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Editorial

Worrying about pension problems in the European Union

L. Stevens

The declining economic growth in the European Union and the prospect of a possible standstill situation severely puts to the test the preservation discipline of the Growth and Stability pact. Furthermore, the strong increase of the ageing population draws heavily on the finance possibilities of both financial and medical provisions for old age and consequently also on national budgets. It is therefore necessary in that respect to critically review the development of the national debts of the EU Member States both separately and in interconnection.

In case of a declining economic growth the already existing tension between the interests of the 'grey generation' and the 'green generation' will increase, especially in countries where the costs of pensions and social security are shifted strongly to the working population. The inter-generational solidarity may then be increased to a higher level than the labour market can bear. On average the 'grey pressure' will double in the EU between 2000 and 2050. By way of reflecting on the increasing retiring age, switching from a final pay pension to an average pay pension and on applying a capital funding system instead of the apportionment system one tries to open up people's minds to the necessity to come to a durable, i.e. affordable, pension system. At the summit conference that took place in Barcelona in spring 2002 the European Council concluded that to promote labour participation, early retirement plans should be limited. Further, according to the Council retirement age should be increased with 10 years in the year 2010.[1]

With regard to the European discussion on the modelling and affordability of the pension system, it is also important to pay attention to the tax facilities for the pension build-up. These are different in every country. Most countries apply the reversal rule. Employees are granted a tax exemption on the payment of pension premiums and during the pension build up no tax is levied. On the other hand, the government expects that at a later stage tax is paid on the pension received; the so-called EET-system (exempt/exempt/taxable). The interest free tax deferral so received is an important incentive for building up pension provisions. At the same time, this tax deferral is also the cause of many domestic pension rules which impede mobility, since applying the reversal rule shifts the right to tax from the source state to the state of destination. This could lead to tax driven pension emigrations. For 'pension exporting countries' this could result in a substantial loss of budgetary funds. Knowing that, for example, the balance sheet total of all pension funds in The Netherlands in 2002 amounts to up to approximately €480 billion[2], that consequence puts under pressure the otherwise fiscally most acceptable tax treatment based on the life-time-income-concept. For upon emigration one country carries over the costs (the exemption of premiums), while the other country receives the income on these premiums. For that reason pension exporting countries will try to maintain their tax claim on pension capitals and discourage cross border pension build-up en pension payment. On balance, an internationally operating employee mostly builds up a worse pension than he would build up should he continue working in his own country.

A number of countries do not apply the reversal rule. In Luxembourg and Germany, pension premiums are partly non-deductible. Consequently, the income from these pensions is not taxed; the TEE-System (taxable/exempt/exempt). In addition to this, Denmark, Sweden and Italy tax the income that pension funds receive on their invested capital. The ten other EU Member States do apply the system of a tax deduction for pension contributions and taxation of the pension received and a tax exemption at the level of the fund. This also leads to mobility impediments.

The European Commission tries to solve the problems that arise from the differences between the pension systems as much as possible. The Commission therefore submitted a proposal for a directive on pension funds.[3] Starting point of that directive is the application of the reversal rule. It is intended that all countries assume this regime. Double taxation should be avoided. By means of a better exchange of information a substantial part of the tax problems could be avoided, according to the Commission. Furthermore, the Commission proposes to allow

1 European Council, 2002: Barcelona European Council; Presidency conclusions

2 Pensioen- en Verzekeringskamer, Pensioenmonitor niet finaciële gegevens pensioenfondsen, stand van zaken 1 januari 2002, Apeldoorn, 2002.

3 Commission of the European Communities 2001: The elimination of tax obstacles to the cross-border provision of occupational pensions.

pension funds to offer pensions cross border and to invest cross border. Besides this, the Commission wants to investigate to what extent it will be possible to have pan-European pension funds operate pension schemes in order to promote labour mobility.

As long as we have national treasuries, the resulting fiscal realism requires that an integral acceptance of the reversal rule is no simple affair. European Commissioner Bolkestein intends to encourage the desired policy co-ordination via the recommendation to the Member States to apply the reversal rule uniformly, to put domestic legislations in line with each other, by presenting disruptions to the European Court of Justice for examination where needed, to improve co-operation between tax authorities by means of a better exchange of information and by the establishment of pan-European pension funds.[4]

All this requires a closer examination of the possibilities to maintain the right to tax pensions built-up in one's own country. In an international context this can be achieved in various ways. One can think of the following possibilities:

- Applying a system, comparable to the German and Luxembourg system, in which pension claims are taxable and only the interest component of the pension benefits is taxable;
- Attribute the right to tax pensions received to the source state;
- Dividing the international right to tax by introducing a withholding tax on pension benefits for the source state. The tax due can be credited subsequently against income tax levied on the pension benefits in the state of destination (residence)[5];
- Applying an exit tax upon emigration on the value of the pension rights built-up in the source state at that moment.

Needless to say that in a European context, where the free movement of persons, goods, services and capital is at the forefront, any mobility impeding levies is not acceptable.[6] The *Danner* judgement (3 October 2002, C-136/00) shows that the limitation of the right to deduct premiums is not justified by the necessity to maintain the domestic tax base integrally. It is true that the Court recognized that the deductibility for systems managed by foreign institutions can lead to fiscal shopping and that Member States have an interest in not granting the tax benefit of deductible premiums if and when the so encouraged savings take place abroad. However, the Court did not accept these arguments as justification for a limitation on deductibility. The Court reminds that its decision in the *Safir* case that the necessity to fill the fiscal gap that would arise if no tax was levied on savings deposits in the form of capital assurances with insurance companies situated in another Member State, did not constitute a justification for the domestic measure concerned that restricted the free movement of services.

The Court also decided that the necessity to prevent a reduction of revenue is not one of the grounds listed in Article 56 of the EC Treaty (now, after amendment, Article 46 EC) and cannot be regarded as a matter of overriding general interest (see Judgement of 21 September 1999, Saint-Gobain (C-307/97, point 51). Moreover, the Court decided that a possible tax benefit for providers of services in the form of a low tax burden in the Member State in which they are situated, does not give another Member State the right to treat the recipients of that services, situated on their territory less favourable (see Judgement of 26 October 1999, Eurowings Luftverkehrs, C-294/97, point 44).

> 'In light of the foregoing considerations, the answer to the question submitted must be that Article 59 of the Treaty is to be interpreted as precluding a Member State's tax legislation from restricting or disallowing the deductibility for income tax purposes of contributions to voluntary pension schemes paid to pension providers in other Member States while allowing such contributions to be deducted when they are paid to institutions in the first-mentioned Member State, if that legislation does not at the same time preclude taxation of the pensions paid by the abovementioned pension providers.'[7]

The surprising thing about this conclusion lurks in the addition that an EU Member State that does not want to lose its domestic tax claim on the pensions and annuities built-up under the reversal rule, has to resort to taxing the pension claim and leaving the benefit untaxed. This option, however, is in flat contradiction to the wish of the European Commission to apply the reversal rule everywhere in the EU. National budgetary interests and the harmonization of the European pension systems remain at odds by the escape provided by the Court. In my opinion it would be advisable to continue to strive for application of the reversal rule and to come to a division of the right to tax the pension benefits between the state of source and the state of residence. One can think of a creditable advance levy on the pension benefits according to a European distributive code. Possibly, such a solution can relieve the growing tension between the systems.

[4] The elimination of tax obstacles to the cross-border provision of occupational pensions, Communication from the Commission to the Council, the European Parliament and the Economic and Social Committee, 19 April 2001, COM (2001)214.

[5] This thought was suggested before by G.J.B. Dietvorst, De drie pijlers van toekomstvoorzieningen en belastingen, Kluwer, Deventer, 1994.

[6] In European Case Law, the following cases are particularly important: Bachmann (C-204/90), Wielockx (C-80/94), Safir (C118/96) and Danner (C-136/00).

[7] ECJ, Danner (C136/00), point 57.