The Role of Taxation in Pensions
- Actual National Practices:
The Case of Germany

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  - 1040 Brussels, Belgium
Introduction: The Focus of the Presentation

- Report on actual practice of taxing pension provision
- WHY? In search of good practice?
  - Normative criteria …
  - … from the pension system: support of the pension system
  - … or from the tax system: fiscal goals, compliance cost
Introduction: The Options of Design

- Taxing pension provision
  - Contributions or savings
  - Implicit or explicit returns on investment
  - Pension benefits: Lump-sum payments, annuities

- Deferred taxation: EET (ETT)
- Frontloaded taxation: TEE (TTE)
- Fiscal: TTT
# The German Pension System: Funding

Full funding: green, PAYG: yellow

<table>
<thead>
<tr>
<th>Third Pillar</th>
<th>Private Pension Insurance</th>
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<tbody>
<tr>
<td>Second Pillar</td>
<td>Occupational Pensions</td>
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<tr>
<td>First Pillar</td>
<td>Farmers' Pension Provision</td>
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<td>Statutory Pension Insurance</td>
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<td>Insurance of Craftspeople</td>
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<td>Insurance of Artists and Publicists</td>
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<td>Insurance of Vulnerable Groups of the Self Employed</td>
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<td>Voluntary Insurance</td>
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<td>Zero Pillar</td>
<td>Means tested Income Maintenance at Subsistence Level</td>
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<td>Chambered Professions</td>
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<td>Civil Servants</td>
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</table>
The German Pension System

- Multi Pillar System
- Focus on gainful occupation
- Coverage: Stratification along occupations and professions, at least in the first pillar
- Funding: Pay-as-you go: first pillar (mostly); Full funding: second and third pillar (mostly)
- Fragmented
The German Income Tax System

- Comprehensive income tax
- Progressive tax schedule
- Principles of income taxation are rooted in the German constitution (Grundgesetz)
  - Article 3: Equal treatment
  - Article 14: Guarantee of property rights
- Ruling of 2002: Correspondence principle:
  - All income must be taxed, but only once
  - Pension provision: either EET or TTE
Tax free Gross Income of a Single Pensioner, a Retired Civil Servant and an Employee (2005)

Pensioner

Pensioner after the Reform

Retired Civil Servant

Employee

Tax free gross pension or earnings
Regimes in Transition to EET

- Social security pensions
- Private pension provision e.g. for the self employed and liberal professions
- Civil servant pensions
- Occupational Pensions-pension rights before 2005
Taxation of Deferred Income: Reduced Tax Allowance for new Retirees
EET Regimes

- Occupational pensions-pension rights after 2004: pension funds, Pensionskasse, direct insurance
  - Up to 4 percent of Income threshold of general statutory pension insurance (approx. € 2,500)
  - Additional € 1800 for pension promises after 31 December 2004
- Supplementary private pensions
# Occupational pensions

<table>
<thead>
<tr>
<th>Type</th>
<th>Contributions</th>
<th>Returns</th>
<th>Pensions</th>
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</thead>
<tbody>
<tr>
<td>Direktzusage</td>
<td>Not applicable</td>
<td>Not applicable</td>
<td>Taxed</td>
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<tr>
<td>Book reserves</td>
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<td>Unterstützungskasse (Provident Fund)</td>
<td>Exempted</td>
<td>Exempted</td>
<td>Taxed</td>
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<td>Pensionskasse</td>
<td>Exempted</td>
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<td>Taxed</td>
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<tr>
<td>Pensionsfonds</td>
<td>Exempted</td>
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<td>Taxed</td>
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<tr>
<td>Direktversicherung Insurance contract</td>
<td>Exempted</td>
<td>Exempted</td>
<td>Taxed</td>
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</tbody>
</table>
Incentives for Supplementary Pension Provision

- In a progressive tax system pension saving without tax effects for
  - Low income earners
  - Families with children (due to tax allowances)
- Subsidised pension saving: 4 per cent of gross earnings
- Basic allowance 154 €
- Signing allowance 200 €
- Child allowance 185 €
- Child allowance for children born in 2007 and later: 300 €

OR

- Tax deduction of contributions

WHATEVER GENERATES HIGHER TAX SAVINGS
Exemptions from the EET Tax System Design

- Supplementary occupational pensions for employees in the public sector
- Private pensions outside the tax privileged regimes
- Benefits from endowment insurance
- Taxation of interests, dividends and capital gains: Flat tax of 25 percent
Summary and Conclusions

- Principles and design of tax regime: Transition to EET

- Distributional Impact:
  - Reduced tax burden for low and medium income earners;
  - Higher tax burden for high income earners, at least during the transitional period
  - Redistributive impact of subsidized pension savings

- Systematic approach and constitutional guarantees facilitate pension planning
Vielen Dank!
Merci!
Mille grazie!
Thank you very much!

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