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**COMMUNICATION FROM THE COMMISSION TO THE COUNCIL, THE
EUROPEAN PARLIAMENT AND THE ECONOMIC AND SOCIAL COMMITTEE**

The elimination of tax obstacles to the cross-border provision of occupational pensions

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1. INTRODUCTION

Pensions are an issue of universal concern: for individual citizens who want adequate provision for their retirement; for employers who seek cost-effective pension provision for their employees; and for governments, who throughout the Union are seeking to maintain adequate pension provision in the face of ageing populations.

The potential benefits of better cross-border pension provision are substantial. At present citizens who take up employment or residence outside their home State are often unable to remain in their existing occupational pension schemes. Around 5.1 million European citizens aged 15 years and over reside in a Member State other than their Member State of origin¹. This figure is increasing, and enlargement of the Union will contribute further to this trend. Impediments to cross-border pension provision may also prevent European businesses from choosing the most efficient way of providing pensions for their employees by centralising their pension provision.

It is estimated that around 25% of the Union's active population is covered by an occupational pension scheme. The proportion can be higher than 80% in some countries. The value of the assets held by the Union's pension institutions exceeds € 2 000 billion, i.e. it is equivalent to about 25% of the Union's gross domestic product. Funded pension assets as a percentage of gross domestic product vary significantly between Member States, from 95% in the United Kingdom to 5% in France and 2% in Spain².

A fully functioning Single Market for occupational pensions is essential to ensure that citizens are able to exercise their rights to free movement enshrined in the EC Treaty and thus to enhance labour mobility³.

¹ Source: Newcronos database of Eurostat, domain Labour Force Study.

² Figures for 1999, source: InterSec Research, OECD.

³ See the Veil Report, "Report of the High Level Panel on the free movement of persons", presented to the Commission on 18 March 1997, in particular the report on supplementary pensions, which led to the creation of the Pensions Forum.

Furthermore, elimination of tax-obstacles to the cross-border provision of occupational pensions will enable pension institutions⁴ to operate with greater efficiency in meeting the needs of workers and employers. It will also make pension institutions more efficient suppliers of capital to business in their capacity as investors in the economy. More generally, it will contribute to European industry's competitiveness.

The Commission has accordingly taken a number of initiatives on occupational pensions. Following a proposal by the Commission, the Council adopted on 29 June 1998 a Directive on the safeguarding of supplementary pensions, which allows in particular posted workers⁵ to remain in their home country supplementary pension schemes⁶. On 11 May 1999 the Commission issued its Communication "Towards a Single Market for Supplementary Pensions"⁷. In October 2000 the Commission issued a Communication on safe and sustainable pensions⁸ and proposed a Pension Fund Directive designed to allow cross-border pension provision and investment while ensuring adequate prudential supervision⁹.

The present Communication supplements the proposed Pension Fund Directive by dealing with the tax aspects of cross-border occupational pension provision. In accordance with the principles set out in the Commission Communication of 11 May 1999 it:

- seeks a co-ordinated approach adapted to the diversity of Member States' rules rather than attempting to achieve harmonisation;
- calls for the elimination of unduly restrictive or discriminatory tax rules;
- presents measures to safeguard Member States' tax revenues.

⁴ "Pension institution" is used in this Communication in the sense of "institution for occupational retirement provision" (IORP), as used in the Proposal for a Directive of the European Parliament and of the Council on the activities of institutions for occupational retirement provision, Brussels, 11.10.2000, COM(2000) 507 final, hereafter called the proposed "Pension Fund Directive".

⁵ Posted workers as defined in Regulation 1408/71: See Council Regulation (EC) No 118/97 of 2 December 1996 amending and updating Regulation (EEC) No 1408/71 on the application of social security schemes to employed persons, to self-employed persons and to members of their families moving within the Community and Regulation (EEC) No 574/72 laying down the procedure for implementing Regulation (EEC) No 1408/71, OJ L 28, 30.1.1997, pp. 1 – 229, as last amended by Council Regulation (EC) No 1399/1999 of 29 April 1999, OJ L 164, 30.6.1999, pp. 1-5.

⁶ Council Directive 98/49/EC of 29 June 1998 on safeguarding the supplementary pension rights of employed and self-employed persons moving within the Community, OJ L 209, 25.7.1998, pp. 0046 – 0049. The Commission's proposal had included an article on the tax treatment of pension contributions, but this was not retained by the Council.

⁷ Communication from the Commission "Towards a Single Market for supplementary pensions, results of the Green Paper on supplementary pensions in the single market, Brussels 11.5.1999, COM(1999) 134 final.

⁸ Communication from the Commission to the Council, to the European Parliament and to the Economic and Social Committee "The Future Evolution Of Social Protection From A Long-Term Point Of View: Safe And Sustainable Pensions", Brussels, 11.10.2000, COM(2000) 622 final.

⁹ The proposed Pension Fund Directive, quoted above.

2. TAXATION OF OCCUPATIONAL PENSIONS IN THE SINGLE MARKET

2.1. *The three pillars*

There are three main categories of retirement provision in the Member States: statutory social security schemes (first pillar), occupational schemes (second pillar) and individual schemes (third pillar). There is no specific Community legislation on the taxation of retirement provisions.

The first pillar consists of statutory schemes, in which participation is generally compulsory for the entire employed or resident population. These schemes are usually financed on a pay-as-you-go basis, where current contributions are used directly to finance pension payments to retired people. These pension benefits are guaranteed by the State and the scheme is usually managed by a public body. At the Community level, Regulation 1408/71 co-ordinates these schemes. Its dual purpose is to avoid double payment of contributions in respect of workers who move from one Member State to another and to ensure that benefits are payable across the European Union to these workers and their survivors by any one Member State corresponding to the worker's contribution and affiliation history in that Member State and having regard, if necessary, to the worker's contribution and affiliation history in other Member States.

Second pillar schemes may be set up unilaterally by an employer or as a result of a collective agreement or a contract agreed individually or collectively between the employer(s) and the employee(s) or their respective representatives. In general, under the second pillar employers and/or employees pay contributions to a pension institution, which invests them. The assets held by the pension institution are used to pay retirement benefits to the members of the scheme. Second pillar pension institutions play a major role in retirement provision in a number of Member States¹⁰.

The third pillar consists of individual schemes, which generally take the form of contracts taken out by individuals, in their personal capacity, with life assurance companies or other financial institutions, although some Member States have personal pension schemes to which both employer and employees contribute.

As this Communication aims at complementing the proposed Pension Fund Directive, its focus is primarily on the second pillar and the pension institutions covered by that proposal, that is to say, pension institutions which operate on a funded basis and are outside the first pillar social security systems. Nevertheless it will be noted that much of the discussion in this Communication applies equally to third pillar pension and life assurance services.

2.2. *The taxation of occupational pensions*

There are basically three levels at which occupational pension provision may be subject to tax: on the contributions, on the investment returns and on the payment of benefits.

¹⁰ Where this Communication uses terms as "pension scheme" and "retirement benefits", such terms should be read as in the proposed Pension Fund Directive, quoted above.

Contributions

Nearly all Member States allow some degree of tax deduction of employer's and/or employee's contributions to pension institutions within their territories, and most do not treat employer's contributions as taxable income of the employee. However, the conditions for tax recognition of schemes vary widely, as does the amount of contributions that are exempted from taxation.

Investment returns

Pension institutions invest the contributions in assets which may generate income and appreciate in value. Most Member States provide for the exemption of any income and capital gains in the hands of pension institutions. Several Member States, however, levy what is often called a “yield tax” on this income.

Benefits

Most Member States tax pension benefits, whether paid periodically or as a lump sum, in the hands of the individual pensioners. However, tax rates and the extent of tax-free allowances vary considerably. A number of Member States tax lump sum payments on more favourable terms or exempt them altogether. Other States do not allow lump sum payments at all.

2.3. *Overview of Member States' systems*

Thus, the large majority of Member States have what is described as the EET system (Exempt contributions, Exempt investment income and capital gains of the pension institution, Taxed benefits). Three Member States have the ETT system (Exempt contributions, Taxed investment income and capital gains of the IORP, Taxed benefits), while two Member States operate a TEE system.

The table below summarises the basic approach of the different Member States to the taxation of second pillar pensions¹¹. There are important differences between Member States in the level of deductibility of contributions and the taxation of benefits. This table provides only a rough overview.

¹¹ Member States may operate more than one system, especially in an international context.

Table : Overview of occupational pension taxation systems

	EET	ETT	TEE
Belgium	X		
Denmark		X	
Germany	X		X
Greece	X		
Spain	X		
France	X		
Italy		X	
Ireland	X		
Luxembourg			X
Netherlands	X		
Austria	X		
Portugal	X		
Finland	X		
Sweden		X	
United Kingdom	X		

In broad terms the table shows that 11 out of 15 Member States have arrangements providing for tax deduction of pension contributions and for taxation of the benefits, with exemption at the level of the fund (EET).

Problems may arise from differences in Member States' tax treatment of occupational pension schemes. For example, an employee may spend his working career in a TEE State but retire to an EET State, in which case he may be subject to double taxation. Conversely, an employee may work in an EET State and retire to a TEE State, which may lead to double non-taxation. Chapter 5 of this Communication explores ways to deal with the diversity of Member States' pension taxation systems.

3. THE IMPACT OF THE FUNDAMENTAL FREEDOMS OF THE EC TREATY

3.1. Introduction

In addition to the problems outlined above, there is at present a more direct tax obstacle to cross-border pension provision and the free movement of workers. Many Member States do not extend the tax relief available domestically to contributions paid to pension institutions established in other Member States. Some impose conditions on this relief which differ from those applied to domestic schemes. In some cases a higher yield tax is levied on pension institutions located in other Member States. Lastly, benefits received from pension institutions established in other Member States may be taxed more heavily than domestic benefits.

The discriminatory treatment of affiliation to foreign pension institutions is a major obstacle to cross-border pension provision and labour mobility. Two types of situation should be distinguished:

- A person who is a scheme member of a pension institution in a Member State moves to another Member State and wishes to stay in the same scheme¹².
- An individual employer or group of employers and the representatives of the employees may wish to make pension arrangements for all employees in different Member States through a pan-European pension institution.

The Commission considers that the EC Treaty obliges Member States to abolish any discriminatory rules. This Chapter sets out the Commission's view of the law on this matter.

3.2. *The Treaty freedoms*

According to Article 14 of the EC Treaty, the internal market shall comprise an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured in accordance with the provisions of the Treaty. Articles 39, 43, 49 and 56 of the EC Treaty elaborate these different freedoms. These articles prohibit discrimination on grounds of nationality, unequal treatment and other restrictions on the free movement of workers, freedom of establishment, and free movement of services and capital.

It is clear from the case law of the Court of Justice that those provisions apply in the areas of pensions and life assurance. For example, in *Safir*¹³ the Court noted that the provision of insurance constituted a service within the meaning of Article 50¹⁴ of the Treaty and held that Article 49 of the Treaty precluded the application of national legislation which impeded a provider of such services from actually exercising the freedom to provide them without objective justification. It held further that, in the perspective of a Single Market and in order to enable its objectives to be attained, Article 49 of the Treaty likewise precluded the application of national legislation which had the effect of making the provision of services between Member States more difficult than the provision of services exclusively within one Member State.

Accordingly, in *Safir* the Court concluded that a Swedish rule imposing a tax on persons paying premiums to a life assurance company established in another Member State, designed to compensate for the yield tax payable by Swedish institutions, dissuaded individuals from taking out policies with companies not established in Sweden and created an unjustified obstacle to the freedom to provide services contrary to Article 49 of the Treaty¹⁵.

¹² A special group within this category are posted workers. By virtue of Council Directive 98/49 posted workers (as defined in Regulation 1408/71) have the right to remain within their old scheme in the home State. This Directive is to be fully implemented by Member States by 25.7.2001.

¹³ Case C-118/96 *Safir* [1998] ECR I-1919.

¹⁴ This Communication consistently refers to the renumbered Articles.

¹⁵ Case C-118/96 *Safir* [1998] ECR I-1919, paragraphs 26 to 30.

In the earlier case of *Bachmann*¹⁶ the Court similarly held that Belgian legislation which made the deductibility of pension and life assurance contributions conditional on those contributions being paid to an institution established in that State was in principle contrary to Article 39 and Article 49 of the Treaty, subject to any overriding justification. In addition it held that the legislation impeded the free movement of workers provided for by Article 39 of the Treaty in so far as it worked to the particular detriment of migrant workers. The latter would often have concluded policies before coming to work in Belgium and switching policies would involve supplementary arrangements and expense.

Given the fundamental freedoms enshrined in the Treaty and their subsequent interpretation by the Court, it is clear that national restrictions which impede the provision of pensions and life assurance without objective justification are incompatible with Community law.

In the Commission's view there are no grounds justifying unequal treatment of schemes operated by pension institutions established in other Member States. The Court has rejected numerous defences put forward by Member States to justify restrictions of the fundamental freedoms. For example, it is clear that the absence of harmonisation of Member States' laws does not prevent the application of the Treaty freedoms¹⁷. In *Eurowings* the Court held that a Member State could not impose higher taxation on the leasing of equipment from another Member State compensating for the lower tax rates imposed on the lessor in that State¹⁸. Moreover, a Member State cannot justify discrimination on the ground that its removal will entail a loss of tax revenue¹⁹. Finally, neither the absence of reciprocity on the part of other Member States²⁰ nor the difficulties in obtaining information constitute valid defences.

With respect to taxation of pensions and life assurance three issues merit particular attention.

3.3. *Fiscal cohesion*

In *Bachmann* the Court accepted that restricting the deductibility of contributions paid to Belgian institutions might be justified by the need to preserve the cohesion of the Belgian tax system. This was based on the Court's assumption that there existed under the Belgian rules a connection between the deductibility of contributions and the liability to tax on sums payable by the insurers under pension and life assurance contracts.

In subsequent cases the Court clearly delineated the scope of the fiscal cohesion principle. In *Wielockx* the Court held that a Dutch rule which denied a non-resident self-employed person the right, granted to residents, to deduct from taxable income a

¹⁶ Case C-204/90 *Bachmann* [1992] ECR I-249.

¹⁷ Case C-270/83 *Avoir fiscal* [1986] ECR 273, paragraph 23.

¹⁸ Case C-294/97 *Eurowings*, [1999] ECR I-7449, paragraph 43.

¹⁹ Case C-264/96 *ICI* [1998] ECR I-4711, paragraph 28.

²⁰ Case C-270/83 *Avoir fiscal* [1986] ECR 273, paragraph 26.

provision made to a pension reserve was contrary to Article 43 of the Treaty. The Dutch Government sought to justify the denial of the deduction by reference to the principle of fiscal cohesion laid down in *Bachmann*. Referring to bilateral conventions entered into by the Netherlands, the Court dismissed that argument:

“the effect of double taxation conventions which ... follow the OECD model is that the State taxes all pensions received by residents in its territory, whatever the State in which the contributions were paid, but, conversely, waives the right to tax pensions received abroad even if they derive from contributions paid in its territory which it treated as deductible. Fiscal cohesion has not therefore been established in relation to one and the same person by a strict correlation between the deductibility of contributions and the taxation of pensions but is shifted to another level, that of reciprocity of the rules applicable in the Contracting States”.

The Court concluded that, since fiscal cohesion was secured by a bilateral convention concluded with another Member State, that principle could not be invoked to justify the refusal of a deduction such as that in issue²¹. In other words, as the Netherlands had surrendered the right to tax pension benefits in their tax treaty with Belgium, they could not claim that they were not obliged to grant a deduction where they were unable to tax the benefits²².

The large majority of Member States' tax treaties, like the treaty concerned in *Wielockx*, follow the principle of residence taxation provided for in Article 18 of the OECD Model Tax Convention. The Court's reasoning in *Wielockx* would therefore apply in such cases. Although a few Member States seek in their treaty negotiations to introduce source State taxing rights over pension benefits paid to non-residents, in practice not all of their treaties make such provision, so that taxing rights over pension benefits are surrendered even though contributions were tax-deductible. Moreover, even if all of a Member State's tax treaties were to provide for source taxation of pension benefits, the refusal of deductibility for contributions paid to pension institutions established in other Member States would be disproportionate as there are less restrictive means of ensuring collection of tax at source by a pension institution established in another Member State. For example, at least one Member State has adopted the practice of entering into arrangements directly with foreign pension institutions in order to ensure compliance with its tax rules. In the event of non-compliance it would be open to the Member State to apply appropriate penalties.

²¹ Case C-80/94 *Wielockx* [1995] ECR I-2493, paragraph 25.

²² It may moreover be noted that, since *Bachmann*, the Court has not upheld broad and general claims of fiscal cohesion advanced by Member States: see in particular Case C-484/93 *Svensson* [1998] ECR I-3955, Case C-107/94 *Asscher* [1996] ECR I-3089, Case C-264/96 *ICI* [1998] ECR I-4711, Case C-294/97 *Eurowings* [1999] ECR I-7449, Case C-55/98 *Vestergaard* [1999] ECR I-7643, Case C-251/98 *Baars* [2000] ECR I-2787 and Case C-35/98 *Verkooijen*, not yet reported.

Moreover, the proposed amendment to the Recovery Directive²³ would provide for mutual assistance for the recovery of tax claims.

The Commission notes finally that a number of Member States which allow deduction of contributions to domestic schemes also allow such deduction to foreign schemes. Such Member States evidently do not consider that a refusal of deductibility is necessary to protect their tax revenues. Although each Member State's pension taxation system should be assessed in its proper context, this confirms the Commission's view that the refusal of deductions for contributions to foreign schemes by EET or ETT States is disproportionate.

3.4. *Social policy and prudential supervision*

Tax approval (i.e. approval for the purposes of tax deduction of the contributions) of occupational pension schemes by Member States is subject to certain conditions. Such conditions may serve policy objectives and be linked to the arrangements applicable under first pillar schemes. For example, the level of tax deductible contributions to occupational schemes is often calculated by reference to first pillar contributions. Thus, a limit is set for the total annual tax-deductible contributions to both statutory and occupational schemes so as to ensure that statutory schemes taken together with the occupational schemes provide for a pension no higher than, for instance, 70% of final pay.

The Commission considers that it is appropriate to distinguish between two basic situations. The first concerns pension arrangements newly entered into by a Member State's residents or by persons employed within their territory with pension institutions established in other Member States. The Commission considers that Member States are entitled to require that such schemes meet the conditions applied to similar domestic schemes relating to the nature and level of benefits, the age of retirement, qualifying beneficiaries and so forth, as well as standards of prudential supervision (pending their harmonisation by the proposed Pension Fund Directive), provided that such conditions are consistent with the Treaty, in particular that they serve legitimate social policy aims and that they are not disproportionate in the sense that they unduly restrict the freedom to provide services.

The second situation concerns pension schemes already entered into by migrant workers before coming, often temporarily, to the host State. If that State were to impose its conditions for tax approval this would unduly restrict the free movement of workers. Migrant workers would be forced, if they wished to benefit from tax advantages in the host State, to join a new scheme meeting the conditions for tax

²³ Directive 76/308/EEC provides for mutual assistance for the recovery of tax claims. At present, this Directive only applies to agricultural levies, customs duties, VAT and excise duties. On 25 June 1998 the Commission presented a proposal to improve the functioning of the Directive and extend its scope to direct taxes in order to bring it into line with Directive 77/799/EEC. It is called "Proposal for a European Parliament and Council Directive amending Council Directive 76/308/EEC on mutual assistance for the recovery of claims resulting from operations forming part of the system of financing the European Agricultural Guidance and Guarantee Fund, and of agricultural levies and customs duties and in respect of value added tax and certain excise duties", COM(1998) 364 final, of 25.6.1998, OJ C 269, 28.8.1998, p. 16, as amended by Commission proposal COM(1999) 183 final of 7.5.1999, OJ C 179, 24.6.1999, p. 6.

approval²⁴. Under the equal treatment principle the total tax deduction which the host State is obliged to grant would nevertheless normally be limited to the deduction granted in respect of contributions to domestic pension institutions.

By contrast, the Commission considers that requirements of *prudential* supervision cannot justify *fiscal* restrictions on contributions to pension schemes with pension institutions in other Member States. In *Bachmann* the Court held that the need to ensure adequate prudential supervision did not constitute a ground for refusing to recognise the existence of contracts which a migrant worker concluded with insurers in another Member State while he was resident there. More generally, fiscal restrictions are neither a necessary nor an appropriate means of ensuring that prudential requirements are met. Member States can use other means of ensuring that such requirements are met. The recent proposal for a Pension Fund Directive puts forward the necessary provisions for the removal of prudential barriers to cross-border management of pension schemes by harmonising certain basic prudential rules, establishing mutual recognition of national prudential systems and introducing a system of notification and co-operation between competent authorities²⁵.

3.5. *Fiscal supervision*

The Court has shown itself reluctant to accept arguments based on the difficulty of verifying compliance with tax laws in the case of cross-border situations as a justification for different treatment. For example, in *Bachmann* the Court rejected Belgium's argument that it was difficult to check certificates relating to the payment of contributions in other Member States, pointing out that Belgium could have recourse to the Mutual Assistance Directive²⁶ or indeed could require that the taxpayer provide evidence himself. The Court has followed similar reasoning in *Wielockx* and other cases²⁷.

In the Commission's view such justification is equally inapplicable here. However, it is open to Member States to put in place arrangements to safeguard the application of their tax laws in the context of cross-border pension provision, in particular by requiring provision of information by pension institutions.

3.6. *Transferability*

A separate issue from the tax obstacles to cross-border participation in pension schemes are the tax obstacles to the cross-border transferability of pension capital.

²⁴ The position might be otherwise if it were possible for the worker to be transferred to another section of the pension institution concerned without terminating his policy: see below.

²⁵ Prudential barriers for life assurances have already been lifted by Council Directive 92/96/EEC of 10 November 1992 on the co-ordination of laws, regulations and administrative provisions relating to direct life assurance and amending Directives 79/267/EEC and 90/619/EEC (third life assurance Directive), OJ L 360, 9.12.1992, pp 0001 – 0027.

²⁶ Council Directive of 19 December 1977 concerning mutual assistance by the competent authorities of the Member States in the field of direct taxation (77/799/EEC), OJ 27.12.1977, L 336, p. 15.

²⁷ Case C-80/94 *Wielockx* [1995] ECR I-2493 and Case C-250/95 *Futura* [1997] ECR I-2471. See also Case C-420/98 *W.N.* [2000] ECR I-2847, where the Court explains Article 4.1. of the Mutual Assistance Directive.

When a worker moves from an employer in one Member State to an employer in another Member State, it may be desirable, both for the employee and the pension institutions that are involved, to transfer the accrued pension capital from the old pension scheme to the new one. It should be noted that even in cases of mobility within a Member State transfers of accrued pension capital may be difficult or even impossible. However, there may be cross-border situations where national tax rules are contrary to the Treaty provisions on the freedom of movement for workers and/or the free movement of capital. An example of such a situation could be an EET or ETT State taxing the value of the pension capital upon cross-border transfer, where it would not tax a transfer within its territory, and where it applies the principle of residence taxation of pension benefits in its double tax treaties. The Commission will examine national tax rules impeding the cross-border transferability of pension capital and take the necessary steps to ensure effective compliance with the Treaty rules.

3.7. Conclusion

The Commission's view of the legal position can be summarised as follows.

Articles 39, 43, 49 and 56 of the EC Treaty guarantee the free movement of workers, the freedom of establishment, the freedom to provide services and the free movement of capital, and they prohibit restrictions to these freedoms. National rules making the deductibility of pension and life assurance contributions conditional on those contributions being paid to a pension institution established within national territory are contrary to those Articles.

Two situations should be distinguished: "sedentary" workers (that is workers remaining in one Member State) and migrant workers. Where citizens resident in a Member State join a foreign scheme the Member State may, in the current state of Community law, require that the scheme meets conditions for tax approval relating to the nature and level of benefits, age of retirement, qualifying beneficiaries and similar proportionate conditions. In the case of citizens who already belong to a scheme approved for tax purposes in their home State and then move, often temporarily, to another Member State, the host State cannot refuse to grant tax deduction of contributions paid to the foreign scheme on the ground that the scheme does not meet its conditions for tax approval.

Accordingly, the Commission considers that national rules denying equal treatment to pension schemes operated by pension institutions established in other Member States are in breach of the Treaty. Member States must ensure that they grant the same tax deductions for contributions to domestic pension institutions and those established in other Member States. Equal treatment must similarly be granted in relation to any yield tax and in relation to the tax treatment of benefits. The Commission will monitor Member States' national rules and take the necessary steps to ensure effective compliance with the fundamental freedoms of the EC Treaty, including bringing the matter before the Court of Justice on the basis of Article 226 of the EC Treaty.

4. SAFEGUARDING THE APPLICATION OF MEMBER STATES TAX RULES

4.1. *Introduction*

This chapter considers how Member States can ensure improved application of their tax laws in the case of cross-border pension provision. Usually Member States' tax laws impose an obligation on domestic pension institutions to inform national tax authorities of any payment of pension benefits and in some cases to deduct tax at source. A common concern of Member States is that they might be unable properly to enforce their tax rules if they allowed their residents to participate in foreign pension schemes. They fear that their tax authorities would not be informed of the payment of benefits, that taxpayers might not declare them, and that consequently cross-border pension provision could lead to unlawful evasion of tax. Accordingly, this chapter of the Communication examines ways in which Member States can take measures to safeguard their revenues.

4.2. *The Mutual Assistance Directive*

Under nearly all tax treaties between Member States pension benefits are taxable in the State of residence of the pensioner. Exchange of information on benefits paid by pension institutions to residents of another Member State would allow Member States to verify compliance by their residents with their tax obligations. Such exchange would also facilitate collection of tax by Member States exercising source taxing rights. The framework for such information exchange already exists under the Mutual Assistance Directive²⁸ of 19 December 1977.

Under Article 1 (1) of the Mutual Assistance Directive the competent authorities of the Member States shall exchange any information that may enable them to effect a correct assessment of taxes on income and on capital. Article 3 of the Directive, entitled "Automatic exchange of information", provides that, for categories of cases which they shall determine under the consultation procedure laid down in Article 9, the competent authorities of the Member States shall regularly exchange the information referred to in Article 1 (1) without prior request. Article 9 (1) provides that consultations shall be held, if necessary in a Committee, between the competent authorities of all the Member States and the Commission, at the request of one of those authorities or the Commission, when the matters involved are not solely of bilateral interest. Since cross-border provision of pensions involves matters which are of interest to all Member States, a Committee would seem the appropriate forum for consultations.

Article 8 of the Directive imposes certain limits on exchange of information. In particular, 8 (1) provides that the Directive shall impose no obligation to have enquiries carried out or to provide information if the requested Member State would be prevented by its laws or administrative practices from carrying out these enquiries or from collecting or using this information for its own purposes.

In the Commission's view, that provision does not allow a Member State to refuse to exchange information on the grounds that the information is not required for

²⁸

Cited above. See also Case C-420/98 *W.N.* [2000] ECR I-2847.

domestic tax purposes. It merely means that a Member State is not obliged to exchange information which it cannot collect or use even for its own purposes. The Commission is not aware of any fundamental impediment in national laws to collection of such information. The Commission concludes that an adequate system of information exchange could be put in place in the area of pensions under the Directive.

4.3. *Request for Committee consultations*

The Commission will request that consultations are held in the Committee provided for by Article 9 (1) of the Mutual Assistance Directive to agree the detailed arrangements for automatic information exchange on occupational pensions. The Committee should address the following issues:

Automatic information exchange

The Commission considers that automatic information exchange is the best means of safeguarding Member States' revenues and promoting the interests of a fully functioning single market in pensions. The Council has already decided upon the principle of automatic information exchange in the area of savings income²⁹. The extension of that principle to pensions will help prevent distortions by ensuring the same level of information exchange for comparable products.

Details of information exchange

Article 9 of the Directive envisages implementation of the Directive through the consultation procedure. This suggests that in the case of automatic information exchange Member States would themselves take the necessary measures for the collection of the information from market operators to allow such exchange. The Committee would nevertheless need to agree on the details of information exchange, in particular the information to be reported and the format and frequency of the information exchanges. The Commission's preliminary assessment of the minimum information which will need to be exchanged is as follows:

- name, address, date and place of birth and, where available, tax identification number of the scheme member;
- name and address of the pension institution;
- name and address of pension provider where different from the pension institution³⁰;
- number of the policy;

²⁹ 2312th Council meeting – Ecofin – Brussels, 26 and 27 November 2000.

³⁰ Usually, pensions are paid directly by the scheme or institution. However, they may also be paid as annuities by regulated providers. While the providers may run schemes they would not be schemes/institutions themselves.

- the date on which the pension entitlement arises or, where different, the date on which the pension first comes into payment³¹;
- total payments made each year by the employee and employer to the pension institution;
- total annual payments made by the pension institution, or pension provider where different from the pension institution, and their nature (periodic or lump-sum);
- name, address, date and place of birth and, where available, tax identification number of the beneficiary (if different from the scheme member).

Where the possibility of the transfer of pension capital between pension institutions of different Member States exists, Member States should also exchange information on such transfers. Moreover, the elements necessary for calculation of yield tax may also be useful to certain Member States.

The Committee might wish to consider whether the information should be exchanged between the Member States, based on information provided by the pension institution, or whether the information should be exchanged between the pension institution and the appropriate Member States directly. The latter might be less onerous on taxation authorities.

The Commission recommends that to ensure technical compatibility the Committee co-ordinates its work with that conducted on savings income, the follow-up to the report of the Ad Hoc Fraud group³² and the work on information exchange being undertaken in the OECD. In this broader framework the Commission will consider the need for legislative measures, and it will consider the need to incorporate the exchange of information on occupational pensions in these measures.

The Commission considers that at a later stage consideration could be given to extending information exchange to third pillar schemes, including life assurance.

5. PAN-EUROPEAN PENSION INSTITUTIONS

The Commission also wishes to bring to the attention of the Council, the European Parliament and the Economic and Social Committee a proposal made by industry for pan-European pension institutions³³. This proposal is designed to enable employees of a multinational company to belong to the same pension institution wherever they are employed. The basic principle of the proposal is that Member States would be able to maintain their own approach to the taxation of pension arrangements for residents in their own State.

³¹ In some Member States payment of the pension can be deferred until after actual retirement.

³² The Ad hoc Working Party on Tax Fraud is a Council working group, dealing with tax fraud in both the indirect and the direct tax areas.

³³ "A European Institution for Occupational Retirement Provision (EIORP) - A Single License to enable Multi-Nationals to pool their pension liabilities and assets on a tax neutral basis", European Federation for Retirement Provision, July 2000.

In practical terms a pan-European pension institution located in one Member State would have different sections, each section complying with the requirements for tax approval and the tax regulations of the State where the member is employed, and its social law. If in the course of his career with the multinational a person were to change his Member State of employment, he would continue to pay contributions to the same pan-European pension institution, but to a different section.

The transfer of accrued benefits between the different sections would not be necessary. After retirement the worker would receive benefits from each national section in accordance with the rights acquired under the national rules applicable to these sections.

In the case of a pan-European pension institution it might be necessary for tax reasons to determine which assets are allocated to each national section and are thus subject to the different national tax rules. The proposal suggests that the assets should be divided between each section in accordance with the corresponding liabilities at the last actuarial valuation, and taxed accordingly.

In order to preserve links which may exist between first and second pillar schemes, arrangements could be made to allow employees on temporary secondment to another Member State not to be transferred immediately to the section for that State. Instead they could remain for a certain period within the section for their Member State of origin, as envisaged by Directive 98/49. That period could be determined by reference to the period for which such employees remain subject to that State's legislation in terms of Regulation 1408/71.

In addition, pan-European pension institutions would comply with the rules on payment and collection of tax applicable in the State of work or residence. For example, if the Member State of work or residence operates an ETT system, the pan-European pension institution would pay the yield tax levied on the fund to the authorities of that State and, where applicable, would also collect tax at source on the benefits and provide information to that State in accordance with the arrangements of that State. Where a pensioner at or after retirement takes up residence in a Member State other than that of his employment, he would be transferred to the section for that Member State (if one existed).

The proposal for pan-European pension institutions was developed with a single employer and a small group of participating States in mind. However, there seems no reason in principle why it could not provide the basis for more general arrangements for cross-border pension provision within the EU, covering several companies or entire sectors or professions. There would of course be a number of detailed technical issues to be considered.

The advantage of pan-European pension institutions with different sections over information exchange is that the relevant section of the pan-European pension institution, although subject to the supervisory rules of its State of establishment, would in effect be treated for tax purposes as established in the territory of the scheme member and would apply the same rules and procedures as a domestic pension institution, including rules concerning the application of yield taxes or

deduction of tax at source. Member States' compliance costs should therefore be lower under pan-European pension institutions proposal³⁴. A further advantage of the proposal is that it might be possible to implement it without new tax legislation. To this end a Member State could conclude an agreement with a pan-European pension institution setting out the obligations of the institution in terms of, for example, the provision of information and the collection of taxes.

It should be noted that the proposal for pan-European pension institutions and the proposed improvement of information exchange are not mutually exclusive. It may be unreasonable to expect smaller pension institutions to operate the pan-European pension institution arrangements given the need to apply the tax laws of different Member States. In the case of smaller pension institutions involved in cross-border pension provision improvement of information exchange would therefore remain an important step forward for Member States, even if the proposal for pan-European pension institutions would be broadly implemented. Accordingly, both avenues could be exploited at the same time. The Commission invites Member States to explore with it how the proposal for pan-European pension institutions could be made operational.

6. DEALING WITH THE DIVERSITY OF MEMBER STATES' TAX ARRANGEMENTS

6.1. *Introduction*

The differences between the national rules for deductibility of contributions and taxation of benefits may lead to double taxation for migrant workers or persons retiring to another Member State. For example, an employee may work in a Member State which gives only limited relief for pension contributions but retire to a Member State which provides for comparatively full taxation of benefits. Conversely, such differences can also lead to non-taxation. For example, another employee may work in a Member State giving generous relief for contributions and then retire to a Member State which has generous tax arrangements for pension benefits, as noted in chapter 2.3. above.

It should be noted that double taxation is in particular a problem for cross-border labour mobility and retirement. It does not arise from the location of a pension institution in another Member State but from the differences in national tax rules and from the treaty practice of Member States, which mostly follows the OECD Model Tax Convention under which a pensioner is taxable in his country of residence (i.e. retirement) regardless of whether and where his contributions were deducted. Double taxation is an issue wherever the fund is located.

6.2. *Broader acceptance of the EET principle*

As indicated in Chapter 2 Member States apply different pension taxation systems in terms of whether they tax or exempt contributions, investment income and capital

³⁴ In order to prevent double taxation and a restriction of pan-European pension institutions' freedom to provide services, it would be necessary for Member States to ensure that the relevant sections of pan-European pension institutions were exempted from any yield taxes levied by the Member States where they were located.

gains of the pension institution, and benefits. If more Member States were to apply the same system this would help to reduce the double taxation and non-taxation arising from the divergence in their systems.

Eleven Member States have an EET system, three have an ETT system, and two have a TEE system³⁵. This means that in practical terms it is probably easiest to strive for alignment of Member States' pension taxation systems on the basis of the EET principle. Moreover, by providing for a tax deferral on the contributions paid, the EET system encourages the making of retirement provision. The EET system also helps to cope with demographic ageing as it reduces tax revenues today in exchange for higher tax revenues at the time when the demographic dependency ratio will be much more unfavourable.

It should however be emphasised that acceptance of the EET principle by all Member States would not provide a complete solution. Even among EET States there are significant differences under the second pillar in the levels of deductibility of contributions. Such differences reflect not merely the individual preferences of Member States in the design of their tax rules but also more fundamental choices in the structure of their systems of pension provision, in particular the relative size of first and second pillar. As noted in Paragraph 3.4., this will generally have an impact on the total deductible contributions under the second pillar.

The Commission does not therefore envisage proposing legislative measures to harmonise Member States' pension taxation systems. Nevertheless, as alignment of Member States' systems according to the EET principle would help to reduce the mismatches which lead both to double taxation non-taxation, the Commission would welcome its broader acceptance.

6.3. *Dealing with the co-existence of different systems*

Accordingly, it is likely that differences between Member States' systems will remain for the foreseeable future. It is therefore useful to explore practical measures to deal with the co-existence of different systems which can be put in practice in the short term.

If a citizen earns his pension in a TEE State and receives it in an EET State his pension may be subject to double taxation. He is granted no or only limited tax deduction of his contributions while his benefits are taxed. Some Member States have unilaterally introduced provisions to eliminate the double taxation arising in such cases, notably by exempting benefits paid by foreign pension institutions to their residents to the extent that the contributions were not deductible. For example, Denmark and Sweden have provisions of this kind.

It is also possible to eliminate double taxation arising from divergent tax rules on pensions by provisions in double taxation treaties. States could, for example, include a provision stating that pensions arising in State A and paid to a resident of State B may be taxed in State B, but the amount of the pension that would be excluded from taxation in State A if the recipient were a resident of State A shall be exempt from

³⁵

The total adds up to 16, as Germany applies both the EET and the TEE system.

taxation in State B³⁶. The effect of such a provision would be that if a worker retired from a TEE State to an EET State the EET State would not tax his pension, as his pension would have been exempt in his State of origin.

In so far as the application by Member States of divergent tax rules creates unjustified obstacles to the fundamental Treaty freedoms discussed above, those obstacles must be eliminated. Measures for their elimination could include unilateral relief or bilateral solutions. The functioning of bilateral solutions could be enhanced by the introduction of rules to resolve conflicts of interpretation and mechanisms to enable the taxpayer to secure consistent treatment by both authorities concerned. The Commission would be prepared to assist Member States in undertaking a detailed study of existing provisions that could find broader application. Subsequently to this study the appropriate Community framework to further their implementation should be identified. Moreover, a multilateral convention pursuant to Article 293 of the Treaty or co-ordinating measures at Community level could be envisaged.

The differences between national rules can also lead to non-taxation of benefits, notably where a citizen earns his pension in an EET State and collects his benefits in a TEE State. In the absence of more uniform rules some Member States, although in principle favouring residence taxation, have sought to resolve this issue by providing in some treaties for source taxation in circumstances where there would be abnormally low taxation in the State of residence.³⁷

7. CONCLUSION

The Commission considers that discriminatory tax treatment of pension and life assurance policies concluded with pension institutions established in other Member States is contrary to the fundamental freedoms of the EC Treaty. The Commission shall monitor the relevant national rules and take the necessary steps to ensure effective compliance with the fundamental freedoms of the EC Treaty, including bringing the matter before the Court of Justice on the basis of Article 226 of the EC Treaty.

The Commission invites the Council, the European Parliament and the Economic and Social Committee to:

- examine the proposals made in this Communication on the exchange of information with a view to safeguarding the proper application of Member States' tax rules;
- examine the proposal for pan-European pension institutions as reflected in this Communication;
- consider broader application of the EET principle within the European Union;

³⁶ A provision of this kind can be found in the Canada-United States taxation treaty.

³⁷ For example the Netherlands-Portugal treaty provides an exception to residence taxation where the pension is "not taxed at the generally applicable rate for income derived from dependent personal services, or less than 90% of the gross amount of the pension or similar remuneration ... is taxed".

- and examine the measures necessary to eliminate unjustified obstacles to the free movement of workers resulting from the diversity of Member States' occupational pension taxation systems, in particular from double taxation.
