Pensions:

What fiscal incentives can Malta implement?

By

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CHAPTER 1

Introduction, Objectives and Methodology

1.1 Introduction

Attainment of older age is becoming more widespread. Although rising longevity is to be celebrated, one cannot disregard the fresh challenges this brings along.

A study carried out by the Maltese National Statistics Office (NSO) in 2005, which surveyed 800 persons, showed that the majority of potential Maltese resident pensioners who are

i) aged 18 years and over and

ii) living within private households,

felt that the income earned from pension and other investments will not be sufficient to live a comfortable life in retirement[1]. Moreover, this study showed that a larger proportion of the potential pensioners did not own any form of life insurance or private pension type product. This, coupled with a declining birth rate and increase in the ageing population in Malta, presents a significant social, political and economic challenge. If population growth persists with this trend, the young working generation will be reduced, resulting in fewer contributions from the working force to sustain the current social security system from which retired people are paid their state pension. At the moment, the working retirement ratio is 5:1, however by 2050 the ratio will be 2:1, making the current system unsustainable.

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[1] National Statistics Office (2005), *Perceptions on Retirement and Pensions*, p.7-8.

This situation calls for action to be taken by both the Government and the private sector in order to protect Maltese society against social exclusion and guarantee a decent standard of living upon retirement. This study focuses on what fiscal incentives the Government could offer in order to help the private sector to provide better pension solutions and thus guarantee a brighter future for forthcoming generations.

1.2 Objectives of the dissertation

The main aim was to examine which fiscal (tax) incentives could be introduced for pension plans in Malta and which would seem most appropriate, considering the local and international pension arenas.

A necessary objective of this dissertation was to evaluate the fiscal incentives applied by other European countries in order to consider which principles the local Government and financial institutions could apply.

For the purpose of this dissertation, ‘private sector pension provision’ was regarded as both occupational pension schemes and private pension schemes. These pensions include occupational final salary schemes, occupational money purchase schemes and personal pension plans. This dissertation has additionally provided an evaluation of the current pension system in Malta.

The study also considers the actions being taken by the United Kingdom (UK) as regards the tax incentives of the private pension sector.

1.3 Methodology employed

Significant information was obtained through the reading of published material and books together with consultation of a number of internet sites.

CHAPTER 2

Pensions Systems in Europe and Malta

In Europe pension systems are typically based on the Three Pillar approach, namely:

1st Pillar: State provided pension

2nd Pillar: Occupational pension schemes

3rd Pillar: Private (or Personal) pensions

Most European countries operate all three pillars but with a different reliance on each.

2.1 State Pension Provision

State pension provision varies from country to country in terms of the eligibility conditions and level of benefits, but most systems are based on the "Pay As You Go" (PAYG) principle where current pensions are paid from current revenue (normally social security contributions). State pensions can be flat rate (Basic state pension in the UK) or earnings related (State second pension or SERPS in the UK). Many European countries are moving towards "means tested" pensions where the amount of pension will be capped or may even be reduced, depending on individual pension saving levels.

2.2 Occupational Pension Provision

Occupational pension provision also varies between countries in terms of design and dominance. The UK has the largest provision and provides Defined Benefit and Defined Contribution schemes which are funded by both employers and employees. Germany in

contrast has traditionally provided work based pensions through Book Reserves, whereby employers would not actually contribute into a fund but would make provision for the liabilities on its balance sheet. The reason for the different approaches is mainly down to tax incentives. UK companies receive tax relief on contributions to approved pensions. German companies receive tax relief for making Book Reserves (although this has recently changed resulting in a growth of funded pensions in Germany).

2.3 Private Pensions

Private pension provision varies across Europe but is dominated by the UK, again due to a system of fiscal incentives that have been available since 1921. The Finance Act introduced tax relief for pension schemes satisfying certain conditions.

2.4 Overall Rankings

Each year AON Consulting formulates a report about pensions, measuring the pressure on EU pension systems. It gives an overall assessment of the pension risks that EU countries face, and focuses on the impact or strains that pension systems place on the economy, employers and the citizens of each EU country.

Private provisions are analysed, along with the changing demographics and government policies on state pension, to determine whether the overall pension system is likely to be adequate.

The table below summarises the results for the four measures – demographics, adequacy of state pension, affordability and sustainability, and private pensions – with a final overall ranking being given to each country. Each category ranks 1-25, where 1 is recognised as the top ranking with favourable conditions and 25 as the lowest in comparison to other European countries. The arrows represent movements since the 2006 report.

Country		*Demographics*	*Adequacy of State Pension*	*Affordability and Sustainability*	*Private Pensions*	*Overall Rank 2007*	*Change over year*	*Overall Rank 2006*
Denmark	DK	4	15	10	2	1	=	1
Netherlands	NL	7	17	8	1	=2	↑↑↑	5
Sweden	SE	5	16	9	3	=2	↑↑↑↑↑	7
Irish Republic	IE	1	24	4	5	4	↓	3
United Kingdom	UK	3	25	3	4	5	↑	6
Estonia	EE	6	22	2	6	6	↓↓↓↓	2
Latvia	LV	12	11	1	13	7	↓↓↓	4
Spain	ES	14	3	13	11	8	=	8
Luxembourg	LU	10	1	18	21	9	↑↑↑↑	=13
Lithuania	LT	16	20	5	10	10	↓	9
Poland	PL	24	9	11	8	11	=	=11
Czech Republic	CZ	22	7	11	14	12	↓↓	10
Germany	DE	13	19	16	7	=13	=	=13
Slovakia	SK	19	10	7	19	=13	↑↑↑↑	17
Finland	FI	8	17	15	17	15	↓↓	=13
Cyprus	CY	2	21	13	22	=16	↓↓↓↓↓	=11
Hungary	HU	20	2	20	16	=16	↑↑	=18
Austria	AT	18	6	19	15	=16	↑↑	=18
Malta	MT	17	12	6	24	19	↑↑	21
Portugal	PT	9	8	24	20	20	↓↓↓↓↓↓↓	13
France	FR	11	13	21	18	21	↑	22
Greece	EL	15	5	25	24	22	↑	=23
Belgium	BE	21	23	17	9	23	↑↑	25
Slovenia	SI	25	14	21	12	24	↓	=23
Italy	IT	23	4	23	23	25	↓↓↓↓↓↓↓	=18

Table 2.1

2.5 Areas of Concern

Within each of the four areas measured, a number of countries are highlighted whose statistics suggest the most concerning position. These are shown in the table below.

Country		***Overall Rank 2007***	***Demographics***	***Adequacy of State Pension***	***Affordability and Sustainability***	***Private Pensions***
Denmark	DK	1				
Netherlands	NL	=2				
Sweden	SE	=2				
Irish Republic	IE	4		Risk		
United Kingdom	UK	5		Risk		
Estonia	EE	6		Risk		
Latvia	LV	7				
Spain	ES	8				
Luxembourg	LU	9				Risk
Lithuania	LT	10	Risk	Risk		
Poland	PL	11	Risk			
Czech Republic	CZ	12	Risk			
Germany	DE	=13		Risk		
Slovakia	SK	=13	Risk			Risk
Finland	FI	15				
Cyprus	CY	=16		Risk		Risk
Hungary	HU	=16	Risk			
Austria	AT	=16	Risk			
Malta	MT	19	Risk			Risk
Portugal	PT	20			Risk	Risk
France	FR	21			Risk	Risk
Greece	EL	22			Risk	Risk
Belgium	BE	23	Risk	Risk		
Slovenia	SI	24	Risk		Risk	
Italy	IT	25	Risk		Risk	Risk

Table 2.2

2.6 Summary of 3 European Countries Pension system

The statistics in each country are complex and varied. A sample of countries to provide a base of the issues across the continent is outlined below.

2.6.1 United Kingdom

Demographics	***Adequacy of State Pension***	***Affordability and Sustainability***	***Private Pensions***	***Overall Rankings***
3/25	25/25	3/25	4/25	5/25

Table 2.3

The UK has improved its position gradually, now making the top five of the Barometer rankings. However, the adequacy of the state pension is still ranked the worst in the EU25.

The UK pension system has seen a gradual shift away from the State towards employers and individuals. The UK state pension system is one of the most affordable systems in the long term. The main reason for this is the relatively low level of state benefits. The future plans to increase the pension age from 65 to 68 over the next thirty years should help to maintain the affordability.

The change in reliance on the state pension has been achievable as the deficiencies are taken up by the private sector through employer schemes and private provision. The funded pension system is mostly present in the UK and represents the largest funded pension system in Europe.

Although private pensions remain sturdy, the switch from defined benefit (DB) schemes to defined contribution (DC) schemes continues. The generosity of company provision is on the decline. Plans for auto-enrolment and mandatory employer and employee contributions is set to increase coverage of private pensions, hopefully compensating for any company contribution shortage.

The UK's demographics are relatively favourable compared to the rest of Europe. The UK has a relatively high immigration (2.17% compared to an EU average of 1.5%) boosting the average working-age of the population. The average retirement age of 62.6 is among the highest in Europe. 57% of the 55-64 age group are actively at work.

The level of state pensions reflects the inadequacy of the state system. For the average earner retiring in 2007, the UK replacement rate of 17% is far below the European average of 57%. Even the second lowest ratio of 30% for the Netherlands is almost double the UK figure.

A consequence of this system is that the UK is one of only seven countries whose spending on state pension is forecast to remain below 10% of GDP.

2.6.2 Denmark

Demographics	***Adequacy of State Pension***	***Affordability and Sustainability***	***Private Pensions***	***Overall Rankings***
4/25	15/25	10/25	2/25	1/25

Table 2.4

Denmark's state pension system is fully funded and is complemented by individuals saving via private pensions. These factors help Denmark achieve top position in terms of the overall rankings.

The future of the pension system in Denmark is stable through adequacy and sustainability. This is reflected in the fact that it is the one of the very few systems worldwide which is in a surplus situation. In view of this the current system is open to future improvements and reforms. The key element in this structure is that the majority of the system is fully funded and based on employer or employee contributions. The expansion of the occupational schemes and the compulsory contributions into the pension system should ensure net replacement rates rise in the future.

The gross replacement rate for the average earner in Denmark is approximately 75% which is significantly above the EU average of 58.7%.

Upon retirement lower earners can expect a higher income in retirement than in work, sometimes providing a replacement rate of 120% according to OECD statistics.

Lower life expectancy is not good news but it is helpful for pension systems. The average retirement age is 61 years and the projected life expectancy of 81 years in 2040 is once again below the EU average.

The pension age is expected to rise from 65 to 67 by 2027 leading the retirement age to change in accordance with the life expectancy. If these reforms do not flow through smoothly Denmark could become vulnerable in the future.

2.6.3 Malta

Demographics	***Adequacy of State Pension***	***Affordability and Sustainability***	***Private Pensions***	***Overall Rankings***
17/25	12/25	6/25	24/25	19/25

Table 2.5

The current Maltese state pension system is a traditional defined benefit pay as you go system with contributions from current workers being used to finance benefits for current pensioners. The pensions are determined by a formula based on the average of the best 3 out of the last 10 years' salaries for employees and the average of the last 10 years' salary for the self-employed, with a pension equal to two-thirds of this

average wage for those having contributed 30 years. Fewer years of contribution result in linearly reduced pensions, with the minimum years of contribution required to collect a pension set at nine.

The pensions are funded out of the social security contributions of 10% each by employer and employee, with an additional 10% coming from the government. The self-employed pay 15%, with a 7.5% contribution from the government. However, these social contributions are used to fund a variety of benefits in addition to pensions, including health and social assistance with none of the contribution earmarked for any specific type of benefit.

The future of the pension system in Malta is relatively unsustainable, with the current system of current workers financing benefits for current pensioners not being viable in the long term. The working retirement ratio is 5:1 whilst if this trend continues by 2050 it will be 2:1 making the current system unsustainable.

Based on the contributions of the employer and employees only, which is the usual basis for looking at pension systems, the current system is running a moderate deficit of 1.2% of GDP in 2003, which is currently being covered by the government contribution of 10% of salary. This government contribution is also needed to cover health expenditures, expenditures for social assistance both to the elderly and other age groups, family allowances, and a variety of other social programs. Based on projections from the World Bank's PROST model, the deficits accelerate to 3.5% of GDP by 2015 and to 4.7% of GDP by 2030 before levelling off in the future. By

2011, the full 10% government contribution will be insufficient to cover the deficit in pensions, leaving nothing left for the other social benefits.

The current situation in Malta provides no fiscal incentives on contributions. Employer pension contributions to private savings are treated as a benefit-in-kind and taxed on the employee. Investment funds in Malta are taxed at 15% or 35% depending on whether they are invested in local or overseas funds.

There are no private pensions in Malta at present, hence its low rating, however many people do use Long Term Contracts of Insurance to help fund for their retirement.

CHAPTER 3

Fiscal Incentives

A wide variety of fiscal incentives can be applied to different pension regimes.

In order to support and encourage funding of pensions there should be a strong fiscal stimulus. These tax incentives may be seen as an added expense by governments, but in the long term they could act to reduce the total expenditure by reducing public reliance on State Benefits.

The fiscal subsidy available on pension savings in most European countries can be divided into three main areas:

1. Contributions
2. Pension Fund
3. Benefits

A typical fixed package could look like:

- Pension contributions are tax exempt.
- Capital gains and income within pension funds is tax exempt.
- Pension benefits are taxed (Usually pensioners are taxed at a relatively low rate).

The above can be described as EET, with E denoting an exemption or relief from tax and T denoting a point at which tax is payable.

Each area can be subdivided, for example contributions can be from the Employer and/or the Employee and Benefits could be in the form of a lump sum and/or an income.

When considering pension products we have to give due consideration to tax. If these products have tax concessions they will be more profitable in the long run because the investment that is poured into them can be transformed into a greater return compared to products which do not benefit from tax incentives.

Tax concessions vary from country to country. Products will also differ but companies that operate multinationally can accommodate their employees all over the world. A product may be considered suitable for a particular individual depending on features of the particular product and also due to consideration to the situation of the particular individual.

The Government can influence the levels of private pension provision by altering the level of tax incentives. By limiting tax incentives the public may have an increased chance in experiencing poverty at retirement. This fact can also lead to a burden on the state because a need will arise for greater State support when people reach old age.

The tax treatment accorded to qualifying pensions can provide incentives both for employers to establish such plans and for employees to participate in them. In such a

system, a contribution to a qualified plan is immediately deductible in computing the employer's taxes but only becomes taxable to the employee on subsequent distribution from the plan.

Governments have a choice of three areas where they can apply fiscal incentives, namely Contributions, Pension Funds and Benefits.

3.1 Contributions

Contributory plans have become widespread all over the world in recent years. Nowadays these plans are the dominant form of pensions in the private sector in many countries. Money contributed can either be from the employee salary or from the employer directly.

Tax relief could be applied to the following:

- Employer Contributions (the employee may receive full relief from Corporate Tax)
- Employee Contributions (the employee could receive full income tax relief at his highest marginal rate, or at fixed flat rate)

Incentives could also be offered to employers and employees in terms of concessions on Social Security Contributions.

The amount of incentives can be restricted to a percentage of salary, a fixed amount and/or by applying a cap (ceiling) on the eligible earnings.

3.2 Pension Fund

A pension fund is a pool of assets forming an independent legal entity which are bought with the contributions to a pension plan for the exclusive purpose of financing retirement benefits. Tax incentives can be applied to the fund by making it exempt from all taxes (Income tax, Investment tax, Capital gains tax etc.).

3.3 Benefits

Retirement plans may be classified as *defined benefit* or *defined contribution* according to how the benefits are determined.

A defined benefit plan guarantees a certain payout at retirement, according to a fixed formula which usually depends on the member's salary and the number of years' membership in the plan.

A defined contribution plan will provide a payout at retirement that is dependent upon the amount of money contributed and the performance of the investment vehicles utilized.

Pension plans generally offer retiring participants a choice between two payment options:

1. An annuity, in which the benefit is paid out in a stream of regular payments, usually monthly and usually over the life of the participant (or lives of the participant and spouse) but sometimes over a specified period;

2. Or in a lump sum.

Benefits can be either fully taxable (normally as earned income), or fully tax free, or as is more commonly the case a combination of the two, e.g. a certain amount available tax free (normally a lump sum), with the balance taxed as earned income at the individuals marginal tax rate.

3.4 Tax Incentives

Pension plans must satisfy a variety of rules depending on the country to qualify for the tax-favoured treatment. These rules are designed to protect employee rights and to guarantee that pension benefits will be available for employees at retirement. Most Governments will only offer tax incentives if certain conditions are met. The following table summarises the conditions a Government could impose in order to restrict tax incentives.

<table>
<tr><td>Membership Criteria:
– available to all employees and is non-discriminatory
– employee membership is compulsory
– categories of membership are clearly defined</td><td rowspan="3">Contributions:
– employer must contribute
– employee contributions are compulsory
– employee contributions are deducted directly from payroll
– contributions are irrevocable
– contributions and benefits have been agreed through a Collective Agreement
– advance funding
– limits on contributions available for tax deductibility:
- typically a percentage of payroll/salary and sometimes subject to an overall cap, or
- based on projected final benefits</td></tr>
<tr><td>Benefits:
– immediate full vesting and portability
– benefits provided are exclusively for retirement, death and disability benefits are provided in pension form
– benefits cannot be accessed before retirement age</td></tr>
<tr><td>Pension Plan:
– equal employee/employer representation on management boards
– separate legal entity from the employer
– subject to solvency standards</td></tr>
</table>

Table 3.1

3.5 Fiscal Incentives

Different countries operate different tax incentives. The table below summarises the fiscal incentives in various European countries.

Country	Contributions	Fund	Benefits
Austria	E	E	T
Belgium	E	T	T
Denmark	E	T	T
Finland	E	E/T	E/T
France	E	E/T	T
Germany	E	E/T	E/T
Greece	E	E/T	E/T
Ireland	E	E	E/T
Italy	E	T	E/T
Luxembourg	E	E/T	E
Netherlands	E	E	T
Portugal	E	E	E/T
Spain	E	T	T
Sweden	E	T	T
UK	E	E	T
Malta	T	T	T

E: Tax Exempt
T: Taxable
E/T: Part Exempt / Part Taxed

Table 3.2

CHAPTER 4

Country Specific Incentives

4.1 Pension Taxation Systems throughout Europe

Malta is one of the countries that lacks in terms of fiscal incentives as shown in Table 3.2. The population is taxed on all aspects. Contribution from the employee and the employer are both taxed. The contributions from the employer are paid from taxed income and profits whilst the contributions from the employee are paid from taxed income. In relation to investment funds, the investment income is taxed at 15% on prescribed funds and normal capital gains tax applies. Benefits paid monthly would be taxed as earned income.

One of the priorities Ireland emphasises is fiscal incentives. Ireland exempts the population in all areas except for one, the benefit aspect. Contributions from the employee and the employer are tax deductible. Employee contributions are deductible up to certain limits. Moreover, the pension fund is free from investment income tax and capital gains tax. The benefit paid as a lump sum is tax free, whilst the benefit paid otherwise is taxed as earned income.

Table 4.1 below shows the collective summary of the pension systems throughout Europe for easier comparison.

Country	Contribution: Employer	Contribution: Employee	Pension Fund	Benefits: Lump Sum	Benefits: Pension
Austria	Deductible up to 10% of payroll	Deductible up to prescribed limits, varying according to marital status	Investment Income is tax-free	Employer funded benefits are taxed as earned income Only 25% of employee funded benefits are taxable (75% tax-free)	
	E	**E**	**E**	**T**	
Belgium	Deductible if : – projected benefits are less than 80% of final salary, and – employee contributions are compulsory, and – uses an external pension fund		Assets taxed at 0.17% Investment Income taxed at 15% or 25%	Taxed	Taxed as earned income but subject to a tax credit
	E		**T**	**T**	**T**
Denmark	Deductible if: – benefits not available before 60 Not a BIK	Deductible without limit if deducted from payroll (i.e. 100% salary)	Investment Income taxed at 15%, but tax-free for income from certain property and bond investments	Taxed at 40% (60% if taken before retirement age)	Taxed as earned income up to 60%
	E	**E**	**T**	**T**	**T**
Finland	Fully deductible Not a BIK	Deductible up to prescribed limits		Tax exempt	Taxed as earned income
	E	**E**		**E**	**T**
France	Deductible up to prescribed limits, if : – employee membership is compulsory, and – employer contributes				Taxed as earned income subject to certain rebates
	E				**T**
Germany	Deductible but subject to certain limits for some arrangements BIK on some contributions	Deductible to some arrangements Many arrangements do not permit employee contributions		Most benefits are taxable as earned income although some arrangements (voluntary directly insured) are tax-free	
	E	**E**		**T / E**	
Greece	Deductible up to 5% of salary (subject to an earnings cap) BIK for contributions over the 5% limit	Deductible subject to limits		Tax-free if paid by a life insurance company	Taxed as earned income
	E	**E**		**E**	**T**

Ireland	Deductible and not a BIK	Deductible up to limits	Free from Investment Income Tax and Capital Gains Tax	Tax-free	Taxed as earned income
	E	**E**	**E**	**E**	**T**
Italy	Fully deductible if: – plan is for a defined group of employees – contributions agreed through a collective agreement – uses an external pension fund	Deductible up to 12% of salary	Investment Income taxed at 11%	Up to 33% tax exempt	Taxed as earned income
	E	**E**	**T**	**E**	**T**
Luxembourg	Deductible up to a limit, but subject to a 1% levy Not a BIK	Deductible up to a limit, but subject to a 1% levy		Tax exempt for benefits accrued after 1 January 2000	Tax exempt for benefits accrued after 1 January 2000
	E	**E**		**E**	**E**
Netherlands	Fully deductible if paid to an approved scheme Not a BIK	Fully deductible	Exempt		Taxed as earned income but a slightly different scale applies
	E	**E**	**E**		**T**
Portugal	Deductible up to 15% of payroll if: – available to all employees – uses an external pension fund – benefits only available at retirement	Deductible up to limits	Free from Investment Income Tax	Taxable	Tax-free up to limits
	E	**E**	**E**	**T**	**E/T**
Spain	Deductible up to limits depending on employee age	Deductible up to limits depending on employee age	Free from Investment Income Tax	Up to 40% tax-free	Taxed as earned income
	E	**E**	**E**	**E**	**T**
Sweden	Deductible up to limits if: – part of collective bargaining agreement	All plans are non-contributory	Investment Income taxed at 15%		Taxed as earned income
	E		**T**		**T**
UK	Deductible up to limits	Deductible up to 100% of salary	Investment Income is tax-free, except 25%	Up to 25% tax-free	Taxed as earned income

			withholding tax on UK dividends		
	E	**E**	**E/T**	**E**	**T**
Malta	Paid from taxed income / profits	Paid from taxed income	Investment income is taxed at 15% on prescribed funds Capital Gains Tax applies		Taxed as earned income
	T	**T**	**T**		**T**

Table 4.1

CHAPTER 5

Conclusion: Malta Implementations

After going through the entire arena on pensions and pension tax incentives, one can see that there is a case in favour of adequate fiscal incentives in Malta. In this way, one can promote the transition from reliance on a PAYG system to one in which individuals will be required, or at least incentivised, to pay an additional segment of their disposable income into funded pension schemes.

There are three possibilities in which tax can be of a particular significance:

- When money is contributed to the fund, normally by employers and employees;
- When investment income and capital gains accrue to the fund; and
- When retired scheme members receive benefits.

The current situation in Malta allows no incentives on contributions, and worse still employer contributions are treated as a benefit-in-kind and the employee is taxed.

Funds in Malta are taxed at 15% or 35% depending on whether they are invested in local or overseas funds.

Benefits paid as a lump sum have been taxed as above.

Therefore, considering all this, what could the Maltese Government do?

The table below shows the incentives the Maltese Government could implement in order to make the country's pension system more favourable.

Least Expensive
Remove Benefit-in-kind tax on Employer contributions
Allow benefits to be taken as an Income free from tax
Allow tax relief on Employee voluntary contributions
Allow tax relief on Employer contributions
Remove withholding tax charge on funds used for retirement planning
Most Expensive

Table 5.1

These are all the possible incentives the Government in Malta could introduce. The Government could elect to have all of them, none of them or a combination.

The deciding factor is one of Public finances. However, a balance must be found to ensure future sustainability of the State Pension and incentives today.

Based on the analysis conducted through this dissertation I conclude that Malta has one of the least sustainable pension systems in Europe. At present no incentives exist for employees or employers.

After having analysed the Pension system in the UK, I think that there is scope for Malta to move from the current system where all aspects including the Employer contribution, Employee contribution, Pension Fund and Benefits are taxed, towards the UK system where

1. The Employer Contributions are exempt up to certain limits;
2. The Employee contributions are deductible up to 100% of the salary;
3. The Investment Income is tax-free;
4. The benefit in Lump sum is tax-free up to 25% of the fund, and
5. The benefit in pension format is taxed as earned income.

Fiscal Incentives will have to be introduced in order to encourage private participation and enable Government pension to be less dominant and relied upon in the future.

The Government has a choice of which incentives to offer and can cap any amounts in order to manage public budget deficits. The Government could also provide public awareness and education campaigns in order to help private participation.

APPENDIX 1

Europe: Different Countries Incentives Available

1.1 AUSTRIA

1.1.1 Pensions

- *Employer*
  - The Employer contributions deductible is up to 10% of the payroll. The Employer funded pension benefits are taxed as assessable income.
- *Employee*
  - The Employee contributions are possible up to a maximum of employer contributions.
  - The tax deductible is subject to prescribed limits varying with the employee's marital status.
  - Only 25% of the employee funded benefits are taxable.
- *Pension Fund Investment*
  - The pension fund investment income is not subject to tax, provided a wide range of requirements are satisfied. These requirements are the following:
    - Covering of the establishment
    - Administration
    - Security of assets
    - Solvency standards
    - Trust deed

- Actuarial supervision
- Investment restrictions
- Reporting
- Disclosure

- *Insurance Tax*
  - The insurance tax is 2.5%

1.1.2 Book Reserves, support funds, direct insurance

There are different tax rules that apply to these funding vehicles, however their importance is declining.

1.2 BELGIUM

1.2.1 Pensions

- *Employer*
  - The contributions which are paid by the company plan and are deductible must conform with the following:
    - Benefit from all the sources not excessive (based) on projected benefit of 80% of final salary.
    - The contributions are irrevocable.
    - The fund is stand-alone.
- *Employee*
  - The contributions which are paid by the company plan and are deductible must conform with the following:

    - Benefit from all the sources not excessive (based) on projected benefit of 80 % of final salary.
    - The employee contributions are compulsory and deducted regularly from salary contribution rates defined in pensions rules.
    - Contributions are irrevocable.
    - The fund is stand-alone.

- *Tax*
  - All pension benefits are taxed as earned income, subject to a tax credit on retirement pensions.
  - The Lump sum retirement or death benefits are taxed including:
    - Social Security
    - Communal
    - Solidarity contribution

    These are taxed at a flat rate in the year they are received and are based on the mathematical reserve established at age 60.
  - The pension fund assets are taxed at 0.17%.
  - The pension fund investment income has a withholding tax of 15% on fixed income and 25% on dividend from shares.
  - The contributions are taxed at 4.4%, plus 8.86% social security contribution.

1.3 DENMARK

1.3.1 Pensions

- *Employer*
  - The contributions to a pension plan are deductible provided :
    - The benefits are not payable prior to age 60.

        - Lump sum retirement payments are made between ages 60-70.
        - Contributions cannot be refunded unless employee leaves before they are legally vested.
    - The combined employer and employee contribution to lump sum plans limit for deductibility is DKK 38,900 per annum.
    - Employers contributions are not benefit-in-kind if above conditions are fulfilled.

- *Employee*
    - Employee contributions are deductible without limit, if contributions paid via withholding towards pension scheme.
    - The tax advantage for employee is not as advantageous as with annuity pensions, as contributions to lump sum pensions are deductible only at a rate of approximately 44% rather than 59% top tax rate.
- *Tax*
    - Pension benefits arte taxed as earned income at up to 59% plus:
        - State church tax
        - Labour market contribution
        - Special 1% additional contribution
    - The Lump sums are taxed at 40%.
    - Surrender value for pension benefits before retirement taxed at 60%.
    - Tax rate on pension investments income is 15% for all investments in bonds and shares.
    - Real estate investments are free except for certain investments in real estate made prior to certain dates in the late 1990s and certain index-linked bonds.

1.4 FINLAND

1.4.1 Pensions

- *Employer*
    - The contributions are:
        - Fully deductible
        - Not a benefit-in-kind up to a prescribed maximum.
- *Employee*
    - The contributions are fully tax-deductible, up to a prescribed maximum level of pension cover if paid to a voluntary unregistered plan. Maximum is based on
        - 66/60% of earnings
        - 60% of any benefit-in-kind amount deductible for the individual, subject to a maximum of approximately €5,000.
- *Tax*
    - Pension benefits are taxed as earned income.
    - Lump sum benefits are exempt from tax.
    - Pension insurance premiums are not tax-deductible if paid to a company that does not have a branch office in Finland. Such premiums are benefits-in-kind.
    - Pensioners receive special allowances.

1.5 FRANCE

1.5.1 Pensions

- *Employer and Employee*

  - The contribution to social security is fully deductible, with few exceptions.
  - The complementary schemes are deductible subject to certain limits provided:
    - Employee affiliation must be compulsory.
    - The contributions fund a retirement benefit.
    - Employer must contribute.
    - The contributions to group insurance contract should be uniform across a group of participants.
  - Excess contributions are subject to social security contributions.
  - The contributions to a group insurance contract are deductible, provided:
    - Benefit guarantee is permanent.
    - Categories of beneficiaries are clearly defined.
    - Retirement benefits are not excessive.
    - If made to a direct contribution plan, employee co-contributions are required.

- *Tax*
  - Retirement pensions are taxed as earned income, subject to certain rebates.
  - Contribution taxes apply to certain insurance premiums.
  - Top-hat policy contributions are treated as benefit-in-kind.

1.6 GERMANY

1.6.1 Pensions

- *Book Reserves (direct pension pledge)*
  - Internal financing through provisions on the balance sheet.

- Annual allocation for the pension provision liabilities is a full tax deductible expense with the limits of the Income Tax Act.
- Pension payment is taxable income for the retiree, but special allowances apply.
- No employee contributions allowed, but deferred compensation is possible.

- *Direct Insurance*
  - Employer contributions are tax-deductible but also a benefit-in-kind for the employee.
  - Flat rate tax when the company assumes employee tax liability within certain limits, only allowed if policy does not mature before age 60 and if its prior surrender by the employee is excluded. This is limited to an amount of €1,752 in general.
  - Salary deferral arrangements are possible and the system of flat rate taxation can be adopted.
  - The benefits from a directly insured plan are tax free in most cases, if certain conditions are met. Only the assumed interest content of annuity is taxed.
- *Pensions*
  - Contributions up to 4% of the Social Security Contribution Ceiling (SSCC) remain income tax free with benefits being fully taxable. Contributions over this ceiling fall under the same flat-rate taxation as for direct insurance. The salary deferral arrangements are equally allowed.
- *Support Funds*
  - Employer contributions are tax-deductible.
  - There are no employee contributions, but salary deferral is possible.

- Taxation of contributions and benefits is the same as that for book reserve benefits.
- A limit is imposed on the amount of individual benefits.
- The tax deductibility in respect of the employer contributions depends on whether benefits are reinsured.

- *Pension Funds*
  - The Employer contributions are tax-deductible.
  - The employee contributions are a benefit-in-kind with a 4% Social Security Contribution Ceiling (SSCC) remaining tax free.
  - Benefits are full taxed, subject to allowances being made.
  - Salary deferral schemes are possible.

1.7 GREECE

1.7.1 Pensions

- *Employer*
  - The contributions are:
    - Are not fully deductible but are limited to 5% of the normal gross salary, with a maximum deductible of €440.21 per employee. Employer contributions below this limit are not treated as benefit-in-kind, but any above are.
- *Employee*
  - The contributions attract tax relief in the same way as individual life insurance premiums.
- *Tax*

- Tax treatment applies if the plan's benefits are guaranteed on basis of approved insurance tariffs.
- Tax relief available for non-insured plans by special approval, provided certain government conditions are met.
- No tax relief allocations to book reserves.
- Pensions are taxed as earned income.
- Lump sum benefits are tax exempt if paid by life insurance companies.

1.8 IRELAND

1.8.1 Pensions

The following is applicable for approved plans. These plans are established under Trust with assets segregated from a company.

- *Employer*
  - The contributions are:
    - Deductible.
    - Not treated as taxable benefit-in-kind.
- *Employee*
  - The contributions are tax-deductible up to certain limits.
- *Tax*
  - Pension benefits are treated as earned income.
  - Lump sum, if allowed, is tax free.
  - Investment income and capital gains are not taxed.
  - Refund employee contributions are generally taxed at 20%.

1.9 ITALY

1.9.1 Pensions

- *Employer*
  - The contributions are fully deductible provided:
    - Plan relates to well-defined group of employees and has well defined rules.
    - Contributions and benefits agreed by employer and employees through National Collective Agreements, company regulations or company agreement.
    - An external pension fund exists. This is a trust arrangement which ensures employer contributions are not taxed as a benefit-in-kind.
- *Employee*
  - The contributions are deductible up to a lower limit of 12% of annual salary or €5,164, provided that 50% of total contributions come from TFR (Trattamento di Fino Rapporto) annual accruals.

- *Tax*
  - Qualification of full fiscal incentives, lump sum at retirement must not exceed one third of the capital.
  - Sums paid as benefits are taxed only if not already taxed as contributions or fund income:
    - Capital: taxed on average rate of previous five years.
    - Annuities: taxed on personal income at the marginal rate.
  - A tax of 11% is levied on investment income of pension funds.

1.10 LUXEMBOURG

1.10.1 Pensions

- *Employer*
  - The contributions are tax deductible within certain limits. The limits vary between Direct Benefit and Direct Contribution plans. In such cases the systems are not taxed as a benefit-in-kind.
  - Contributions are subject to levy of 1% as dependency insurance contribution.
- *Employee*
  - The contributions are tax-deductible, up to a limit.
  - Contributions are subject to levy of 1% as dependency insurance contribution.

- *Tax*
  - Pension benefits taxed as earned income for the part of benefit which accrued prior to 1st January 2000 and tax exempt for the part which accrued after 1st January 2000.
  - 20 % tax on employer contributions/book reserve allocations, which can be deducted from liability for corporate tax.
  - Lump sum benefits are fully exempt from income tax fro part which accrued after 1st January 2000. Portion that accrued prior to 1st January 2000 only taxed if funded by book reserves.
  - Investment income from SEPCAV fund is tax exempt.
  - Tax regime of ASSEP fund similar to that of an ASBL.

1.11 NETHERLANDS

1.11.1 Pensions

- *Employer*
    - The contributions are fully deductible to either approved or non-approved plans provided plan meets the following criteria:
        - Provides exclusively retirement, death and disability benefits, for employees.
        - Benefits within accepted limits
        - In pension form
        - Guaranteed by insurer or pension fund.
        - Insurer or pension fund established in the Netherlands.
    - If non-approved contributions will be taxed as benefit-in-kind.
- *Employee*
    - The contributions are fully deductible unless the plan is non-approved, in which case benefits must be in form of pension for tax deductibility to apply.
- *Tax*
    - Lump sum benefits are not tax relieved.
    - Pension benefits are taxed on a scale which varies slightly from the income tax scale.
    - No tax is payable on pension foundation assets.

1.12 PORTUGAL

1.12.1 Pensions

- *Employer*
  - The contributions to pension funds and insurance contracts will be deductible up to a maximum of 15% of payroll, provided that:
    - The plan is open to all permanent employees and is non-discriminatory.
    - Retirement benefits are not paid as a lump sum although up to one third may be taken as a lump sum, with the balance being in the form of an annuity.
    - Benefits are paid at the same time as social security benefits and to some beneficiaries.
    - Funding is external
- *Employee*
  - 25 % of employee contributions to the company plan funded through a pension fund are tax-deductible, up to limits.
  - Lower limits exist for plans funded through insurance contracts.
- *Tax*
  - Employer contributions to funds with vested rights are taxed as a benefit-in-kind to employee unless the conditions for tax qualified plans are observed. In this case, there is no additional employee tax liability.
  - Pension benefits are tax free up to limits.
  - Benefits resulting from book reserve arrangements are tax-deductible for the employer when paid, and are earned income for the employee.

- Lump sum benefits are subject to tax, depending on the size of the interest component and timing of payment of premiums.
- Investment income on pension funds and insurance contracts funding pension plans are exempt from taxes.
- Allocations to book reserve are not deductible.

Note: The 15% limit applies cumulatively to all employee benefit plans, including death & disability covers, medical care and pension funds. If the sponsor is not covered by social security (e.g. banks) the limit is increased to 25%.

1.13 SPAIN

1.13.1 Pensions

- *Employer*
  - The contributions to a company tax qualified pension plan (CTOPP) are tax-deductible, within limits varying with beneficiaries' age.
  - Although company contributions to CTQPP are taxable as a benefit-in-kind, the combined effect on personal tax is neutral because the employee may claim a tax deduction by the same amount.
  - Company contributions to a group insurance policy are only tax deductible from corporate tax if they are inputted to employees.
  - Since 16 November 2002, the practice of book reserving pension obligations has been outlawed.

- *Employee*
  - The contributions are tax-deductible, within limits varying with age of beneficiaries, if paid to qualified plan only.
- *Tax*
  - All CTQPP benefits are subject to income tax.
  - Withholding tax on pensions applies at between 0% and 45%.
  - Retirement lump sums are taxed as income yet keeping in mind that the taxable basis equals only 60% of the vested rights; the remaining 40% are tax exempt if over two years have elapsed since payment of first contribution.
  - Investment income from qualified plans is tax-free.
  - Investment income from non-qualified plans is subject to a 25% withholding tax.
  - Favourable tax treatment requires satisfaction of:
    - Non-discrimination and eligibility criteria to all employees with at least two years' service. This is context that whatever is agreed in the plan specification is deemed non-discriminatory.
    - Irrevocable contributions.
    - Immediate full vesting and portability.
    - Limit on total contributions.
    - Advance funding, according to actuarial advice. This has to be reviewed every 3 years.
    - Solvency standards.
    - Equal employee/sponsor representation on plan management board.

1.14 SWEDEN

1.14.1 Pensions

- *Employer*
    - The contributions to plans are deductible for the employer, and not considered a benefit-in-kind if:
        - Paid for collective bargaining agreements; or
        - Satisfy prescribed maximum benefit and contribution rules.
- *Employee*
    - All plans are not contributory for employees.
    - Premium payments are not taxable income for the employee.
- *Tax*
    - Contributions are levied an alternative social security tax of 24.26%.
    - Allocations to book reserves are also subject to 24.26% social security tax.
    - Contributions to pension plans other than those based on collective agreements may be tax-deductible under certain conditions and limits.
    - Pension payments paid by the employer are tax-deductible and subject to 24.26% social security tax.
    - Pension benefits are subject to income tax.
    - The greater of pension liability and assets are levied as an investment return tax of 15% of a national return.

1.15 UNITED KINGDOM

1.15.1 Pensions

- *Employer*
  - The contributions deductible, if fund is run as a trust and conforms to benefit limits.
- *Employee*
  - The contributions including additional voluntary contributions (AVCs) are deductible up to 15% of earnings.
- *Tax*
  - Pension benefits are taxed as earned income.
  - A tax free lump sum may be taken.
  - Investment income is tax-free, except for 25% withholding tax on UK dividends.

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