Pensions in European economic and social governance
Taxation issues
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Introduction (1)

This paper is part of a joint research project being carried out by EURELPRO and OSE. It describes the general context in Europe, to be borne in mind when discussing the taxation of pensions. The issue of tax is at the heart of various elements of the social and economic governance of the EU. It is seen as a tool which a) contributes to the long-term sustainability of public finances (Stability Pact); b) can help to create employment, when tax on labour is reduced, or to facilitate the return to work of older people (Europe 2020 and the European Semester); c) can help to attain an adequate level of pension benefits (2); and d) promotes economic growth by shifting the tax burden from labour (personal income tax and social security contributions) to other factors such as financial transactions and VAT. All this should be done within a context of improved fiscal coordination within the EU (European Semester and Euro Plus Pact). At the heart of European governance, therefore, are these four dimensions, which we shall examine further below.

In the next few pages, we begin by analysing (Section 1) three key elements of the current system of governance: the Stability and Growth Pact, set up in 1997, reformed firstly in 2005 and then again in 2011, by means of the Six Pack; the European Semester, a key part, since 2011, of the procedure for coordinating budgetary policy, macroeconomic policy and structural reforms; and finally the Europe 2020 Strategy and the Euro Plus Pact. Having described this general system of governance, we then examine the issue of taxation, from two angles. We consider firstly the tax on financial transactions (Section 2), and then look at the possibility of taxing added value in financial services (Section 3). Our aim is to highlight the potential impact of these two fiscal measures on pensions. We conclude by identifying a number of key issues in this discussion (Section 4).

1. The author wishes to thank Madeleine Schavoir and David Natali for their constructively-critical comments. This paper expresses only the views of the author, who is solely responsible for any remaining errors.
2. The purpose of pensions is to provide an adequate income stream in retirement. Pension adequacy is defined and measured along the two dimensions of income replacement and poverty protection. To achieve adequacy, pensions also need to be sustainable, safe and adapted to changing circumstances, as reflected in the three European pension objectives of adequacy, sustainability and modernisation (or adaptability). When trying to reconcile and optimise sustainability and adequacy concerns, Member States face trade-offs and difficult choices. Achieving the goal of a cost-effective and safe delivery of adequate benefits is quite challenging, as the time people spend in retirement and out of the labour market increases. Moreover, challenges have increased significantly as a result of the economic crisis (Pension Adequacy Report, 2012).
1. Pensions in the social and economic governance of the EU

1.1 The Stability and Growth Pact and the Six Pack

The Stability and Growth Pack (SGP) is the element of European governance with most influence on pensions. Its purpose is to guarantee the sustainability of public finances (dimension (a)) through various measures, including structural reforms (of pensions, among others). The Treaty of Maastricht (1992) set out the objectives and the conditions to be met for the introduction of a single currency, and determined the convergence criteria required for the creation of a Monetary Union, i.e. government debt below 60% of GDP, a government deficit below 3% of GDP and an inflation rate which must not exceed by more than 1.5% that of the three Member States with the lowest inflation rates.

To give more weight to these criteria, the Member States signed in 1996 (entry into force in 1997) the Stability and Growth Pact (SGP), which contained two important provisions: multilateral surveillance, through the use of stability programmes with medium-term budgetary objectives, and the excessive debt procedure (Council, 1997). The SGP sets out a framework for viable public finances, including pension systems. It requires Member States to submit stability or convergence programmes, and up-dates of these. These programmes are then used by Council to monitor budgetary headings and for the coordination of economic policies. On the basis of a Commission recommendation, and having consulted the Economic and Financial Committee, Council may issue an opinion on each of the updated programmes. If it feels that the objectives and content should be strengthened, it may invite the Member State to make adjustments. A specific analysis must be made of the structural reforms designed to help towards the achievement of the programme’s objectives. The programmes should also give details of the measures planned to improve public finances, in terms of both revenue and expenditure (fiscal reforms, measures to optimise resources, measures to improve tax collection levels and to control public spending). More importantly, they are required to describe strategies developed by the countries to ensure the sustainability of public finances, particularly in light of the economic and budgetary impact of the ageing of the population.

In 2004, the Commission proposed a reform to the SGP, in order to increase the contribution made by budgetary policy to economic growth. By doing so it was taking note of one of the main criticisms levelled at the Stability Pact: that in a situation of low growth, the Pact could aggravate the situation by preventing states from taking budgetary measures to revive the economy, if this meant exceeding the 3% threshold. The European Council Conclusions of 22 and 23 March 2005 emphasised the need ‘to safeguard the sustainability of public finances in the long run, to promote
growth and to avoid imposing excessive burdens on future generations.’ The reform was agreed on 27 June 2005. Although the system is still based around the reference values of 3% and 60% of GDP for deficit and debt ratios, Member States may now exceed these temporarily, particularly if they have implemented structural reforms designed to have a positive impact on the long-term viability of public finances (Council of the EU, 2005b).

Given the disastrous state of public finances, and the unsustainable increase in levels of public indebtedness, all policies, including pension policy, are subject to the need for budgetary consolidation.

On 16 November 2011 the Six Pack was adopted, reforming the Stability and Growth Pact (EP and EC, 2011). In a context of economic crisis, it quickly became clear that the SGP did not provide sufficient constraints to guarantee sound economic governance of the euro zone and of the European Union as a whole. According to the European Commission, the Six Pack represents a step towards ensuring budgetary discipline, fostering the economic stability of the European Union and preventing a new crisis within it (Leprêtre, 2012). The Six Pack sets up a system of a priori controls on public expenditure policy, and on the pace of change and political measures taken to work in the long term towards a reduction of government debt.

### 1.2 The Euro Plus Pact

With the Euro Plus Pact, adopted by the Heads of State and Government on 11 March 2011, Europe gives a series of indications and priorities of importance for economic governance. Its focus is on competitiveness and economic growth, both of which objectives are to be met through structural reforms (including that of pension systems) (dimension (a)), and by a fiscal policy which promotes labour (dimensions (b) and (d)). The Euro Plus Pact has four objectives: fostering competitiveness, fostering employment, contributing to the sustainability of public finances and reinforcing financial stability. All this leads to a fifth dimension: coordination of fiscal policies. Each year, leaders of the Euro Plus countries will have to present objectives relating to these priorities. Countries shall adopt ‘respecting national traditions of social dialogue (...) measures to ensure costs developments in line with productivity.’ There will, however, be no sanctions attached to this requirement. After carrying out an analysis of competitiveness, the Commission may conclude that priority should be given to certain problems on the labour market. The solutions put forward are greater flexicurity and reducing tax on labour (while retaining overall tax revenue levels, and, in the initial drafts, mainly shifting taxation to indirect taxes). In order to maintain healthy levels of public expenditure, recommendations will be made to align the pensions system to the national demographic situation, for example by aligning the effective retirement age with life expectancy or...
by increasing participation rates. Early retirement schemes should gradually be limited (dimension (a)), and further measures should be taken to encourage those aged 55+ back to work (3) (dimension (b)). The Pact also stresses the need for fiscal reforms which would, for example, make it possible to lower taxes on labour to make work pay, while preserving overall tax revenues (dimension (d)).

1.3 Europe 2020

As well as measures to reduce sovereign debt and stem the crisis, the European Commission has submitted a new framework to promote growth and job-creation in Europe. The Europe 2020 strategy follows on from the Lisbon agenda, and covers a ten-year period, aiming to achieve smart, sustainable and inclusive growth. This strategy is based on five specific targets, which are to be implemented in a decentralised fashion. These are targets for employment rates (75% for those aged 20-64), research and development (3% of GDP); education (fewer than 10% of students should leave secondary school without a secondary-level qualification, and 40% should have a post-secondary qualification); poverty and the environment (EC, 2010c). In order to overcome the crisis, Europe 2020 calls for budgetary consolidation and long-term financial sustainability, hand in hand with significant structural reforms, particularly in the area of pensions, healthcare and social protection and education systems (EC, 2010c, p.30). Implementation of these recommendations is spelt out in the 10 guidelines (4) adopted by the European Council in June 2010. These concern macroeconomic surveillance relating to the Stability and Growth Pact (Guidelines 1 to 3) and thematic coordination (Guidelines 4 to 10). Europe 2020 is based on an analysis of those bottlenecks which restrain growth. The strategy also involves preventive and corrective measures to ensure economic and monetary stability (Barbier, 2010; Pochet, 2010).

Pensions are referred to twice in the integrated guidelines. Guideline no. 10, Promoting social inclusion and combating poverty, emphasises that ‘social protection systems, including pensions and access to healthcare, should be modernised and fully deployed to ensure adequate income support and services (…) whilst remaining financially sustainable and encouraging participation in society and in the labour market.’ (Council of the European Union, 2010a). This clearly relates to dimension (c) in our introduction, i.e. helping achieve an adequate level of pensions. Pensions, however, are very clearly seen as a priority when it comes to addressing long-term costs for government finances. Guideline no. 1, Ensuring the quality and the sustainability of public finances, states that ‘Member States should strengthen national

4. Also, a set of 7 European flagship initiatives: innovation, education, digital society, climate and energy, youth on the move, jobs and skills and combating poverty.
budgetary frameworks, enhance the quality of public expenditure and improve the sustainability of public finances, pursuing in particular determined debt reduction, reform of age-related public expenditure, such as pensions and health spending, and policies contributing to raising employment and effective retirement ages, to ensure that age-related public expenditure and social welfare systems are financially sustainable’ (Council of the European Union, 2010b).

The Europe 2020 strategy places considerable restrictions on the role of taxation in pension policy, since pension benefits are not considered as enhancing growth, and since they are often financed by wage deductions and taxation. The strategy strengthens the link between pension and employment policies, with adequate pensions being seen as the outcome of greater participation in the labour market over one’s lifetime (Willert, 2012).

With a view to the consolidation of public finances, the Commission also recalls the need to consider the ‘revenue’ side of the budget. It emphasises that it would be better to avoid any increase of tax on labour, which could harm employment levels, and invites the Member States to shift the tax burden towards energy and the environment.

The Europe 2020 strategy stimulated debate on the future role of the EU in the area of pension policies. This discussion was launched at a public consultation in July 2010, focusing on the Green Paper on adequate, sustainable and safe European pension systems (EC, 2010a). The White Paper presented by the Commission in February 2012 sets out certain priorities to ensure that pension systems are adequate and sustainable in the long term (EC, 2012a). Since there is little support for the further involvement of the EU in pension policy, and differences of view on the policy measures required, the White Paper makes no new proposals over and above those already put forward. It stresses that longer working lives and better access to supplementary pensions are key ways to move towards adequacy and sustainability. A greater emphasis is placed on activation measures allowing people to work for longer (Willert 2012). The issue of taxation of pensions is addressed from the angle of pension funds, with a view to developing pan-European pension funds (in order to encourage the free movement of workers) and in terms of active ageing. The issue of adequate pensions and the important role of taxation in this regard is dealt with in the report on the adequacy of pensions, drafted jointly by DG Employment and Social Affairs and the Social Protection Committee and published in 2012 (SPC, 2012).
1.4 European semester and Annual Growth Surveys

The objectives (especially the macro-economic) objectives of Europe 2020 are similar to those of the Stability and Growth Pact. The new procedures are centred around the European Semester, which begins with the publication of the Annual Growth Survey.

Many medium and long-term measures have been taken in recent years to relaunch the European economy and to develop sounder economic governance. In this context, national policies to meet the objectives of the Europe 2020 strategy are now coordinated at European level, particularly through the ‘European semester’. This begins with the publication by the Commission of an annual growth survey, which is then used as a basis for discussions in Council and the European Council on short and medium-term political priorities. The Member States then draw up their stability and convergence programmes (for euro zone and non-euro zone countries respectively), and their national reform programmes. The situation of each Member State, and of the EU as a whole, is then analysed by the Economic Policy Committee, the Social Protection Committee and the Employment Committee. The European Semester concludes with the adoption of recommendations for each Member State. These are proposed by the Commission, finalised by the Council and approved by the European Council. Each Member State then applies these recommendations when preparing its national budgets and policies (EC, 2010b).

In the annual growth surveys published in 2011 and 2012, the European Commission recognised that the issue of pensions was increasingly a subject of common concern within the European Union. It stressed how important it was to strike a balance between the length of a working life and time spent in retirement, and to promote supplementary savings/pensions. The surveys take a broad approach and cover three of the four dimensions mentioned in the introduction: sustainability of public finances (dimension (a)), job creation (dimension (b)) and economic growth (dimension (d)).

In order to ensure differentiated expressions of budgetary consolidation, favourable to growth, the Commission invites Member States to act on expenditure and revenue through taxation: ‘On the expenditure side, Member States should keep public expenditure growth below the rate of medium-term trend GDP growth. The Commission considers that Member States should give particular attention to the following: pursuing the reform and modernisation of pension systems, respecting national traditions of social dialogue to ensure the financial sustainability and adequacy of pensions, by aligning the retirement age with increasing life expectancy, restricting access to early retirement schemes and other early exit pathways, supporting longer working lives by providing better access to life-long learning, adapting work places to a more diverse workforce, developing employment opportunities for older workers; adopting measures to extend professional
life; equalising the pensionable age between men and women; and supporting the development of complementary private savings to enhance retirement incomes’ (EC, 2011a, 2011d).

The Commission has emphasised that successfully implementing pension reforms along these lines will contribute to putting the pension systems on a more sustainable path, and thereby help Member States to offer their citizens adequate incomes in old age (EC, 2012a). The main themes in its recommendations to individual Member States were the following: increasing the effective retirement age; preventing early exit from the labour market; eliminating fiscal measures which discouraged people of pensionable age from working; consider aligning the retirement age with life expectancy; finding a way to combat the risks of poverty affecting retired people (EC, 2011b).

In order to take proper account of the need to integrate tax policy, the annual growth survey 2012 contains a new annex on growth-friendly tax policies applied in Member States and better tax coordination in the EU (5), which is also particularly important for the Euro Plus Pact. To improve the ‘revenue’ side of budgetary consolidation, greater attention must be paid to the design and structure of tax systems, to make them more effective, more efficient and fairer, whilst remembering that Member States may have to increase taxes. The analysis given in the report ‘Tax reforms in EU Member States 2011’, which looks at how to make tax structures more growth-friendly, suggests that some Member States could promote economic growth by shifting the tax burden on labour (personal income tax and/or social security contributions) onto other factors. Some Member States have already transferred a proportion of the tax burden to consumption by increasing VAT and excise duty rates. Increasing taxes on consumption, housing or the environment could be one way of alleviating the strong pressure on labour, while increasing the growth potential of the economy (EC, 2011e). Although there have been tax reforms in many Member States, more are necessary. The Commission proposals include the following:

- Broadening the tax base of certain taxes. For instance, deductions and exemptions from the standard tax base often create economic distortions and lower the efficiency of the tax system. This is the case for VAT exemptions and reduced rates. Restricting VAT exemptions and the application of reduced rates while respecting the VAT directive could help to broaden the tax base and increase the overall tax-effectiveness;
- Greater efforts should be made to shift taxation away from labour towards taxation which is less detrimental to growth. Increasing taxes on consumption, the environment or wealth can help to alleviate the tax burden on labour, thus making hiring more attractive. Particular attention should be paid to the needs of the most vulnerable groups in any tax shifts;

5. This report is a response to the invitation from the European Council to the Commission, on 24 June 2011, asking it to report on progress made in the structured discussions on fiscal policy in the context of the Euro Plus Pact.
• Member States should coordinate their efforts through enhanced dialogue at EU level. Progress should be made on the proposals announced by the Commission in its last Annual Growth Survey – for a common consolidated corporate tax base, a financial transaction tax and for energy taxation (EC, 2011c).

Having described the main elements of EU social and economic governance, we shall now analyse two tax measures which could have a considerable impact on pensions, and which lie at the heart of current discussions.

2. Taxing the financial sector: what impact on pensions?

In recent years, the introduction of new taxes on the financial sector has been under discussion in many Member States. The reason for this debate is the role played by the banks and other financial service institutions in the causes of the crisis, as well as the government support given to the sector. Furthermore, financial services are under-taxed in comparison with other segments of the economy, since financial activities are generally exempt from VAT. The taxes being considered include most significantly a financial activities tax (FAT) and a tax on financial transactions (FTT) (EC, 2011e).

The draft FTT directive submitted by the European Commission in 2011 (EC, 2011f) was designed to cover as many financial transactions as possible, i.e. shares, bonds, derivatives, structured products and over-the-counter derivatives, which are not currently traded on the stock exchange. It would cover all financial institutions except for Central Counter Parties and Central Banks. Day to day activities such as payment services and mortgages would also be excluded. The Commission has proposed a tax rate of 0.1% on shares and bonds and 0.01% on derivatives. The FTT would bring in considerable amounts of revenue. According to the impact assessment carried out by the Commission services, a tax of this kind would generate almost 57 billion EUR per year (EC, 2011g). Tax revenue would be collected on the basis of the principle of residence of the financial institution or operator. Nevertheless, the question remains as to whether a tax on transactions is the best way to address the main problem, i.e. the fact that the consequences of risk-taking are not internalised in the price of transactions. Proponents of the FTT claim that it could have a stabilising effect.

6. The FAT is an instrument proposed by the International Monetary Fund (IMF), with the following features: it is a tax, in principle, on all profits and wages; it can be designed as a tax on purely economic risk and/or revenue; it applies to companies. If this tax were to be applied at a 5% rate by the 22 ‘developed economies’, as mooted in the IMF report to the G20, it could generate the equivalent of 0.28% of their GDP. At an EU scale, revenue from this tax could amount to 25 billion EUR. In principle, the FAT does not affect the price of financial instruments or influence market structure. However, it could lead to the transfer of profits by a relocation of revenue and wages outside the EU. Some technical aspects of this tax still need, then, to be examined, to avoid this sort of effect, The Commission is of the opinion that a FAT tax would be more effective if applied throughout the EU.
influence on the financial markets, by reducing speculation. They struggle, however, to prove that it could reduce volatility, especially since many economic studies suggest the opposite. Furthermore, the ultimate impact of such a tax is still unclear, and there is a risk of circumvention: it would be easy to relocate transactions without changing the location of the financial activity. Any bank based in the EU could thus locate its transactions in a subsidiary in Singapore (Valenduc, 2011).

The European Federation for Retirement Provision (EFRP, 2012), the arguments of which are put forward by APG (7), has made a number of criticisms of the FTT, concerning its possible effects on pensioners. The cost increases resulting from the tax would ultimately be borne by those in retirement, in the form of reductions in the value of their pensions. Current and future pensioners would have to pay an even higher price for a financial crisis which has already affected their income. Pension funds and Institutions for Occupational Retirement Provision (IORPs) would be taxed, to offset the costs of a financial crisis for which they were not responsible. They have, indeed, already been hard hit by the crisis, and have helped to alleviate its effects by carrying out long-term investments and increasing liquidity on the market. The FTT would affect the IORPs in various ways:

- Net returns would be lower;
- Investment strategies would be less effective: the tax would discourage IORPs, pension funds and asset management institutions acting on their behalf from carrying out transactions;
- The FTT would restrict the amount of liquidity in circulation on the market, at a time when there is an urgent need for liquidity;
- It would be more expensive for pension funds and IORPs to protect themselves against risks. They generally use derivatives to minimise risks. The tax would deter them from using derivatives in this way, thus increasing the risk for pension funds, IORPs and pensioners.

Other arguments, however, have been put forward to deny that the FTT would have such an impact on pensioners. Compared to other investors (hedge funds or high frequency traders), pension funds invest according to long-term strategies. The vast majority of their capital is invested over long time horizons, so a micro-tax applied at entry and exit from the market would have a minimal impact compared with other costs and benefits. The key consideration when speaking about the impact of the FTT, claim proponents of the tax, is the holding period. The cost of the FTT is disproportionately high for short-term trades, marginal for medium-term trades, and negligible for long-term trades (such as the purchase of a 10-year bond, and redemption at

7. APG Memorandum, 31 October 2011, Amsterdam: ‘The FTT would hit ordinary pension savers very hard and would result in pensioners paying for the FTT through reductions in the value of their pensions’, http://www.apg.nl
maturity). Furthermore, by reducing the systemic risks associated with high-frequency trading, the FTT would contribute to market stability, improving pension-value over the long term. Banks and hedge funds tend to benefit disproportionately from extremely volatile markets and from high-volume trading, skimming off the transaction fees and trading profits, and exploiting their computer firepower while passing on most of the risks to their clients. An FTT could reduce the chance for the banks to profit in this way at the expense of savers (Ashford and Hillman, 2012). The number of financial intermediaries involved in trading is also an important factor. One consequence of the FTT could be to reduce the chain of financial intermediaries, the cost of which is passed on to workers’ savings and pensions (Botsch, 2012).

These arguments, however, did not convince the European Parliament, which, in a legislative resolution adopted on 23 May 2012, declared that ‘a pension fund or institution for occupational retirement provision as defined in Article 6a of Directive 2003/41/EC of the European Parliament and the Council on the activities and supervision of institutions for occupational retirement provision, an investment manager of such fund or institution, and an entity set up for the purpose of investment of such funds or institutions acting solely and exclusively in the interests of such funds or institutions, shall not be considered a financial institution for the purposes of this Directive until the review of this Directive pursuant to Article 16’ (EP, 2012).

During the meetings of the ‘ECOFIN’ Council of June and July 2012, it became clear that there would be no unanimous support within Council in the foreseeable future for a common system of financial transaction tax throughout the Union, as proposed by the Commission. In the course of these ‘ECOFIN’ meetings, a number of delegations had already pointed out that it would, however, be possible for a more restricted group of Member States to make progress in this area, through the mechanism of enhanced cooperation between interested states.

As of 28 September 2012, the Commission received requests from ten Member States (DE, FR, AT, BE, PT, SI, EL, IT, ES, SK) asking it to present a draft Council decision to authorise enhanced cooperation. The requests asked for the objectives and scope of the proposal to be based on the initial Commission proposal. An analysis by the Commission had a positive outcome. On 23 October 2012, the Commission submitted a proposal to Council to authorise enhanced cooperation in the area of financial transaction tax. The Council will have to decide having received the consent of the European Parliament (EC, 2012b). The Commission will then, when appropriate, submit a draft directive implementing enhanced cooperation in the area of financial transaction tax.
3. The taxation of added value in financial services

Since the adoption of the 6th VAT Directive in 1977, financial services, including insurance services and investment funds, are generally exempted from VAT. The reasons for this exemption, which is usually justified by social or economic considerations, are here related to the inherent technical difficulties in taxing financial services. The Directive reflects the lack of a clear approach to this subject, as it gives the option to Member States to choose to apply tax to these services. At the moment, Member States do not apply this exemption in a uniform fashion, so the Court of Justice has regularly had to fill the legal vacuum and clarify the correct way for the legislation to be interpreted. On 28 November 2007, the European Commission adopted a draft directive to modernise and simplify the complex rules applicable to VAT on financial and insurance services, in order to ensure, in a pan-European market, equitable VAT treatment of these services. The Commission hoped that by proposing clear and up-to-date definitions of the services to be exempted, it would provide greater legal certainty for Member States and for insurance companies and financial institutions (EC, 2007a). The draft directive went hand in hand with a draft regulation extending the definitions of the exempted services and directly applicable in all Member States (EC, 2007b). In November 2010, Council adopted guidelines to direct work in this area. Under the Polish Presidency, the group concentrated on the definitions of the exempted financial services. Member States, however, did not support the Commission’s intentions to give financial institutions the chance to better manage the costs of non-deductible VAT by extending the taxation option and clarifying the existing system to exempt shared costs (Council of the European Union, 2010c).

The activities of pension funds, institutions for occupational retirement provision and investment funds acting on their behalf are generally exempt from VAT for reasons of tax neutrality and to avoid distortions of competition. The VAT exemption for the necessary costs of managing these funds allows them, in principle, to keep the costs of pension services low, ensuring that small-scale investors (small and medium-sized pension or investment funds which do not have sufficient resources to invest in a broad range of assets) are not treated unfavourably compared to larger funds (EFRP, 2012). The Commission nevertheless feels that this VAT exemption results in preferential treatment of the financial sector compared to other sectors of the economy, as well as distorting prices. This is one of the reasons put forward in favour of a financial transaction tax (EC, 2011e). In practical terms, this VAT exemption means that the generation of added value on financial services is not taxed, but also means that the VAT paid on goods and services acquired by the financial institutions cannot usually be recovered (except in certain specific circumstances). By way of an exception, the costs of outsourced management services for certain investment and pension funds may be exempted from VAT. Member States are allowed to determine which funds shall benefit from this exemption, subject to the principle of neutrality. Some interpret the exception in broad terms, whereas others are more restrictive and exclude certain categories of pension fund (Freihen and van Kasteren, 2007). In this respect, the Council session of 19
December 2011 took note of a progress report from the Polish Presidency on work on the legislative proposals concerning the VAT treatment of insurance and financial services (Council of the European Union, 2011b). The report, noted, in particular, that progress had been made on the definition of investment fund and pension fund. Most delegations supported equal VAT treatment of both these types of fund, by application of this exemption to the management of funds, irrespective of their legal form and business structure, in order to avoid possible distortions of competition, and so as not to create unnecessary burdens in the area of management of these types of funds. However, a few Member States argued that certain types of pension funds were by their very nature different from investment funds and in their view should not be exempt. These differences reflect the current practices and preferred interpretations of Member States. Unless some are prepared to show flexibility, it will not be possible to reach agreement on this issue.

Certain Member States maintain that the exemption should be limited to investment funds collecting the savings of small investors (Council of the European Union, 2011a). The complete lack of discussion of this proposal in 2012 and the fact that it is no longer listed as a priority for forthcoming Presidencies is a clear reflection of the entrenched positions of Member States on this question.

Despite the difficulties remaining in Council, the question of exempted funds is currently being examined by the Court of Justice of the European Union in the cases Wheels Common Investment Fund Trustees and PPG Holding (8). The Wheels case was heard before the Court at the beginning of September. This case was brought to the Court in 2008 by the National Association of Pension Funds and Wheels Common Investment, following a Court judgement which found that as investment trusts were special investment funds, they should be exempt from VAT on investment management services (9). Wheels and the NAPF claimed that defined benefit pension schemes should be eligible for this exemption, since defined contribution schemes were already exempted. The Commission defended before the Court the arguments of the British Customs administration, which denied the legitimacy of an exemption in this case, to the great displeasure of the employers and trustees. A decision is expected in the next few months. These decisions could result in a more uniform application of the exemption. The Court’s view, be it restrictive or broader, will have to be followed by all Member States and will have clear consequences for pension funds. Indeed, the economic consequences of this decision for pension funds will be far greater than those which could result from the introduction of a Financial Transaction Tax.

8. C-424/11 Wheels Common Investment Fund Trustees; C-26/12 PPG Holding.
4. Conclusions

This overview of the key elements of the social and economic governance of the EU, together with our consideration of the current discussions concerning taxation of financial activities and the taxation of added value, should have clarified the background to the issue of the taxation of pensions.

There are three key elements influencing current discussions, which deserve careful consideration.

I. EU measures are concentrated on 4 areas: a. sustainability of public finances; b. increasing employment-levels; c. adequacy of benefits; d. economic growth. These dimensions must be carefully considered in order to reach a better understanding of the potential effects of measures to be discussed at national and European levels.

II. The question of coordination of the fiscal policies of Member States is a crosscutting one. It brings us back, firstly, to the need to strengthen the internal market, and also to the importance of respecting national competencies in this area (e.g. the taxation of added value and the option left open to Member States to apply this to financial services, including pension funds).

III. A second cross-cutting question concerns how to ensure the financial viability of pension systems, and how to defend the rights of workers signed up to pension funds (cf. tax on financial transactions).
References


