable income in Finland.

39 The Republic of Finland states that that deduction is related to the nature of the business of pension insurance bodies, in the context of which receipts are received before the expenses are due. The technical provision referred to by that measure corresponds to the capital value of the benefits payable when the event insured occurs on the basis of current contracts and sums due for insured events which have already taken place, that is to say reserves constituted by insurance bodies for the payment of future pensions. According to that Member State, the technical provision is fixed in accordance with the applicable national rules. Any increase in that technical provision which occurs during the tax year is tax deductible and any reduction in that provision is regarded as a taxable receipt.

40 It follows, according to the Republic of Finland, that the increase in the provision for pensions is an expense related to the pension fund's overall activity, so that there is no direct link, for the purpose of the case?law of the Court, to the dividend received by the pension fund.

41 In that regard, it suffices to state that, in the national legislation at issue and, in particular, in Paragraphs 7 and point 10 of the first subparagraph of Paragraph 8 of the LEV, the national legislation explicitly treats the amounts reserved/set aside with a view to meeting their obligations in respect of pension liabilities as 'expenses … incurred in order to acquire or maintain the income from economic activity'. It thereby creates a direct link between those amounts and the activity of the pension insurance bodies generating taxable income and itself makes them indissociable.

42 Thus, the direct link between expenses and taxable income results from the technique of assimilation chosen by the Finnish legislature, among other possible techniques, such as a pure and simple tax exemption, in order to take account of the specific purpose of the pension funds which is to accumulate capital, by way of investments producing, in particular, an income in the form of dividends in order to meet their future obligations under insurance contracts.

43 Therefore that specific purpose is also that of the non-resident pension funds which pursue the same activity, the latter are in a situation objectively comparable to that of resident pension funds as regards Finnish sourced dividends.

44 Furthermore, it cannot be held, contrary to the submissions of the Kingdom of Denmark, the Kingdom of the Netherlands and the Kingdom of Sweden, that resident and non-resident pension funds are in a different situation solely because the dividends paid to the latter are subject to a withholding tax. The national legislation at issue in the main proceedings does not simply provide for different procedures for charging tax depending on the place of residence of the recipient of nationally sourced dividends, but provides, in fact, that only non-resident pension funds are to be

taxed on those dividends (see, by analogy, Joined Cases C?338/11 to C?347/11 *Santander Asset Management SGIIC and Others* [2012] ECR, paragraph 43).

45 As regards the question whether the national legislation concerned is justified by an overriding reason of public interest, the Republic of Finland, supported by the Kingdom of Denmark, the French Republic, the Kingdom of the Netherlands and the Kingdom of Sweden, refer to the principle of territoriality which is an overriding reason and from which it is clear that the tax base for non-resident taxpayers in a Member State is fixed taking into account only the profits and losses which arise from their activities in that State.

46 That argument corresponds essentially to that, set out in paragraph 38 of the present judgment, according to which resident and non-resident pension funds are not in an objectively comparable situation, since the deduction of obligations in respect of pension liabilities does not concern expenses directly linked to an activity generating taxable income in Finland by a non-resident pension fund.

47 For the reasons set out in paragraphs 41 to 44 of the present judgment, such an argument cannot be accepted.

48 The Republic of Finland also argues that the difference in treatment between resident and non-resident pension funds is justified by the need to ensure the coherence of the tax system. It points out that the shares do not only earn dividends, but may also generate a surplus. In practice, a non-resident pension fund does not pay tax in Finland on the share surplus of Finnish companies listed on the stock exchange which it owns. It is logical for the pension fund to be unable to deduct from part of the product of those shares, that is the dividend, expenses relating to all the shares.

49 For an argument based on such a justification to succeed, a direct link must be established between the tax advantage concerned and the offsetting of that advantage by a particular tax levy (see Case C?380/11 *DI. VI. Finanziaria di Diego della Valle & C.* [2012] ECR, paragraph 47 and the case?law cited).

50 However, as the Commission observes, without being contradicted on that point by the Republic of Finland, as far as concerns resident pension funds, surpluses, like dividends, are used to increase reserves and are either not subject to income tax or are subject to it only to a limited extent.

51 The Kingdom of the Netherlands continues to assert that the difference in treatment is justified by the need to ensure the coherence of the tax system, since the counter part of the possibility of deducting pension obligations is that deductions on those provisions are taxable.

52 In that regard, it suffices to state that the only reference to any subsequent taxation of benefits paid by pension funds to beneficiaries does not mean that a direct link exists, within the meaning of the case?law cited in paragraph 49 of the present judgment, to the required legal standard (see, to that effect, *Commission* v *Portugal*, paragraph 37).

53 With regard to the adverse effect that the system at issue has on Article 40 of the EEA Agreement, a point raised by the Commission, it should be noted that, in so far as the provisions of that article have the same legal scope as the substantially identical provisions of Article 63 TFEU all the foregoing considerations may, in circumstances such as those in the present case, be transposed, *mutatis mutandis*, to Article 40 of the EEA Agreement (see, Case C?250/08 *Commission* v *Belgium* [2011] ECR I?12341, paragraph 83 and the case?law cited).

54 Consequently, it must be stated that, by instituting and maintaining in force a discriminatory tax system as regards dividends paid to non-resident pension funds, the Republic of Finland has failed to fulfil its obligations under Article 63 TFEU and Article 40 of the EEA Agreement.

Costs

55 Under Article 138(1) of the Rules of Procedure, the unsuccessful party is to be ordered to pay the costs if they have been applied for in the successful party's pleadings. Since the Commission has asked for the Italian Republic to be ordered to pay the costs, and the latter has been unsuccessful, it must be ordered to pay the costs.

56 Under the first subparagraph of Article 140(1) of the Rules of Procedure, Member States which intervene in the proceedings are to bear their own costs. The Kingdom of Denmark, the French Republic, the Kingdom of the Netherlands, the Kingdom of Sweden and the United Kingdom must therefore bear their own costs.

On those grounds, the Court (Fourth Chamber) hereby:

1) **Declares that, by introducing and maintaining in force a scheme under which dividends paid to foreign pension funds 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 European Economic Area Agreement of 2 May 1992.**

2) **Orders the Republic of Finland to bear its own costs and to pay those incurred by the European Commission.**

3) **Orders the Kingdom of Denmark, the French Republic, the Kingdom of the Netherlands, the Kingdom of Sweden and the United Kingdom of Great Britain and Northern Ireland to bear their own costs.**

[Signatures]

* Language of the case: Finnish.