

Xu, Angela

Article

Pension Taxation in the EU: A Concern for Mobile Pensioners?

CESifo DICE Report

Provided in Cooperation with:

Ifo Institute – Leibniz Institute for Economic Research at the University of Munich

Suggested Citation: Xu, Angela (2015) : Pension Taxation in the EU: A Concern for Mobile Pensioners?, CESifo DICE Report, ISSN 1613-6373, ifo Institut - Leibniz-Institut für Wirtschaftsforschung an der Universität München, München, Vol. 13, Iss. 3, pp. 75-77

This Version is available at:

<https://hdl.handle.net/10419/167230>

Standard-Nutzungsbedingungen:

Die Dokumente auf EconStor dürfen zu eigenen wissenschaftlichen Zwecken und zum Privatgebrauch gespeichert und kopiert werden.

Sie dürfen die Dokumente nicht für öffentliche oder kommerzielle Zwecke vervielfältigen, öffentlich ausstellen, öffentlich zugänglich machen, vertreiben oder anderweitig nutzen.

Sofern die Verfasser die Dokumente unter Open-Content-Lizenzen (insbesondere CC-Lizenzen) zur Verfügung gestellt haben sollten, gelten abweichend von diesen Nutzungsbedingungen die in der dort genannten Lizenz gewährten Nutzungsrechte.

Terms of use:

Documents in EconStor may be saved and copied for your personal and scholarly purposes.

You are not to copy documents for public or commercial purposes, to exhibit the documents publicly, to make them publicly available on the internet, or to distribute or otherwise use the documents in public.

If the documents have been made available under an Open Content Licence (especially Creative Commons Licences), you may exercise further usage rights as specified in the indicated licence.

PENSION TAXATION IN THE EU: A CONCERN FOR MOBILE PENSIONERS?

In the face of an ageing population and an increasing proportion of pensioners, there has been some recent policy reform to shift the tax burden toward the elderly, as part of the effort to combat potentially unsustainable pension systems. The ongoing transition to the deferred taxation of pensions in Germany, where contributions are not taxed, but pension benefits are taxed in full, is one such example.

For pensioners, the structure of the personal tax system and the amount of social security contributions they are expected to pay play a large role in determining the actual level of old-age income received. Within countries, pensioners tend to receive preferential treatment over workers in terms of taxation and social contributions, often paying lower rates or nothing at all. However, unequal tax treatment of pensions across different countries could motivate increasingly wealthy and mobile pensioners to consider taxation as an important factor in the emigration decision, as well as in the choice of a destination country. This possibility is particularly relevant in the EU, where mobility is relatively high and continues to improve.

This article begins by comparing the current second pillar pension taxation systems in EU countries, Iceland, Norway, and Switzerland. It then focuses on the taxation of pension benefits, and examines whether mobile pensioners might have tax incentives to migrate to or from particular countries.

Pension taxation systems

In addition to the first pillar public pension, most countries in the EU have some form of fully funded second pillar, mandatory pension, usually occupational, or a similar voluntary occupational pension. However, there are exceptions: the Czech Republic did not have a second pillar until 2013, and thereafter it did not prove popular and is to be phased out by 2016 (Pension Funds Online); Malta has never had a second pillar pension (OECD 2008). Many countries have a third pillar as well, usually consisting of a variety of voluntary private pension products, and in some countries, second and third pillar

pensions may receive different tax treatment. However, third pillar pensions are difficult to compare across countries, even in cases where they exist because of highly varied composition.

The size and importance of second and third pillar pensions in each country depends partially on how generous the first pillar public pension is, and whether or not the second pillar pension is mandatory. France, for example, has a large public pension system as well as a mandatory occupational pension, and has a very small third pillar. In contrast, the three pillars in Switzerland are almost the same size. Countries like Austria, Greece, Italy, Luxembourg, Portugal, and Spain (Pension Funds Online, OECD 2008) in which participation in second pillar pensions is voluntary may see low participation.

There are essentially three transactions that make up a pension, and therefore three points at which it can be taxed: when contributions or premiums are paid, when investment income accrues, and when the benefit is received. Usually tax will be levied at one or two of these times.

Most countries tax pension benefits, while leaving contributions and interest tax exempt. This deferred taxation scheme is commonly referred to EET (exempt, exempt, taxed). Additionally, pensioners in Cyprus, Croatia, Estonia, Latvia, Ireland, Slovenia and the United Kingdom receive tax relief or exemption on a portion of their benefits, and those in Austria, France, Italy, and Norway are taxed at a lower rate than workers (Insurance Europe 2014). In Finland, however, wealthy pensioners must pay an additional tax. Denmark, Portugal, Italy, and Sweden are ETT countries that tax the investment yields on pension plans in addition to benefits. Hungary, Luxembourg and Poland have a TEE system where the initial contributions or premiums are taxed, but the investment yields and pension benefits are exempt. However, Hungary grants a tax allowance that effectively makes contributions exempt. Bulgaria and the Slovak Republic also have an EEE system where pensions are not taxed at all (OECD 2008). Table 1 offers a summary of the above information.

Migration incentives for pensioners

For first pillar public pensions, the ability to tax at source largely eliminates any possibility of tax avoidance, but this does not apply to second pillar private pensions. Emigration to avoid taxation could undermine the ef-

fectiveness of deferred taxation and again lead to shifting the tax burden towards youth. Meier and Wagener (2015) show that immediate taxation of savings and tax exemption on interest is never optimal for countries; and in the case of mobile pensioners, the optimal tax policy is partial deferral and lower taxation on interest. For immobile pensioners, the optimal case is full deferral with full taxation of interest, or ETT. With a high enough level of mobility, full taxation of savings combined with a high taxation of interest, or TTE, could become optimal. This finding contradicts the assertion by Whitehouse (2005) that, because taxation of interest is distortive, it is also suboptimal, and that EET or TEE systems should be used. In the context of trying to shift the tax burden away from youth, however, some form of deferred taxation is still preferred; and as long as pensioner mobility in response to taxes remains low, deferred taxation should remain optimal and functional.

Not all EU countries have adopted an EET or ETT system, however, and in TEE and EEE countries, pension benefits are not taxed at all, in contrast with the case of countries implementing deferred taxation. For pensioners and individuals who are nearing retirement, taxation on benefits is the only pension tax that remains relevant, and it makes an immediate difference for net pension income.

The comparison is not quite between tax and no tax. There are great differences across countries in the tax rate itself. Furthermore, personal income tax is not the only concern for net pension income. Countries also vary in whether they expect pensioners to make social or solidarity contributions. Social contributions can be treated as an additional tax, since they are compulsory and the benefits received are not proportional to the payments.

Figure 1 compares the total taxes and contributions that a pensioner who has continuously worked in a given country would expect to pay at the gross replacement rate of an average and high earner. The variation across countries is large, with the tax and contribution rate for an average earner ranging from zero in Bulgaria, Ireland, Lithuania, Malta, the Slovak Republic, and Slovenia to over 30 percent in Denmark and the Netherlands. There is also a clear cross-country variation in progressivity of tax, with wealthy pensioners facing a rate twice as high as their less wealthy counterparts in some countries, while enjoying nearly the same rate in others. Pensioners considering a move to a wealthier (poorer) country must then also determine whether they would

move down (up) tax brackets. These considerations may make some countries more appealing than others from a tax perspective.

Government policies geared towards attracting immigrants may also be relevant for mobile pensioners. Portugal, for example, has a tax regime for non-habitual residents that provides favourable income tax rates to recent arrivals and tax exemption on foreign income for ten years. As most double taxation treaties grant taxation rights to the country of residence, pensioners emigrating from some countries may be able to avoid taxation of their private pension, or achieve a lower rate.

The actual portability of pensions and the content of double taxation agreements vary across origin and destination countries, so that migrating from a country with a high tax rate to one with a low tax rate does not have as straightforward effects as a simple comparison of tax rates might suggest. Considering taxation only as a cost would also be a mistake, as countries with higher taxes and contributions tend to provide better social benefits that pensioners may find important, such as quality healthcare. Furthermore, in countries where private pensions are unpopular, the taxation of such pensions would be irrelevant to many pensioners. It is therefore

Figure 1



not immediately clear what role, if any, differences in taxation play for mobile pensioners in migration decisions.

There is very little research into the migration decisions of the elderly. The difficulties encountered by Williams, King and Warnes (1997), who looked at elderly migration from northern to southern Europe, remain in place. These include a lack of data on the age of migrants or unreliable estimates thereof, difficulty in determining which movements of the elderly should be considered migration, and uncertainty about the level of unrecorded retirement migration.

Determining the response of mobile pensioners to taxation is important, however, as different possibilities could result in very different outcomes. Notably, three of the four countries implementing the ETT system are also in the top six countries with the highest overall taxes and social contributions for pensioners. If tax rates play a negligible role in pensioner migration decisions, then these countries are implementing the optimal taxation system. But if mobile pensioners respond significantly to tax rates, then this taxation system could be undermined.

Angela Xu

Table 1

Second pillar taxation systems				
	EET	ETT	TEE	EEE
Austria	x			
Belgium	x			
Bulgaria				x
Croatia	x			
Cyprus	x			
Czech Republic	x			
Denmark		x		
Estonia	x			
Finland	x			
France	x			
Germany	x		x	
Greece	x			
Hungary			x	x
Iceland	x			
Ireland	x			
Italy		x		
Latvia	x			
Lithuania	x			
Luxembourg			x	
Netherlands	x			
Norway	x			
Poland			x	
Portugal		x		
Romania	x			
Slovak Republic				x
Slovenia	x			
Spain	x			
Sweden		x		
Switzerland	x			
United Kingdom	x			

Source: Pension Funds Online, Insurance Europe, OECD 2008.

References

Insurance Europe (2014), "Tax Treatment of 2nd and 3rd Pillar Pension Products", <http://www.insuranceeurope.eu>.

Meier, V. and A. Wagener (2015), "Do Mobile Pensioners Threaten the Deferred Taxation of Savings?", *CESifo Economic Studies* 61 (2), 465–83.

OECD (2008), *Private Pensions Outlook 2008*, OECD Publishing, Paris.

OECD (2015), ELS Pension Statistics, <https://stats.oecd.org/Index.aspx?DataSetCode=ELSPENSIONS>.

Pension Funds Online. Country profiles. <http://www.pensionfundsonline.co.uk/content/country-profiles>.

Whitehouse, E. (2005), *Taxation: The Tax Treatment of Funded Pensions*, World Bank Pension Reform Primer Series, Washington, DC.

Williams, A. M., R. King and T. Warnes, (1997), "A Place in the Sun. International Retirement Migration from Northern to Southern Europe", *European Urban and Regional Studies* 4 (2), 115–34.