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The cost-effectiveness of pensions and the role of taxation: an emerging European debate

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Introduction

This Working Paper is part of a collaborative research project carried out between October 2012 and February 2013 by the European Social Observatory (OSE) and EURELPRO with a view to sharing the results with the wider research community and the stakeholders in the field of pensions ([1]). The present essay sheds light on three dimensions that are key in the European debate on the taxation of pensions. First we refer to the EU governance on economic and social policy and the way pension policy is framed within it. Second we look at taxation, a theme that has attracted increased attention, especially in relation to social and pensions policy. The European Commission asserts that to assess the efficacy of the European welfare states it is essential to consider both the expenditure and the revenue side of social and employment policies (EC, 2013a). Third we shed light on the most recent and emerging issues: the need for growth-friendly taxes in the context of economic stagnation; the launch of the Social Investment paradigm; and the case of pension schemes for liberal professions. This last issue is placed at the crossroads of the EU debate on mainstream social policy, taxation and the need to establish more growth-friendly framework conditions for the self- employed.

Given the pressure on public finances, pensions have increasingly become a subject of common concern at the EU level in the attempt to address long-term costs for state budgets (Europe2020 and White paper on pensions). To ensure cost developments that are in line with productivity, Member States are required to look at structural reforms, including the reform of pensions systems and fiscal policies that promote labour (EuroPlusPact). In line with a growing EU competence on social policy, notably the role assumed by the European Commission in the European Semester, the question of efficient social spending and the cost-effectiveness of pensions has long been a common concern at the EU level, which imposes itself on national pension reforms.

In the last years, the focus of the EU has largely broadened through the parallel reference to pension spending (cost containment and the provision of adequate protection against old-age risks) and revenues. As for the latter, there has been a growing interest in the consequences of the economic and financial crisis for a fairer distribution of the responsibilities for financing the system.

The issue of tax is also 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

1. The results were presented during an international conference organised by EURELPRO on 25 February 2013.

attain an adequate level of pension benefits; 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 services or consumption (using e.g. FTT, VAT or other consumption taxes). All this should be done where possible 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.

As stressed above, while our analysis will provide a summary of the EU governance on both pension spending and revenues, we will also refer to the case of widening participation in social protection, social investment and social innovation through autonomous and self-managed social security institutions for specific occupational groups. We will take Italy as an example. In countries most hit by the crisis, the potential role of these pension schemes in terms of efficiency gains is of interest to the European debate on efficient social spending and the role of taxation. In several EU countries, self-managed pension institutions for certain professions are entrusted by law with the management of pensions and the coverage of various social risks for their members. They are created by a legal act at national level that establishes their operating and governance rules according to the national social laws, traditions and practices. They are technically responsible (self-managed) and financially autonomous—namely, they do not depend on state budgets. As compulsory pension schemes, they are subject to public control by the competent authorities in their countries.

In the next pages, Section 1 analyses four key elements of the current system of governance: the Stability and Growth Pact (set up in 1997, reformed first in 2005 and then again in 2011, by means of the Six Pack); Europe 2020 (the long-term strategy for a smart, sustainable and inclusive growth); the European Semester (a key part, since 2011, of the procedure for coordinating budgetary policy, macroeconomic policy and structural reforms); and finally the Euro Plus Pact (which aims at improving the growth potential of the signatory member states). Having described this general system of governance, we then examine the issue of taxation from three angles (Section 2). We consider first the coexistence of different taxation regimes and their impact on pensions, taxation on financial transactions, and the possibility of taxing added value in financial services. Our aim is to highlight the potential impact of these fiscal measures on pensions schemes. In Section 3, we look at the most recent pensions and taxation issues in the EU debate. We describe some of the insights into national concerns and practices that we gathered at an *ad hoc* roundtable discussion with representatives from different groups of the pension sector ([2]). While in the previous sections we have concentrated on a mere description of the existing European framework related to pensions and taxations, this section proposes new considerations.

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2. "Emerging challenges in the impact of taxes on pensions. What happens in the EU today and what developments are likely for the Future", Preparatory Workshops 26 November 2012, European Economic and Social Committee.

We invite readers to look at the subsidiary role of professional pension schemes in aligning cost-effectiveness with productivity and take Italy as an example. Section 4 concludes with a brief summary of the points to be addressed through the debate both at European and national level.

1. Pensions in the economic and social governance of the EU

1.1 The Stability and Growth Pact and the Six Pack

The **Stability and Growth Pact (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: government debt below 60% of GDP, a government deficit below 3% of GDP and an inflation rate that 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 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 to update them regularly. These programmes are then used by the Council to monitor budgetary headings and to coordinate economic policies. On the basis of a Commission recommendation, and having consulted the Economic and Financial Committee, the 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 achieve 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. This highlighted one of the main criticisms levelled at the Stability Pact: that in times of low growth, the Pact could aggravate the situation by preventing states from taking budgetary measures to revive the economy if it 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 on 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 to reform 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 eurozone 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 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 up 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 spelled out in the **10 guidelines** ([3]) 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

3. 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.

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, that of helping to achieve an adequate level of pensions. Defining *pension adequacy* is clearly more controversial than defining *pension sustainability*. While the definition of *sustainability* implies the notion of actuarial fairness, there is no such straightforward reference point for the concept of *adequacy*. A pension system should provide a solution to a central problem: the falling earning power of the ageing individual. A consensus seems to be emerging that a pension system needs to reflect the need to both keep individuals out of poverty and allow them to maintain previous living standards. The World Bank report on pension reforms defined *pension adequacy* as a system that provides benefits to the full population sufficient to prevent old-age poverty on a country-specific absolute level, in addition to providing a reliable means to smooth lifetime consumption for the vast majority of the population (Holzmann and Hinz, 2005, Draxler and Mortensen, 2009). Similarly, the Laeken summit (2001), which fixed eleven objectives for pension systems ranging from financial sustainability to modernisation, mentioned two that specifically referred to adequacy. Pension systems should ensure that older people are not placed at risk of poverty and can enjoy a decent standard of living, and they should enable people to maintain, to a reasonable degree, their living standards after retirement. A further requirement called for pension systems to promote solidarity within and between generations (European Commission, 2003). The goals of pension systems as defined by both institutions display a multidimensional approach to pension system adequacy. They focus primarily on the level of pension benefits, but they also stress the necessity of providing instruments for the allocation of income over the lifecycle, as well as the necessary solidarity, not just within generations, but also between them (Chybalski, 2012). 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).

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 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 growth-enhancing and since they are often financed by wage deductions and taxation. The strategy strengthens the link between pension and employment policies, with adequate pensions seen as the outcome of greater participation in the labour market over an individual'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 as required by differing views 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 that allow people to work for longer (Willert 2012). The issue of pension taxation 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).

1.3 European Semester and Annual Growth Surveys

Many medium and long-term measures have been taken in recent years to re-launch 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 the 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 eurozone and non-eurozone 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 the successful implementation of 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;
- aligning the retirement age with life expectancy;
- finding a way to combat the risks of poverty affecting retired people (EC, 2011b).

As shown below in Section 3, the Annex 'Growth-friendly tax policies in member States and better tax coordination in the EU' to the Annual Growth Survey 2012 did directly focus on taxation as a key element for strengthened economic governance.

1.4 The Euro Plus Pact

With the Euro Plus Pact, adopted by 23 heads of state and governments (the EU27 minus the United Kingdom, Sweden, Hungary and the Czech Republic) 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 that 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: the 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 the reduction of 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 (dimension (b)). The Pact also stresses the need for fiscal reforms that would, for example, make it possible to lower taxes on labour to make work pay, while preserving overall tax revenues (dimension (d)).

2. Pensions and the impact of taxation

Having described the main elements of EU social and economic governance and its messages on pensions policy (with a growing emphasis on taxation), we shall now analyse tax issues, which could have a considerable impact on pensions and which lie at the heart of current discussions. As stressed above, this issue is of growing importance in the EU debate. One of the key elements of the EU Commission's White Paper on adequate and sustainable pensions in Europe is promoting complementary pension savings to assure adequate pension benefits for an increasingly ageing population. The cost-effectiveness of pensions also becomes a crucial challenge in periods of budget consolidation and austerity. To ensure budget consolidation that is conducive to growth, Member States look at tax revenues generally but also at reliefs from taxation and tax expenditure. Looking at social and employment policies, the more traditional focus on expenditures has to be

paralleled by that on revenues. In line with the Annual Growth Survey (the Annex on 'growth-friendly' tax policies), we refer to some key policy dimensions that are of interest here: the coordination of different tax regimes, taxation of the financial sector, and value added taxation. It is widely accepted that tax measures will increasingly play a fundamental role in setting incentives or disincentives for preferred social objectives.

2.1 The design of tax rules for pensions

Two normative principles govern the design of tax rules for pension provision: **the correspondence principle**, which means income is taxed either when earned (comprehensive income tax) or when spent (expenditure tax) and **the principle of neutrality** in relation to present and future consumption, statutory or private pension saving, domestic or international investment. On the other hand, taxation is not just a means of raising revenue but is also used as a policy instrument, a way of steering behaviour.

Pensions can be taxed at different stages: 1) savings for pensions or pension contribution, 2) investment process and return on investment (accrual of capital), and 3) retirement income. This gives rise to various options for the design of tax incentives through tax allowances and subsidies, exemption from tax in the interest of efficiency, the increase of pension saving, equity, and fairness.

According to the different approaches to how tax is applied, in the early stages of accumulation, investment (as far as taxation on investment returns is concerned), and provision of pensions, the fiscal impact is divided into three main categories:

- EET (Exempt-Exempt-Taxed): contributions and returns are exempt during the period of accumulation, but the distribution is taxed;
- ETT (Exempt-Taxed-Taxed): the taxation of contributions occurs when distributing the returns, as in the previous model, while the taxation of returns occurs in the accumulation phase;
- TTE (Taxed-Taxed-Exempt): the contributions and the returns are taxed at the time of accumulation, allowing exemption on distribution.

2.2 European issues related to the coexistence of different tax regimes

Most Member States have the EET system, which exempts contributions and capital gains but taxes benefits ([4]). The ETT system (Sweden, Italy and Denmark) exempts contributions but taxes capital gains and benefits. The TEE System (Hungary, Luxembourg and Poland) taxes

4. This section is largely inspired by the report drafted in 2011 by OSE and the University of Milan for the European Commission, DG Employment on "Scope of the coordination system in pension field", http://www.ose.be/files/publication/2011/OSE_2011_ScopeCoordinationPensionField_FinalReport.pdf

contributions but exempts capital gains and benefits. Differences between Member States can lead to double taxation, (if an employee is working in a TEE state and retires to an EET State) or non-taxation (if an employee works in an EET State and retires to a TEE State) (Schonewille, 2007).

Table 1 Taxation regimes across the EU-27

Country	***Pension taxation system***	***Discrimination regarding tax treatment of cross-border payments***
Belgium	EET	The taxation of outbound transfers was condemned by ECJ in *Commission v/ Belgium* (C-522/04). Discrimination abolished in 2007 on 1st January.
Bulgaria	EET	No info
Czech Republic	No second pillar	No
Denmark	ETT	Non tax deductibility on pension contributions paid to foreign funds was condemned by ECJ in *Commission V/Denmark* (C-150/04).
Sweden	ETT	Non tax deductibility of contributions paid to foreign pension providers was condemned by ECJ in *Skandia* (C-422/04). Discrimination abolished in 2007 on 2nd February.
Estonia	EET	Abolished in 2007
Greece	No second pillar	No
Spain	EET	No
France	EET	No
Italy	ETT	No
Cyprus	EET	No info
Latvia	EET	No
Lithuania	EET	No
Ireland	EET	No
Luxembourg	TEE	No
Hungary	TEE (claims to have no second pillar)	No
Malta	No second pillar	No
Netherlands	EET	No
Austria	EET	No
Poland	TEE (claims to have no second pillar)	No info
Portugal	EET	No
Romania	EET	No info
Slovenia	EET	No
Slovakia	EET	No info
Finland	EET	No
Germany	EET/TEE	No
UK	EET	No

Source: Schonewille (2007) completed by OSE (2013)

In the past, many advocated wider application of the EET principle within the European Union for three main reasons ([5]). First, most Member States use it already; second, the tax deferral on contributions encourages retirement provision; and third, it helps to cope with ageing by reducing tax revenues today in exchange for higher tax revenues once the demographic situation has become less favourable (Schonewille, 2003). But it must be stressed that the EET systems vary widely among the different states with respect to conditions of tax deductibility. Progress in this field has failed because Member States fear a loss of tax revenue.

The coexistence of different taxation regimes has four main negative consequences:

1. The different fiscal arrangements regulating supplementary pensions across the EU represent the principal **barrier to the transferability of pension rights and to freedom of movement for workers**. This is a major issue, especially in terms of cross-border transferability ([6])."Lack of transferability of pension rights within the EU arises principally because of unequal taxation regulations and discriminatory taxation practices" (Hennion, 2010). This implies the need for an initiative to deal with the fiscal aspects of transferability of pension rights, addressing in particular the following three main problems: double taxation for workers moving between Member States because of different tax exemption and payment systems; taxes on transfers of accrued capital across borders but not within Member States; and discriminatory rules such as taxation on contributions paid into an occupational pension scheme in another Member State, which create obstacles for cross-border affiliation of occupational pension schemes ([7]).
2. **Tax neutrality with respect to premia**: many Member States did not allow tax deduction of pension contributions paid to a pension fund in another Member State, thereby sealing off their national pensions markets from competition from other Member States and creating major obstacles to pan-European funds and to the free movement of workers (Esposito and Mum, 2004). Tax obstacles to the realisation of cross-border pension contributions are being gradually removed

5. CEC (2001), 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, COM(2001) 214.
6. That view was endorsed by the report of the working group of experts looking at transferability of pension rights within the Pensions Forum, which acknowledged that "tax issues are the most important obstacle to cross-border transfers", UEAPM (2009).
7. UEAPM (2002), Response to the first Commission consultation of the social partners on the portability of supplementary pension rights, www.ueapme.com/docs/pos.../Position%20UEAPME%20200802e.doc

- in October 2002, the European Court of Justice ruled in the ***Danner*** case ([8]) that the Finnish authorities were wrong to impose income tax deductions on contributions to a pension insurance scheme established in Germany;
- in ***Skandia*** ([9]), the Court ruled against the Swedish tax authorities for refusing deduction of contributions paid to foreign pension providers. Sweden eliminated the restriction condemned by the Court but introduced a new restriction. It was then referred to the Court by the Commission in 2006. In reaction to the ruling against Denmark (see below), Sweden announced that it would comply with the ruling with a retroactive effect to 2nd February 2007;
- the European Commission achieved a court ruling against **Belgium** ([10]) to prevent the taxation of capital transfers from a Belgian pension fund to a fund in another Member State. The ECJ agreed with the Commission on all accounts, and Belgium did not defend itself because it had already extended the tax exemption to transfers to pension funds and insurance undertakings elsewhere in the EEA from 1st January 2007;
- in ***Commission v Kingdom of Denmark*** ([11]), the Court required the Danish tax authorities to amend their legislation so that contributions to foreign-based pension funds would be given full tax deductibility in line with contributions made to domestic funds.

In practice, the overwhelming majority of Member States with EET or ETT systems now also allow tax deductibility of such cross-border payments. The focus must now shift to any discrimination concerning the cross-border transfer of pension capital. In some Member States domestic transfers are tax exempt, whereas cross-border transfers are taxed or forbidden (Stevens, 2011).

3. **Dividends and interests paid to foreign pension funds**: before the implementation of the IORP Directive and the drafting of the Pension Taxation Communication of April 2001, there was widespread discrimination against foreign pension funds with respect to corporate taxation. The European Federation for Retirement Provision (EFRP) and PricewaterhouseCoopers lodged 26 complaints with the Commission in December 2005 against 18 Member States, aimed at ending their discrimination against non-resident European Economic Area (EEA) pension funds concerning the taxation of dividends and interest. In the vast majority of cases, domestic funds are taxed on a net basis (or are even exempt), whereas foreign ones are taxed on a gross basis. The Commission agreed that this practice breaches EU rules on the free movement of capital (EFRP, 2009a, 2009b).

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8. ECJ, 3 January 2002, *Danner*, C-136/00, ECR I-8147.
9. ECJ, 26 June 2003, Skandia, C-422/01, ECRR I-6817.
10. ECJ, 5 July 2007, Commission v Kingdom of Belgium, C-522/04, ECR I-5701.
11. ECJ, 30 January 2007, *Commission v Kingdom of Denmark*, C-150/04, ECR I-1163.

4. The difficulty of **transferring pension capital** across borders, attracting unjustified tax liabilities: in certain cases discrimination is obvious, as in whena Member State taxes the value of the pension capital upon cross-border transfer when it would not tax a transfer within its own territory. In other cases, transfers are being prohibited due to different rules governing the pay-out phase. In fact, according to the Federation of Dutch Pension Funds (2011), transferring pension rights to and from the Netherlands has become more difficult in recent years. Transferring pension rights to, for example, a British Superannuation Scheme has been prohibited since 2007 because of a larger possibility that an individual in the UK might receive part of his or her pension benefit in the form of a lump sum.

2.3 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 a perceived need to compensate the government support given to the sector. Furthermore, it is widely held that financial services are under-taxed in comparison with other segments of the economy, since financial activities are generally exempt from VAT—although this is offset to some extent through the non-recoverability of input VAT, which is borne as a cost by financial institutions. The taxes considered include most significantly a financial activities tax ([12]) (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, including 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. The definition of financial institutions is broad and essentially includes investment firms, organised markets, credit institutions, insurance and reinsurance undertakings, collective investment undertakings and their managers, pension funds and their managers, holding companies, financial leasing companies, special purpose entities, and where possible it refers to the definitions provided

12. 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.

by the relevant EU legislation adopted for regulatory purposes. Additionally other persons carrying out certain significant financial activities should be considered financial institutions ([13]).

Day to day activities such as payment services and mortgages would 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 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 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), whose arguments are put forward by APG ([14]), 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 retirees 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 that has already affected their income. Pension funds and Institutions for Occupational Retirement Provision (IORPs) would be taxed to offset the costs of a

13. Article 2 (7): 'Financial institution' means any of the following:(a) an investment firm as defined in Article 4 of Directive 2004/39/EC; (b) a regulated market as defined in Article 4 of Directive 2004/39/EC and any other organised trade venue or platform; (c) a credit institution as defined in Article 4 of Directive 2006/48/EC; (d) an insurance and reinsurance undertaking as defined in Article 13 of Directive 2009/138/EC of the European Parliament and the Council; (e) an undertaking for collective investments in transferable securities (UCITS) as defined in Article 1 of Directive 2009/65/EC and a management company as defined in Article 2 of Directive 2009/65/EC; (f) a pension fund or an institution for occupational retirement provision as defined in Article 6(a) of Directive 2003/41/EC of the European Parliament and the Council, an investment manager of such fund or institution; (g) an alternative investment fund (AIF) and an alternative investment fund manager (AIFM) as defined in Article 4 of Directive 2011/61/EU; (h) a securitisation special purpose entity as defined in Article 4 of Directive 2006/48/EC; (i) a special purpose vehicle as defined in Article 13(26) of Directive 2009/138/EC; (j) any other undertaking carrying out one or more of the following activities, in case these activities constitute a significant part of its overall activity, in terms of volume or value of financial transactions: (i) activities referred to in points 1, 2, 3, 6 of Annex I of Directive 2006/48/EC; ii) trading for own account or for account of customers with respect to any financial instrument; (iii) acquisition of holdings in undertakings; (iv) participation in or issuance of financial instruments; (v) the provision of services related to activities referred to in point (iv).
14. 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

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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, claim proponents of the FTT, 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 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. The FTT could reduce the chain of financial intermediaries, the cost of which is passed on to workers' savings and pensions (Botsch, 2012).

The European Parliament declared in a legislative resolution adopted on 23 May 2012 that 'a **pension fund or institution for occupational retirement provision ([15]) shall not be**

15. The Parliament referred to 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, where IORPs are defined as 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.

considered a financial institution for the purposes of this Directive until the review of this Directive pursuant to Article 16' (EP, 2012). This resolution, however, has been overhauled by subsequent events (see below).

During the meetings of the Economic and Financial Affairs Council (ECOFIN) of June and July 2012, it became clear that there would be no unanimous support within the 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 had 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. The Commission assessed these requests against the criteria for enhanced cooperation in the Treaties. In particular, it concluded that enhanced cooperation on the FTT would in the view of the Commission not have a negative impact on the Single Market or on the obligations, rights and competences of non-participating Member States.

On the basis of that assessment, in October 2012, the Commission proposed a decision to allow enhanced cooperation on the FTT (EC, 2012b). This was backed by the European Parliament in December and agreed to by European Finance Ministers at the ECOFIN on 22nd January 2013 ([16]).

The details of the Financial Transaction Tax to be implemented under enhanced cooperation have been set out in a proposal adopted by the Commission on 14th February (EC, 2013). As requested by the 11 Member States that will proceed with this tax, the proposed Directive mirrors the scope and objectives of the original FTT proposal. The approach of taxing all transactions with an established link to the FTT-zone is maintained, as are the rates of 0.1% for shares and bonds and 0.01% for derivatives. There are certain limited changes in the current FTT proposal compared to the original one, to take into account the fact that the tax will be implemented on a smaller geographical scale than originally foreseen.

As in the original proposal, the FTT will have low rates, a wide base and safety nets against the relocation of the financial sector. As before, the "residence principle" will apply. This means that the tax will be due if any party to the transaction is established in a participating Member State, regardless of where the transaction takes place. This is the case both if a financial institution

16. Council of the European Union, "Financial transaction tax : Council agrees to enhanced cooperation", Press Release 5555/13, Brussels, 22 January 2013.

engaged in the transaction is itself established in the FTT-zone, or if it is acting on behalf of a party established in that jurisdiction.

As a further safeguard against avoidance of the tax, the proposal adds the "issuance principle," meaning that financial instruments issued in the 11 Member States will be taxed when traded, even if those trading them are not established within the FTT-zone. Furthermore, explicit anti-abuse provisions are now included.

In order to protect the real economy, the FTT will not apply to day-to-day financial activities of citizens and businesses (loans, payments, insurance, deposits etc.). Nor will it apply to the traditional investment banking activities in the context of the raising of capital or to financial transactions carried out as part restructuring operations. Transactions with central banks and the ECB, with the European Financial Stability Facility and with the European Stability Mechanism, as well as transactions with the European Union, will be exempted from the tax.

The proposed Directive will now be discussed by Member States, with a view to its implementation under enhanced cooperation. All 27 Member States may participate in the discussions on this proposal. However, only the Member States participating in enhanced cooperation will have a vote, and they must agree unanimously before it can be implemented. Since the arrangements under the enforced enhanced cooperation procedure are subject to international law, the European Parliament is only being consulted.

Current discussions between the 11 participating Member States are very fluid and technical agreement seems still a long way off. There is, however, continued impetus from the Commission and certain Member States (FR, DE) to deliver something. In any event, it is clear that non-participating Member States (UK) will challenge the project in CJEU. In the meantime discussions continue at the technical level, item-by-item. It looks like technical agreement can only be reached by restricting the scope. At this stage it is not clear what this will look like.

2.4 The taxation of added value (VAT) in financial services

Since the adoption of the 6th VAT Directive in 1977, financial services, including insurance services and investment funds, have generally been 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 uncertainty about the legislators' reasons, as it gives the option to Member States to choose to apply tax to the services. At the moment, Member States do not uniformly apply this exemption, and the 1977 legislation is often difficult to apply in today´s more complex financial markets, 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 proposal for a directive

to modernise and simplify the complex rules applicable to VAT on financial and insurance services, in order to ensure equitable VAT treatment of these services in a pan-European market. The Commission had hoped to provide greater legal certainty for Member States, insurance companies, and financial institutions (EC, 2007a) with the aid of a draft regulation extending the definitions of the exempted services and directly applicable in all Member States (EC, 2007b). Legislative progress has been slow, although in November 2010, the Council adopted some general guidelines in an attempt to direct work in this area. But this measure produced no real progress. Moreover, Member States had earlier indicated their lack of support for any move to reduce non-deductible VAT by extending the taxation option or clarifying the existing system to exempt shared costs because they feared tax revenue losses (Council of the European Union, 2010c).

The management of special investment funds (a term whose precise definition is left for Member States to decide, but which can include certain pension funds) is 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 their costs low, ensuring that small-scale investors or savers are not treated unfavourably.

The Commission nevertheless feels that the VAT exemption generally results in preferential treatment of the financial sector compared to other sectors of the economy, as well as distorting prices. This was a reason 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 VAT paid on goods and services acquired by the financial institutions cannot usually be recovered. Only the costs of outsourced management services for certain investment and pension funds may be exempted from VAT.

Member States have some scope to determine which funds shall benefit from this exemption, but this is subject to the principle of neutrality and fair competition. Some interpret the exception in broad terms, whereas others are more restrictive and exclude certain categories of pension fund (Frehen and van Kasteren, 2007). In the Council discussions, most delegations supported equal VAT treatment of both these types of funds to avoid possible distortions of competition and to avoid unnecessary burdens. However, a few Member States argued against changing the 1977 legislation on the grounds that many pension funds are by their very nature different from investment funds, and in their view the existing exemption should not be broadened. These differences reflect the current practices and 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), notwithstanding that the complexity of the industry would make this difficult to ensure. 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 reflects the entrenched positions of Member States. Legislative reform here is unlikely in the foreseeable future.

Given the failures of discussions in the Council, it was inevitable that questions on the VAT treatment of pension funds would present themselves to the Court of Justice of the European Union. Two recent such cases before the Court were *Wheels Common Investment Fund Trustees* and *PPG Holding* ([17]). The *Wheels* case was brought to the Court in 2008 by the UK's National Association of Pension Funds and Wheels Common Investment, following an earlier Court judgement that effectively broadened the categories of investment trusts that were to be considered as special investment funds and that should accordingly be exempt from VAT on investment management services ([18]). Wheels and the NAPF claimed that defined benefit pension schemes should be eligible for this exemption, largely on the grounds that defined contribution schemes were already exempted.

The Commission supported the narrow interpretation of the UK administration, sustaining this view in its final judgment and finding that defined benefit schemes are not entitled to the benefit of this particular exemption. The Court said that a defined benefit pension scheme was not sufficiently comparable to a collective investment undertaking within the meaning of the UCITS Directive because it was not open to the public. The decision of the court in *Wheels* should, however, result in a more uniform application of the exemption in all Member States. Indeed, the economic consequences of this decision for pension funds in some Member States are likely to be far greater than those which could result from the introduction of a Financial Transaction Tax.

In *PPG Holdings* ([19]) an employer had sought to recover VAT incurred in relation to services obtained in relation to a pension fund operated for the benefit of its employees. The Court held that the management fees paid by PPG fell into its general overheads and as such permitted deduction of VAT. It is likely that the Court will have to deal with further challenges to the VAT treatment around pension funds in the near future.

17. C-424/11 *Wheels Common Investment Fund Trustees;* C-26/12 *PPG Holding.*
18. CJEU, judgement of 28 June 2007, *JP Morgan Fleming Claverhouse Investment Trust and The Association of Investment Trust Companies*, C-363/05, Rec. p. I-5517.
19. Case C-26/12 *Fiscalle eenheid PPG Holdings BV v Belastingdienst.*

3. Pensions and efficient social spending – Emerging challenges

In the previous sections we have summarized key aspects of the economic and social governance of the EU (which touch pensions and taxation in many respects) and the more traditional issues of taxation in the EU debate. The present section focuses on the most recent themes at the core of the EU discussion. These are the most evident emerging challenges at the top of the agenda.

3.1 Consolidation of public finances and the role of taxation

As stressed above, the European Semester has dedicated much attention to tax policy. In particular, 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 (EC, 2011C), which is also particularly important for the Euro Plus Pact. For the Commission, in order 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, while remembering that Member States may have to increase taxes. The report 'Tax reforms in EU Member States 2011', which examines how to make tax structures more growth-friendly, suggests that some Member States could promote economic growth by shifting the tax burden from labour (personal income tax and social security contributions) onto other sources. 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). Such a shift, however, risks regressive consequences with the result that the already disadvantaged will face greater difficulties in saving for the future.

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, as 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. Such a restriction on VAT exemptions could of course have consequences for pensions – any re-visiting of the exemptions would inevitably put existing treatment of pensions into question.
- Greater efforts should be made to shift taxation away from labour towards taxation that 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.
- Member States should coordinate their efforts through enhanced dialogue at the EU level. Progress should be made on the proposals announced by the Commission in its Annual

Growth Survey – for a common consolidated corporate tax base, a financial transaction tax, and for energy taxation (EC, 2011c).

3.2 The social investment paradigm: new considerations

One of the main innovations in the EU economic and social governance has consisted in the articulation of a new paradigm for inclusive growth. Last documents from the Commission have clearly stressed the need to 'modernise social policies to optimise their effectiveness and efficiency and the way they are financed' (EC, 2013b). The efforts demanded by the EU can be summarised in the label 'Social investment'. The latter involves strengthening people's current and future capacities with a great potential for economic and social returns in terms of employment and labour incomes. In 2012 and 2013 the EU has reinforced its 'social dimension' through the launch of new 'social' packages aimed at coordinating Member States in the modernisation of social and employment policies: the Employment Package for a job-rich recovery, the Youth Employment Package with the aim to activate young people, and the Social Investment package to shape European welfare states towards a more effective, adequate and sustainable social protection systems ([20]).

The 'Employment and Social developments in Europe, 2012' (EC, 2012c) sheds light on the social investment paradigm. In this paradigm, employment, social protection and social inclusion policies are seen as an investment for the future, leading to greater employment and social participation, as well as social cohesion and stability while at the same time acknowledging their key role as a productive factor. In this respect, the social investment approach puts emphasis on the long-term benefits for society of current policies and stresses a life cycle approach for the individuals. As stressed in the literature, the focus is on public policies that 'prepare' individuals, families and societies to adapt to various transformations, such as changing career patterns and working conditions, and the emergence of new social risks, such as population ageing, rather than simply generating responses to 'repair' damages caused by market failure, social misfortune, poor health or prevailing policy inadequacies (ibidem, 174). While the Social Investment approach relates in particular to education, child care, social inclusion and active labour market policies, it has also to do with pensions. For those concerned with pension reforms, investment into education, training and new skills for new jobs needs to be seen as an integrated part of it (Hemerijck). Labour participation at all ages is a means of achieving social cohesion and economic competitiveness. A core element is thus the implementation of active labour market policies (ALMPs), in which, for example, non-employed individuals are provided with education and training, as well as active ageing policies, where older workers are encouraged and provided opportunities to stay longer on

20. The White Paper on pensions is a further element of the renewed impulse for the modernization of social and employment policies.

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the labour market. Such policies facilitate integration into the labour market, minimise long-term unemployment and decrease the loss of productive human capital (ibidem, 176-77).

A second key dimension of the new paradigm has to do with so-called efficient social policy: efficiency is related to the capacity of the Member States to prevent and/or reduce poverty by providing the population with social protection benefits and whether they do so in an efficient way. As for activation, from the labour-market point of view, efficient social policy must be employment-friendly.

In all this, reforms must focus on making efficiency gains, paying attention that reforms are well designed in order to avoid negative repercussions on poverty levels, productivity, economic growth and social cohesion. EU comparative data shows countries with similar levels of expenditure achieve very different results in terms of both social (poverty reduction) and economic (stabilization) outcomes. Thus investing in efficiency gains, and a more efficient structure and design of social expenditure all matter for the performance of welfare systems. Improving effectiveness of social transfers and assistance systems, ensuring access to quality services and prolonging working lives are all priorities set by the Commission (EC, 2013b: 5-6).

For pensions this means both public and private providers must follow innovative approaches to financing and management allowing for budgetary savings without affecting the benefit and services level. Here again the link between expenditures and revenues: efficiency must relate to both.

All this is related to taxation. In the following we give some insights into national debates that we gained at a workshop with different stakeholders from the pension sector ([21]). In many countries policymakers and stakeholders are discussing the right way to tax pension schemes in order not to discourage pension funds and to safeguard the pension rights of the insured. In some countries EET is being supported/promoted as the most neutral model of taxation. See the case of Germany where a transition period was agreed on in 2005.

The consistency between the taxation rules applied to first- and second- pillar pension schemes is also an issue. Here the fundamental role of pension schemes and their role in providing adequate resources for their members is equally valid.

A third issue is that of the level of taxation on pensioners compared to that applied to workers and active citizens in general. This is the case of Portugal, where in a few years (especially since the

21. Expert roundtable organized by EURELPRO on 26 November 2012 in Brussels "A stocktaking exercise on the impact of taxation on pensions".

recent economic crisis) the relative positions of the active and inactive population have been reversed. While before the crisis pensioners enjoyed a favourable position (paying lower taxes than workers), they have since the recession been forced to contribute as much as the active part of the population and in some cases even more. This may have an impact on inter-generational equality and the broad fairness of taxation.

A fourth dimension is related to the issue of taxing financial institutions to contribute to the general effort for economic recovery, while avoiding the shift of such a burden from financial institutions to the final consumer.

A fifth dimension is the coordination of fiscal regimes and the need to improve mobility across the EU. As already mentioned, the different fiscal arrangements regulating supplementary pensions across the EU represent the principal barrier to the transferability of pension rights and therefore to freedom of movement for workers. This is a major issue, especially in terms of cross-border transferability and the double taxation for workers moving between Member States, which this results in some workers being taxed on both contributions and benefits).

Exempting old age insurance or savings contributions from the income tax base should not be seen as "tax expenditure" or even a "tax gift", but as a deferral of taxation to a later cycle in life when income is created. In addition, this solution will certainly help to maintain the long term sustainability of public finances

While taxation is crucial in this debate, we also emphasized another crucial dimension of the social investment paradigm: the "supplier" side (Hemerijck) ([22]). This means that public policies must also focus on ensuring the financial and political sustainability of the welfare state by upholding a productive, knowledge-based economy while ensuring social resilience ([23]). In the creation of value through knowledge-based growth, the competitiveness of the economy reaps significant benefits from the strong performance of liberal professions who work on the basis of highly specialized knowledge and skills ([24]).

22. Anton Hemerijck is professor at the Free University Amsterdam and member of the advisory group to the European Commission on Social Investment.
23. See OSE- Opinion Paper N°5 "The EU needs a Social Investment Pact" Vandenbroucke, F., Hemerijck, A.,Pallier, B. (2011),
24. "Liberal Professions are those practiced on the basis of relevant professional qualifications in a personal, responsible and professionally independent capacity by those providing intellectual and conceptual services in the interest of the client and the public." Directive 2005/36/CE.

3.3 The subsidiary role of professional pension institutions – the case in Italy

The potential role of pension schemes for liberal professions in a modernised welfare state has also attracted some interest at the EU level. Among the documents published by the EU, the 'Entrepreneurship 2020 Action Plan' has been indicative of the key role of entrepreneurship, including liberal professions, in bringing Europe back to growth and higher levels of employment (EC, 2013c). One of the issues here is related to social rights and obligations for the small entrepreneurs as well as easier access to micro-credits and finance. The legal frameworks for the social security of self-employed persons differ substantially from those of the employed, creating additional barriers to entrepreneurs. Support for new businesses and the people behind them is particularly important in helping them become economically independent. Welfare bridges can also help transitions from unemployment to self-employment. Therefore, Member States should explore the possibility of giving benefits to the self-employed (e.g. health, retirement, disability, unemployment benefit in case of business closure/bankruptcy) that are comparable to but do not reduce the benefits for employed workers. As for social contributions and taxation, the Commission has also stressed the importance of introducing reforms in payment schedules for social contributions for a limited time based on the specific situation of the firm and sound justifications. Moreover, the need is stressed to make the national tax administration environment more favourable to early stage business (e.g. to reduce the cost of tax compliance) and to promote tax coordination to ensure that inconsistencies in tax treatment do not lead to double taxation or other harmful tax practices (ibidem, 13-14).

Liberal professions are not immune to the effects of the crisis or to new social risks related to low income and precariousness as a result of a fragmented career, with periods of unemployment and inactivity. Pension institutions for liberal professions can have a key role in contributing social protection and enhancing the opportunities for growth by fostering a more business-friendly environment. This potential is very much related to many of the issues presented in the previous sections ([25]). It is quite evident that the economic environment for liberal professions has also changed through the crisis, particularly for young professional entrepreneurs. In Italy, the role that social security institutions for liberal professions play in providing welfare for their members is currently high on the political agenda. According to a survey carried out by Acta, the Italian knowledge workers' trade union, 30% of professionals earn less than 1000 euro per month and 15% of young professionals are looking for another job. Having the status of a professional entrepreneur is clearly no longer a protection against the precariousness of the labour market. Moreover, the number of graduates deciding to enter a profession decreased by 7.5% in 2011.

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25. This section is also inspired by the workshop organized by EURELPRO.

ADEPP, the national association for social security institutions for professions ([26]) and other representatives of the Italian professionals have attracted the attention of politicians and public opinion to their employment conditions, their difficulties, and the consequences for their pension schemes. They emphasize the technological and economic challenges affecting professionals and the new welfare needs of this important sector of the economy.

The fiscal burden of the Italian social security system is another concern. From 1 January 2012, the tax legislation regarding private professional social protection schemes provides that deductions, substitute tax on interests, premiums and all other returns are taxed at 20%. This makes the Italian system one of the most onerous in Europe ([27]).

"In Italy Social Security Institutions for Liberal Professions - although they are non-profit schemes - are burdened by double taxation and also by discrimination compared with Complementary Pension Funds: property incomes are burdened by a 27,5% tax rate, in addition to other taxes (IMU); financial incomes pays taxes equal to 20%, instead of 11% (on a net value) of Complementary Pension Funds. At the same time, the Italian retiree pays a progressive tax on pensions, from 23% to 43%" ([28]).

The payment of hundreds of millions of euro each year to the state by non-profit organizations places the Italian professionals in a clear and unfair disadvantage to their European counterparts. In just three years, taxes have doubled, taking resources away from social security and services to professionals and reducing the amount of capital available to guarantee the viability of institutions and the solidarity between generations.

Social security institutions for liberal professions are to be considered a key part of the modernized welfare state. Such schemes should consist of more than just accountants managing their members' contributions. They can invest, thus boosting the development of employment and growth in the country and safeguarding the interests of their members. An integrated study taking into account the economic cycles, life expectancy, the entire life-cycle, and future benefits must be put on the government's agenda. Furthermore, the private professional schemes may play an important subsidiary role in assisting the entire career of a professional by taking adequate measures regarding health care, services, access to credit, and policies for young people (Camporese) ([29]).

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26. ADEPP, http://www.adepp.info
27. Isidoro Trovato, « Previdenza Casse all'attacco : più autonomia, meno tasse , *CorrierEconomia*, 4February 2013, p.17; Mario Castagna, "Le richieste dei professionisti, a partire dal welfare, *L'Unità*, 4 February 2013, p.7.
28. Brunella Carriero - Segretario della Cassa Nazionale del Notariato
29. Andrea Camporese is President of AdEPP and Vice-President of EURELPRO

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4. Conclusions

The present working paper has consisted in an overview of the key elements of the social and economic governance of the EU, with a more direct reference to the current debate on pensions and taxation. The two themes are increasingly interconnected in the EU agenda in view of enhancing the efficiency of social and employment policies. The parallel focus on expenditures and revenues is crucial for a more balanced approach to the more evident challenges to social protection and national budgets.

As stressed in the first section, EU measures are concentrated on four 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 in the field of pensions.

As stressed above, the coordination of the fiscal policies of Member States is a crosscutting issue. It brings us back firstly to the internal market and secondly to the importance of respecting national competencies in this area. 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 for pension funds.

These themes are paralleled by some issues of growing importance, especially in the countries suffering the most from economic stagnation. Implementing measures for a 'growth-friendly' taxation (to contribute to balanced public budgets and economic competitiveness) as well as modernizing social and employment policies according to the so-called social investment paradigm are at the top of the EU policymakers' debate.

These broad issues have been then referred to the case of pension schemes for specific occupational groups such as liberal professions, where interplay between the new social investment paradigm, knowledge-based growth and taxation seems pertinent. Both the taxation of pensions and the adequacy of social protection for the liberal professions lead us to the more basic question of the specific role of these pension schemes for their members, and whether such schemes may lead to efficiency gains and protection against the emergence of the new social risks these occupational groups face due to the negative effects of the current crisis. We learned that taxation is decisive for the future role of pension schemes for the liberal professions, not only their own sustainability but also in their capacity to contribute to economic growth in general and the functions they could deliver, like by giving their members access to finance or by directing investments and assets in specific directions to improve general economic conditions. As stressed

by some of the participants at the workshops of that Eurelpro organized in Brussels, the right interplay between private management and public control has proven to create flexibility and reliability – particularly in times of crisis. The fact that those specific pensions schemes, which are legally defined, do not depend on state budgets but are financially autonomous could be of interest in a strategy for more efficient social expenditures proposed by the Commission, considering the importance of this economic sector.

Taxation is also a crucial theme in approaching the problem of the mobility of workers (including the self-employed) in and across Member States. More generally the condition of present and future pensioners is affected by taxation. Increased taxation is reducing net pension income, while differing fiscal treatments of first and second pillar pensions is leading to some inconsistencies and undue advantages for some categories and social groups.

The tax environment should help to improve the conditions under which citizens are obliged to provide for old age. The combined effects of both direct and indirect taxation, however, often fail to sustain a sufficiently benign environment that encourages and rewards the commitment to retirement savings. This should be taken into consideration before increasing public tax revenues in a way that creates additional burden to pension providers.

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