



### International Winter Course on Pensions 2008 – Porto PROGRAMME

Sunday November 16, 2008

#### 18.30 Arrival at Porto (fligth 1386 Ryanair) 20.00 Arrival at the Hotel adress: Best Western Hotel Inca Praça Coronel Pacheco 52, Porto (+351 222 084 151) and meet Gloria Teixeira and team at the hotel. 20.30 Informal reception to everyone at café Guarany Monday November 17, 2008 09.00 - 09:30Welcome and tour at Faculty of Law of University of Porto 'The Portuguese treatment of pension income' 09:30 - 10:30Gloria Teixeira 10:30 - 11:00Coffee break 11.00 - 12:00'The Dutch pension system' Gerry Dietvorst 12.00 - 13:00'The International and EU perspectives' Yelakaturi Nakheetha (P.h. D candidate, Faculty of Law, University of 13:00 - 14:30Lunch at the University 14:30 - 15:30Thematical presentations of papers by the students I 16:00 - 18:00Visit 'Casa da Música' 19:00 - 22.00Dinner – Restaurant Círculo Universitário do Porto **Tuesday November 18, 2008** 09.00 - 10.30Thematic presentations of papers by the students II and III 10:30 - 11:00Coffee break Thematic presentations of papers by the students III and IV 11.00 - 12.00'Pensions and Expats'; and Guidelines to compare the systems 12.00 - 12.30Helga van Bijnen Lunch at the University 12.30 - 13:3014:00 - 15:30Caves Vinho do Porto Leisure time and preparation for Wednesday (dinner at own expense) 15.30 - 18.00

#### Wednesday November 19, 2008

| 09.00 – 12.30 | Combined presentation of students: SWOT analyses of the systems and answers to the questions put on Tuesday |
|---------------|---|
| 12.30 - 13.30 | Lunch at the University   |
| 12.30 - 13.30 | Lunch at the University   |
| 13.30 - 14.45 | Summary, conclusions and recommendations  |
|               | Gloria Teixeira and Gerry Dietvorst   |
| 15:00 –       | afternoon entertainment   |
| 18.55 - 22:40 | Flight back tot The Netherlands (flight Ryanair 1387)   |





## International Winter Course on Pensions

### Faculdade de Direito da Universidade do Porto 16-19 November 2008





Glória Teixeira **FDUP/CIJE**Associate Professor

Interaction with the Social Security Regime

 Mandatory contributions fully deductible from the tax base

Pension income taxable at the time of retirement

## The 2009 Financial Budget

- The new rules applying to EU and EEA resident employees, professionals or traders and pensioners: the conditions
- . The criteria of minimum 90% income derived in Portugal or from outside source;
- . The existence of exchange of information agreement.

# • • The 2009 Financial Budget

The new rules applying to EU and EEA resident employees, professionals or traders and pensioners:

If the above conditions are met, those residents may elect to be taxed under the rules applying to residents and become entitled to the same tax deductions available to residents.

## • • Tax deductions

- -Mandatory social security contributions;
- Personal deduction;
- Health deduction;
- Education and training deduction;
- Elderly expenses deduction;
- Residential loan expense or rental deduction;
- Life or Personal Insurance premium deduction;
- Other deductions available under the Tax Benefits Code

## • • The 2009 Financial Budget

 In the circumstances mentioned above, non-resident income is subject to the same withholding tax rates applicable to non-residents unless a Double Tax Treaty applies.

## • • The 2009 Financial Budget

Tax compliance requirements applicable to non-residents, for the above mentioned situations:

- . Submission of the annual tax return;
- . Deadlines: as applicable to resident taxpayers

### International Winter Course On Pensions





# IRS Tax for Foreign citizens in Portugal: The Impact of Finance Budget 2009

#### **International Winter Course on Pensions**

Faculty of Law, University of Porto November 17-19, 2008

Amanda Sachetim Marçal Rigo André Miguel Santos Silva FDUP/CIJE

## • • • Key concepts

Personal Income Tax (IRS)

Foreign Citizens

New additions in Finance Budget 2009

### • • Introduction

Personal Income Tax (IRS) for Foreign residents in Portugal.

All Foreigners who work in Portugal are entitled to pay their IRS in the same jurisdiction.

## • • New IRS Code 2009

With the new provisions of the IRS Code, for 2009, there will be a new optional regime for residents in Portugal or others residents of the EU or the EEA.

## New provisions of the IRS Code - 2009

The optional regime for non-residents allows that IRS is levied on the value of the following categories of Income:

Category A: Labour Income

Category B: Income from Business and

**Professional Services** 

Category H: Pensions

For tax purposes, a foreign citizen is considered resident, and so liable to pay income tax (IRS) on the present year.

## Bibliography and relevant web pages

www.dgci.min-financas.pt www.dgo.pt

Glória Teixeira, Manual de Direito Fiscal, Almedina, 2008.

# EU perspective on taxation of pensions

Internacional Winter Course on Pensions Faculdade de Direito da Universidade do Porto November 2008

Francisco Pimenta Francisco Matos FDUP/CIJE

## • • Program

- European Perspective on Pensions
- Double Taxation
- Double Taxation Conflicts
- How to solve double taxation conflicts
- Individual retirement plans
- The Portuguese pension system

## • • Main Concepts

Non-deductibility

Double Taxation

## European Perspective on Taxation of Pensions

Taxation is the base of the sovereignty of a State

Financial resources

**Economic Instruments** 

On tax policy, it is convenient for EU States to work together, not in opposite directions.

### **Definitions**

 Double-taxation – taxing the same income twice.

Deductible – What can be deductible from income

## • • Main Problems

 The costs of deductibility to the States finances.

 Lack of coordination between EU states.

# External problems of individual retirement plans (IRP)

Incomes from IRP

Double-taxation or non deductibility

## Basic Structures of the Portuguese pension system

 EET structure – Exempted contributions /Exempted Pension Funds / Taxable Pension.

 TER structure – Taxable contribution/ Exempted Pension Funds /Reduced Taxation of Pension.

## Solution proposed

The TER structure should be adopted in the EU, in order to achieve more coordination.

Taxing/Exempting (partially)

"At the entry" "At the exit" (taxing workers (reduced taxation contributions) for pensioners)

The revenues will be divided between the source and the residence states.

# • • IRS Code –main provisions

- Art. 13, 1 Everyone who resides in Portugal, and those who do not reside in Portugal but have incomes from here are taxed under the IRS.
- Art. 71, 2, f Pensions earned by non-residents in Portugal are taxed at a 20% rate.
- Art. 81 Tax credit by international double taxation.

## Bibliography

- Glória Teixeira, Manual de Direito Fiscal , Almedina, 2008
- Glória Teixeira (coord.), Tributação dos Rendimentos de Trabalho Dependente – relação com as contribuições para a Segurança Social, Vida Económica, 2000
- A política fiscal na UE, Serviço das Publicações Oficiais das Comunidades Europeias, 2000

# • • Recomended Internet Sites

o <a href="http://www.min-financas.pt">http://www.min-financas.pt</a>

o <a href="http://curia.europa.eu/">http://curia.europa.eu/</a>

o <a href="http://ec.europa.eu/">http://ec.europa.eu/</a>

o http://www.direito.up.pt



International Winter Course on Pensions Faculty of Law, University of Porto November 2008

Daniel Almeida António Maia

### • • • Introduction

- Increase of life expectations;
- Rise of the retirement age to 65 years;
- Many pensioners;
- Increase of the costs with the National Health Care System;
- Low birth tax (one child by couple);



Less contributions.

### • • • Introduction

- One worker to sustain two pensioners;
- Budget: Costs higher than the gains;
- A needed increase of the birth rate;
- National Social Security law 4/2007, published in January 16<sup>th</sup>:
  - √ Main articles 2° ,26°, 81°.

## • • • Three main pillars

- The Portuguese social security system has three main structures:
- Public System;
- Alternative schemes of social security:
   Company pensions and public pensions fund;
- Individual retirement saving plans.



- Main base of the social security;
- Universal (all citizens included have the right to a pension irrespective of their contributions to the system);
- Own budget inside of the general state budget;
- Organized and managed by the State.



- The contributions are calculated based in the employees wage and paid by both employer and employee;
- Distribution financial scheme organized as a fund of stabilization;
- Supported by the mandatory contributions of the employers, employees and by the transfers from the general state budget.

## • • • Public System

- The pension system is divided in two schemes: General scheme or contributory and the non-contributory scheme;
- The general scheme is an obligation either to dependent workers or to independent workers;
- Non-contributory scheme: includes all the citizens that are not in the general scheme or in other one legally established scheme.



- In case of residents in Portugal, they are taxed on their wages and other possible profits;
- Progressive taxation applies after being made the allowed deductions (IRS code);
- Foreigners working in Portugal are taxed in their income derived from the country.
- Impossibility of deductions, with 2009 FA exceptions.
- Contribution to the Social Security System aren't deducted to taxable income except under new provisions of the 2009 Finance Act.



- The residents in Portugal are bound to contribute to the Social Security System;
- The interaction between the IRS and the Social Security System;
- Taxation of wages under the IRS Code;
- Other employees benefits.

## Taxation of employees

 The importance of the regulation Decree no 12/83, February 12th.





Organization of regulation.

Determination of the base of calculation.

## Taxation of employees and taxation of the pensions

- Definition of income for contributions purposes. The criteria of periodicity;
- For tax purposes, the deduction is always allowed to the gross income of resident workers;
- Taxation of pensions: Article 53 of the IRS code (annually updated);
- Taxation and the relation with residence of the taxpayer.

## Alternative schemes of social security

- The importance of the development of this second pillar is related with the difficulties that the Social Security System faces;
- The pensions plans are from three different types:
  - ✓ Plans with defined benefit;
  - ✓ Plans with defined contribution;
  - ✓ Plans mixed.
- Definition of professional and additional schemes of pensions.

## Alternative schemes of social security

- The additional professional schemes for dependent workers have to follow some standards:
  - ✓ The schemes have to be managed by independent institutions with financial autonomy;
  - √ Financed by the employers and employees;
  - ✓ Created by free initiative by the enterprises and their employees by means of an agreement in which there are defined the objectives and the content of the professional complementary scheme.

## Alternative schemes of social security

- The contributions made by the employer are considered for tax purposes as deductible costs;
- Incentive to these alternative schemes;
- The problem of the national legislation in the case of foreigners, the immediate taxation;
- The contributions as acquired rights and personal rights;
- The IRC (corporate income tax article 40° IRC code).

## Individual retirement saving plans

- Voluntary participation and the acceptance is only conditioned by the financial institution that manages the retirement saving plan.
- Supervision made by the institutions.
- The tax benefits of these plans.
- Three forms: investment fund, pensions fund or a similar fund.
- There are certain rules that have to be respected.

## Bibliography and relevant web pages

- Manual de Direito Fiscal, Glória Teixeira Almedina, 2008
- o www.min-financas.pt
- www.mtss.gov.pt
- o <a href="https://www.seg-social.pt">https://www.seg-social.pt</a>

## The International View on Pensions: A Comparative Perspective Between

A Comparative Perspective Between Portugal and Netherlands

International Autumn Course on Pensions Faculdade de Direito da Universidade do Porto November, 2008

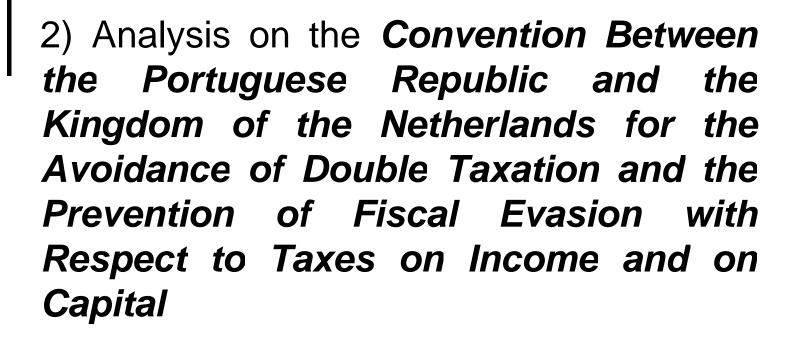
Ana Rita Pereira and Hugo Cabral

### • • Presentation's Structure

- Advent and Evolution of the Social Security System in Portugal;
- 2. Analysis on the Convention Between the Portuguese Republic and the Kingdom of the Netherlands for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and on Capital (from now on referred as "the Convention");
- 3. Organisation for Economic Co-operation and Development;
- 4. Private Pension Savings;
- 5. Analysis of a Case Law of the Supreme Administrative Court;

## 1) Advent and Evolution of the Social Security System in Portugal;

- Definition;
- Christian influency, Mercy Brotherhood, Casa Pia and other institutions;
- 1935 Approval of the general basis above which the Social Security would be organised;
- 1962 A first reform;
- 1977 A new structure;
- The 80's The Law 28/84, from August 14th and other legislative measures;
- The 90's Increase of the financial pressure, but still some measures;
- The 21st Century The present and the future challenges;



- The Convention main questions to discuss:
  - Adoption of the Residence Criteria;
  - Measures taken to pursuit the agreed goals;
  - Can pensions be transfered?

### Analysing the Convention between Portugal and the Netherlands

A convention is a <u>bilateral treaty</u> and it is written and comes into force in both languages.

This convention is also applied in English.

According to Article 2 of the Vienna Convention on the Law of Treaties...

"(...) "treaty" means an international agreement concluded between States in written form and governed by international law, whether embodied in a single instrument or in two or more related instruments and whatever its particular designation (...)."

## The Existing Taxes Covered by the Convention (in 1999)

### o In Portugal:

- Imposto sobre o Rendimento das Pessoas Singulares (IRS);
- Imposto sobre o Rendimento das Pessoas Colectivas (IRC);
- Derrama;

### o In the Netherlands:

- Inkomstenbelasting;
- Loonbelasting;
- Vennootschapsbelasting;
- Dividendbelasting;
- Vermogenbelasting;

### • • Article 4 -"Resident"

Article 4 establishes in its first paragraph that a "<u>resident</u> of a State" is any person who, on account of that State's legislation, is submitted to a tax due to his or her residence.

 But what if the individual resides in <u>both</u> of the Contracting States?

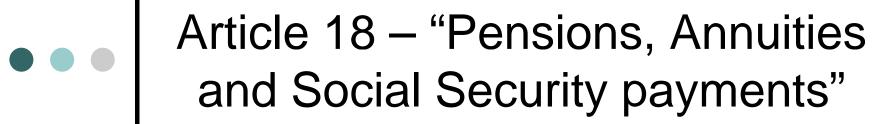
The second paragraph of article 4 provides several solutions.



## Avoiding double taxation: Paragraph 2 of article 4

- The individual may be considered resident only in the State in which he possesses a permanent home. If he has it in both States, it shall only be considered the one where his economical and personal relations are more significant.
- The individual will be thought as resident of the State where he usually lives if there is no possibility to decide where the centre of his or her vital interests lies or if he or she does not possess a permanent home in any of the States.
- The individual's nationality will be taken as a criteria if he or she lives permanently in both States or if the contrary is noticeable. Among us, consult the article 4° of the Constitution, which points to the organic law n.° 2/2006, dated from April, 17<sup>th</sup>.
- The authorities of the Contracting States are to decide by mutual agreement, if he is national of both States or of neither of them.

Paragraph 3 of the same article refers to companies saying that if the resident considered is a company established in both States, its residence shall be that of the State where its effective management is located.



### Pensions and other similar remunerations...

- a) Of a past employment Taxable only in the State where the resident was paid.
- b) Provided by the <u>social security system</u> of a Contracting State to the resident of the other Taxable in that other State.

### However, the pensions paid by a security system may also be taxed in the other Contracting State if...

- The entitlement to that pension is exempt from tax in the State where it would be taxable or when there has been a deduction (tax relief).
- That pension is not taxable by the internal laws of the State where the recipient is resident.
- The total gross amount of pensions exceeds the sum of € 10 000.

## Article 19 "Government service"

The main principle states that the salaries, wages and other remunerations are to be taxed only in the Contracting State who paid them.

The same may be taxable only in the other State if the services were rendered within its territory and if the individual resides there, being its national or if he or she has not become its national only for the purpose of rendering those services.

As for the pensions concerning government services, they may be taxed in the other Contracting State if the individual is its resident and national.

### 3) Organisation for Economic Co-Operation Development

 The OECD is compelled to bring together the governments of its 30 member countries; it also invites non-members to membership talks.

Its main missions are to support economic growth, to boost employment and to assist countries' economic development.

 To reach an ideal economical stability, the OECD encourages its members to conclude agreements such as the conventions to avoid double taxation and, more recently, it has promoted the private pension savings.

## 4) Private Pension Savings:

- Reminding the Social Security System current problems;
  - Its relations with Private Pension Savings;
- A mathematical inevitability;
- The Private Pension Savings in Portugal:
  - The "Planos de Poupança Reforma" (PPR's);
  - €12,7 billion and €150 billion (11,8%);
- The future will judge on the rightness of this product;

## 5) Case Law of the Supreme Administrative Court (Portugal)

- An example from Comparative Law: Sentence dated from 18-10-2006.
- Main Problem: Two finish citizens, currently residing in Portugal, developed an activity in our country which was ordered by Finland and the earnings of their work were taxed both in Finland and Portugal.
  - The claims of the applicants;
  - The judicial answer from the Court;
  - The law in the Convention and in the Portuguese IRS Code;

• • • Ending...

Hope you have enjoyed...

 We would be grateful to answer all your questions;

### **ISoP**

### International Summer course on Pensions 2008 Porto (IWoP)

### Students:

Amanda Sachetim Marçal Rigo Ana Rita Pereira André Miguel Santos Silva Antonio Maia Nick Theunissen Daniel Almeida Francisco Pimenta Francisco Matos Hugo Cabral Inge Wouters Maarten Ceelen Maurice Smans Paul Sebregts Paul Straetemans Tim Maas

### **Professors and teachers:**

Gerry Dietvorst Glória Texeira Helga van Bijnen Yelakaturi Nakheetha

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### **Programm**

### **Presentation Gerry Dietvorst**

### **Assignment 1a: Introduction**

- 1. The first pillar of the Dutch pensionsystem: "AOW and ANW insurance"
- 2. Second pillar: employee's pension
- 3. The Third pillar

### **Assignment 1b: Introduction**

- 1. sheets first pillar
- 2. sheets second pillar
- 3. sheets third pillar

### Portuguese presentations

- 1. Glória Teixeira
- 2. Portuguese students

### Presentation Helga van Bijnen

Assignment 2a: Transfer of capital (1)

Assignment 2b: Transfer of capital (2)

Assignment 2c: Transfer of capital (3)

**Assignment 2d: emigration** 

### **Analyse pensionsystems**

- 1. Analyse Dutch pensionsystem
- 2. Analyse Portuguese pensionsystem
- 3. Recommendation ISOP

### Introduction

The CompetenceCentre for Pension Research (CCP) is an interdisciplinary research institute of Tilburg University that focuses on the fiscal and legal aspects on pensions and other future provisions. The CCP organised in 2008 for the second time an international pension related study trip for students. The International Summer course on Pensions (ISoP) is an optional part of two pension related courses provided at Tilburg University. ISoP offers students the possibility to get in touch with international pension issues in a unique way.

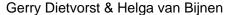
### The aim of ISoP is to:

- let students examine a foreign pension system and enlarge the international view to pensions:
- involve students with 'the pension discussion' worldwide;
- offer students an international network possibility;
- stimulate young talents on pensions.

The ISoP took place in Porto (Portugal) from Sunday, November 16 till Thursday, November 20 2008. Students of Tilburg University and the Universidado do Porto together examined and compared the pension systems of Portugal and The Netherlands. During the 4 day study trip in Porto the students presented their conclusions en discussed which future challenges will be faced. The concerning documents are included.

Next to the academic matters, there was enough time to discover the social-cultural highlights of Porto. For example there was the trip to the caves!

We hereby want to thank the students but especially Gloria Texeira, proffessor at the University of Porto, for her activities for this years course.





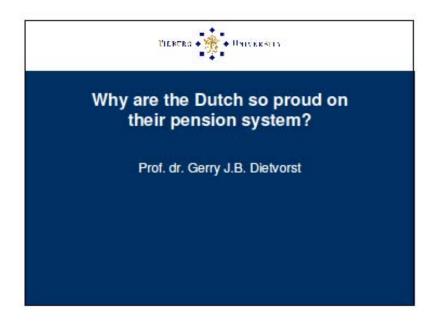


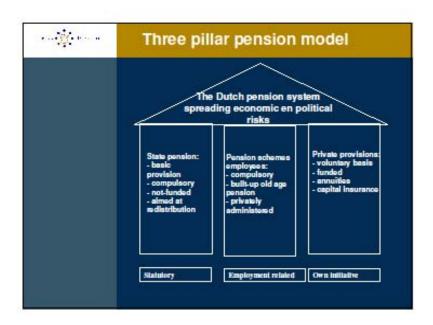


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|-------------------------|--|
|                         | Manday Navambar 47, 2000   |
| 09.00 - 09:30           | Monday November 17, 2008  Welcome and tour at Faculty of Law of University of Porto  |
| 09:30 - 10:30           | 'The Portuguese treatment of pension income'   |
|                         | Gloria Teixeira  |
| 10:30 - 11:00           | Coffee break   |
| 11.00 – 12:00           | 'The Dutch pension system'   |
|                         | Gerry Dietvorst  |
| 12.00 – 13:00           | 'The International an EU perspectives'   |
| University of           | Yelakaturi Nakheetha (P.h. D candidate, Faculty of Law,  |
| University of           | Porto  |
| 13:00 – 14:30           | Lunch at the University  |
| 14:30 – 15:30           | Thematical presentations of papers by the students I   |
| 16:00 - 18:00           | Visit 'Casa da Música'   |
| 19:00 – 22.00           | Dinner – Restaurant Circulo Universitário do Porto   |
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| 15:00 –                 | afternoonentertainment   |
| 18.55 – 22:40           | Flight back tot The Netherlands (flight Ryanair 1387)  |

### **Presentation Gerry Dietvorst**

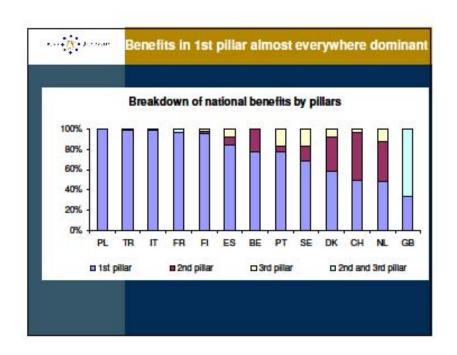




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# Pension awareness: > people rather go to the dentist then look at their pension > Pension awareness starts with the first reading glasses > Majority of the employees have no idea how much they will receive after reteriment > National pension register (2011)

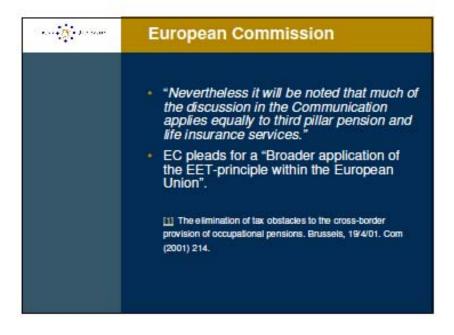
# The Dutch pension system Well balanced Second and third pillar funded Sector wise organised via collective agreements Solidarity between generations, working population (sector wise) Tax framework: EET



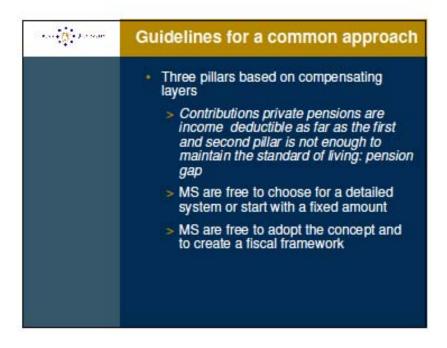
| r different | The Dutch pens                     | ion system |  |
|-------------|------------------------------------|------------|--|
|             | Assets pension funds as a % of GDP |            |  |
|             | > Italy                            | 1,2        |  |
|             | Belgium                            | 4,1        |  |
|             | > France                           | 5,6        |  |
|             | > Germany                          | 5,8        |  |
|             | > Sweden                           | 32,6       |  |
|             | > UK                               | 74,6       |  |
|             | > Netherlands                      | 187,3      |  |

## Pension schemes are not compulsory 95% of the employees participate in a pension scheme, mainly based on average salary Pension providers Sectorial funds, company pension funds, insurance companies

# The approach of the Dutch legislator Tax reform: umbrella idea Fiscal support up to 70 % of last income Alle sorts of old-age income on the base of communicating vessels: three pillars Detailled regulations but flexible



## The importance of a common approach and a compensating layer Member States Better balance between the three pillars Solidarity Funded/not funded Own responsability private citizens Helps mobile workers Contributes to the sustainability of the pension systems Helps the Lisbon strategy



# Why have an integrated multi pillar pension system? Helps mobile workers Better balance between the three pillars Solidarity Funded/non-funded Stimulates responsability Contributes to sustainability Supports Lisbon objectives

### **International Summer Course on Pensions Porto 2008**

### **Assignment 1a: Introduction**

The main assignment was divided in two parts. The first part was to write a short thesis in English about a particular part of the national Pension system.

1. First Pillar: State pensions

2. Second Pillar: supplementary pensions

3. Third Pillar: private pensions

Followed by the treatment off the several pensions in the Tax Treaty and the OESO model treaty. The thesis had to include:

- legislation
- literature
- case law

### The first pillar of the Dutch pension system: "AOW and Anw insurance"

In this short description of the first pillar the AOW (National Old Age Pensions Act) and the Anw insurance (Surviving Dependants Act) are taken into consideration. First of all I shall describe in short some characteristics of the two social insurances. Afterwards the production and functioning of the AOW is described, this is followed by the same description of the Anw insurance. Finally the functioning of AOW as well as the Anw insurance under OESO-modelverdrag and treaty between the Netherlands and Portugal will be described.

Both the AOW and Anw insurance are compulsory insurance for all inhabitants of the Netherlands. The right to a complete benefit of the AOW is built in 50 years and the Anw insurance comes to full benefit if has been met the put conditions. Both the AOW and the Anw insurance are financed by an unfunded scheme this means that the ones who work pay for the people who receive a AOW benefit or survivor's benefit. The Sociale Verzekeringsbank (Social insurance bank) has been charged with the task to supply the AOW and the Anw insurance benefits. If one disagrees with a decision of the SVB one must object within 6 weeks by means of an objection.

### **AOW**

### Establishment of the AOW

At the beginning of the 20th century the first regulations arose concerning social security in the Netherlands. The first law which provided for a regulation was the accident law of 1901, the aim of this law was to protect workers against industrial accidents and sickness. This law was succeeded by the Invalidity Act and the Old Age Pensions Act. The aim of the Old Age Pensions Act was to offer employees the possibility to foresee in maintenance on later age by means of a voluntary insurance. After the Second World War the public opinion changed. One found it undesirable that only workers could insure themselves on the basis of the Old Age Pensions Act. Meanwhile the amount provided on the basis of the insurance came too low to benefit the maintenance of the insured person. In response to above lacks the 'Noodwet Drees' ('Urgent law Drees) came about. For the arrangement made in this law one didn't need to pay premium, the state paid the costs. In principle everyone was entitled to a benefit however there had to be certain destitution. One had satisfied to this requirement when one came below a certain income border. On 1 January 1957 the first real social insurance came about, the AOW. *Insured people* 

The aim of the AOW is a general compulsory insurance for the whole population against the financial impact of old age. The one which are insured for the AOW are all residents of the Netherlands. Someone is resident when one lives in the Netherlands, one does not need to have the Dutch nationality.

Also one has been insured for the AOW if one works in the Netherlands and is involved in the salaries tax. When one emigrates, the choice exists to keep up the AOW insurance, in principle for 10 years. One has to keep paying the premium to maintain the right of AOW insurance.

65 year old age

The 65 year old age is an important age for the AOW, the AOW benefit is paid at the start of the month in which the insured person becomes 65 years old. The right to the AOW benefit has been purely coupled to one's age and there are no other factors which influence the right to the benefit.

The amount of the AOW benefit

The amount of the AOW benefit depends on a number of factors. The first factor is related how long the insured person is a resident of the Netherlands, or has been a resident of the Netherlands. The reason that this is important is found in the advancement system of the AOW. The advancement of the AOW benefit is built in 50 years to 100%. This is therefore 2% per year, therefore when one has been a resident less than 50 years one is shortened thus proportionally on his benefit with 2% per year. The second important factor for the altitude of the AOW is the type of household the insured person lives in.

Types of household and the amount of the AOW benefit

When an old age pensioner is married to another old age pensioner they both receive a benefit for the size of 50% of the net minimum wage, together therefore they obtain 100% of the net minimum wage. An old age pensioner who married a partner younger than 65 years also gets a benefit for the size of 50% of the net minimum wage but has the possibility of asking an allowance to for the partner. This allowance can run up to 50% of the minimum wage, so that the old age pensioner with a younger partner can nevertheless obtain a benefit of 100% of the minimum wage. If partners cohabit unmarried they are equated with married people if there is a joint household. The term joint household is completed if followed, the partners live together in a common house and there should be financial entanglement. A financial entanglement means that both partners must contribute financially for the maintenance or otherwise. The unmarried old age pensioner is entitled to a benefit for the size of 90% of the minimum wage if a child belongs to the household that's younger than 18 years old. A single gets an AOW benefit for the size of 70% of the minimum wage.

### **Anw insurance**

Establishment of the Anw insurance

In 1921, there was the first statutory regulation which foresaw to ensure widows and orphans; this law was called the accident law 1921. When an insured worker as a result of an industrial accident diseased. His widow and his children obtained right to an interest. The interest however was so low that it was not sufficient to foresee in the maintenance of the children and the widow. After the Second World War a research was started by Commissie-Van Rhijn to recommend concerning the supplies for widows. As a result of the recommendation brought out by the commission the government intervened. The general Widows and Orphans Law came about in 1959 (AWW). This law provided for a regulation where women of whom it could not be demanded that they provided for their own income were supported by the state. The women whom the put criteria met could claim the pension regulated in this law. These were women who were invalided, had reached the age of 50 or had children had younger than 18 years. This law remained nearly unchanged until it was replaced on 1 July 1996 by the Anw insurance, the Surviving Dependants Act. Replaced of AWW was necessary because AWW was still based on the idea that the man was the breadwinner and the woman did

not participated in employment. This idea had become obsolete in the nineties since much new types of household had arisen and the ideas concerning the marriage had changed.

Insured people for the Anw insurance

As well as the AOW everyone who is a resident of the Netherlands has been insured for the Anw insurance. In contrast to the AOW the insurance passes through after reaching 65 year old age. This is necessary because when an insured person reaches the age of 65 years old, its partner will otherwise not able to claim the insurance benefit. The Anw insurance knows 3 types of benefit; the first of it is the survivor's benefit.

The survivor's benefit

At the time of dying the deceased had to be insured for the Anw insurance wants the surviving dependant is able to claim the benefit. For the Anw insurance married people and unmarried people are equated if the unmarried people conducted a joint household. One can claim the survivor's benefit when the insured person cohabited with the deceased at the time of death and conducted a joint household. The term joint household is filled in as follows: the unmarried people have their main residence in the same house, and they take care of each other. Reciprocal care exists when both partners make a contribution in the household. The following groups of surviving dependants can qualify for a benefit: The surviving dependant with a child below the 18 years old, the incapable of work surviving dependant and the surviving dependant who is born for 1 January 1950. There also a right to claim the benefit if one has separated and there exists a certificate which aims at providing for alimony. There is no right to claim the Anw insurance if the insured person has diseased within a year after insuring and seen the circumstances was expected to pass away within the year. There is also no right to claim the Anw insurance if the insured person has been deprived of living by beneficiary. The amount of the benefit is net right to 70% of the net minimum wage. However If the beneficiary has one or more children under the age of 18 years old the benefit increases to 90%. The amount of the benefit also depends on the income of the beneficiary because there the benefit will be shortened when the beneficiary has a certain income. The survivor's benefit is withdrawn if the surviving dependant contracts a marriage or will conduct a joint household. When however the joint household is concluded within a half year is entitled one still to a survivor's benefit

The dependent child benefit

The second type of the Anw insurance is called the dependent child benefit and one is entitled to this maintenance when one of the parents of the beneficiary parents diseased. The surviving dependant is entitled to the dependent child benefit if the beneficiary has to take care for a child younger than 18 years old. Whatever the number of remaining children is the beneficiary will only be entitled to the dependent child benefit once. The surviving dependant who looks after the dependent child does not need be the parent of the dependent child for the dependent child pension; however the surviving dependant must carry the care for the dependent child to be entitled to the benefit. The amount of the dependent child benefit amounts to 20% of net minimum wage and is it is not influenced by the income of the surviving dependant.

The orphan's benefit

The third type concerns the orphan's benefit and an orphan is entitled to this benefit when both parents are deceased and the orphan is younger than 16 years. If the orphan studies and its age is between 16 and the 21 years old, the orphan is entitled to an orphan's benefit, the same applies to if an orphan looks after a household to which belongs another orphan beside itself. An orphan incapable of work can receive the orphan's benefit until it reaches the 18 years old age. The amount of the orphan's benefit depends on the age on the orphan. An orphan younger than 10 years is entitled to orphan's benefit off 32% of the survivor's benefit. An orphan whose age lies between 10 and the 16 years old is entitled to 48% off the survivor's benefit. When the age of the orphan lies between 16 and the 21 years old the orphan is entitled to 64% of the survivor's benefit, if the orphan has met the above mentioned requirements.

The functioning of the AOW and Anw insurance abroad

Since 2000 the BEU Act- has applied, Export of Benefits (Restrictions) Act. The aim of this law is increase the monitoring of benefit money. By this law the right to a benefit of above social insurances, the AOW and Anw insurance has been bound for living in the Netherlands. Unless an agreement has been come to with regard to the treatment of the social security with another country there is no export restriction, as is the case with Portugal. However based on the OECD model tax convention, subject to provisions of paragraph 2 of article 19 payments under the provisions of a regulation concerning social security of the Netherlands to an inhabitant of the other state, can be charged in the Netherlands based upon article 18 paragraph 1 last sentence of the treaty between the Netherlands and Portugal.

P.J.A. (Paul) Sebregts

#### The second pillar of the Dutch pension system

#### Introduction

In this paper the second pillar of the Dutch pension system will be explained. The first part will state the basic principles of the second pillar. The second part will discuss the articles of the OECD Model Convention and the tax treaty between the Netherlands and Portugal concerning the supplementary pensions of the second pillar. The third part will discuss the taxation of dismissal compensation in the Netherlands, by the OECD Model Convention and the tax treaty between the Netherlands and Portugal.

#### Second pillar: employee's pension

N.M.E. (Nick) Theunissen

The second pillar of the notorious Dutch three-pillar-system is the supplementary pension or the employee's pension. What is in a name, it is related to employment. Pension is within a labour relation a right on financial determined and personal payments concerning age, decease and disability. 1 The types of pensions are therefore the old-age pension, surviving dependant's pension and the orphan's pension. In article 1 of the Dutch law of pensions is determined that pension is a contract between employer and employee. Next to those two there is also the pension executer or insurance company. One could speak about a triangular relationship.

#### **Dutch law of pensions**

#### **Parties**

Between the employee and the employer exists a pension contract, as mentioned in article 1 of the Dutch law of pensions (PW). The conditions in this contract are abstracted from the collective labour agreement and generate, with the substance of the pension scheme, the pension contract. The pension scheme is important because there is no general legislation about supplementary pensions.<sup>2</sup> The relation between the employer and the pension executer contains an execution contract, also based on article 1PW. The employer is obliged to organize the pension pledge on one of the following five ways. He has the possibility to connect his company to a pension fund of an industry sector where his company is in. He also

Furthermore de employer has the possibility to execute the pension scheme by a Dutch insurer on a profit base. He can also act by foreign pension schemes or he could contact a foreign insurer on a profit base, according to art. 23 PW. Thus, de pension executor has to implement pension agreements on the basis of an execution agreement or an execution scheme, based on art. 23 paragraph 1 PW. The

could start his own company pension fund.

<sup>&</sup>lt;sup>1</sup> *Kamerstukken II* 2005/06, 30413, nr. 3, p. 11. <sup>2</sup> *Kamerstukken II* 2005/06, 30413, nr. 3, p. 12.

conditions determined by an industry (sector) pension fund are already phrased in an execution scheme, according to art. 23 paragraph 2 PW.<sup>3</sup>

The pension scheme applies between the employer and the pension executor. The Dutch executors are company pension funds, industry (sector) pension funds, (foreign) insurers on a profit base or executions in the employer's own management. An employer is not obliged to participate in a pension scheme, unless the employer is already covered by a scheme of an industry.

#### Types of additional pension schemes

Article 10 PW makes a distinction between a threesome pension schemes. The legislator made this difference because practice experience led to pension promises with an unclear character. At a certain level it was not obvious anymore where possible hazards would be. To guarantee transparency, the character of the pension agreement had to be described. One could split up this threesome in benefit agreements (defined benefit), capital agreements and contribution agreements (defined contribution). There's also another variation, a combination scheme, but this type of agreement is inferred of the more general defined contribution and defined benefit.4

In case of defined benefit, employer and employee make an agreement about a certain maximum of payments, received on a certain age. The most occurring versions are the final pay schemes and the average pay scheme. Investment risks are at any time for the pension executor. In case of a final pay scheme the build-up pension raises each time in proportion to the salary increase. The remainder of the old salary and the new salary is called 'backservice'. On the average pay scheme the annual pension build-up is the percentage of the average income. The pension basis is at this scheme is not as high as the basis of the final pay because there is no backservice.

In case of capital agreements the employee is only certain, when the pension payment starts, about the amount of capital determined in the agreement. This capital has to be converted, at the latest on the pension date, into a periodically paid benefit at the then applying rates. Furthermore it's important to notice that capital agreements concern just a certain claim definite sized capital, but it does not concern a claim on periodical payment.<sup>5</sup> The investment risk during the pension build-up has to be taken care of by the pension executor. The long-live risk, that is when the life expectancy is increasing faster than the initial estimation, has to be taken care of by the employee. 6 Such pension scheme is rare in the Netherlands.

<sup>&</sup>lt;sup>3</sup> A.T.J.M. Jacobs, Pensioenrecht, de sociaalrechtelijke en sociaalpolitieke aspecten, Deventer: 2007, p.

Kamerstukken II 2005/06, 30413, nr. 3, p. 32.

Kamerstukken II 2005/06, 30413, nr. 24, p. 38.
 Kamerstukken II 2005/06, 30413, nr. 24, p. 37.

The third pension scheme is the defined contribution. This scheme concerns primarily a deal about the periodical amount in behalf of the disposable pension payment. With this is as well as the long-live risk as the investment risk a care for the employee. But there are some variants distinguishable where the investment risk has to be taken care of by the pension executor of where both investment risk and long-live risk is a care for the pension executor.

#### System of capital cover

All existing old-age pensions are financed by a so called system of capital cover. In case of this system all payments has to be done out of which is paid by employers and employees. The system of capital cover is obliged for old-age pensions, according to art. 127 PW. In case of surviving dependant's pensions and disability pensions financing on the basis of risk cover is also allowed.<sup>7</sup>

#### **Dutch tax law on pensions**

As it had turned out, pension is promised on grounds of conditions of employment. Therefore one could consider a pension as a reward for the employee's realization of the employment. The basic rule of the Dutch taxation is that pensions shall be taxed, according to art. 10 paragraph 1 LB (tax on wages):' all that which is received from a present of former employment.' Art. 11, paragraph 1, subsection c, LB is a differentiation of the basic rule. This article contains the so called 'reversal rule', which implies that claims in case of pension schemes are exempt, but the payment or benefit shall be taxed. The contribution is deductible based on art. 11, paragraph 1, subsection j, LB. That's why just benefits or payments are taxed when they are realized, according to art. 10 LB.

To prevent that employer and employee certain promises treat like pensions to avoid tax on wages, definitions of pensions are specified in art. 18 LB and the following articles. The pension promise is exempt and the employee's contribution is deductible if they do comply with these conditions according to art. 18 LB en further. This article generally defines the types of pension. The main variants, like we have seen in the Dutch law of pensions, are the old-age pension, the surviving dependant's pension, the orphan's pension and the disability pension. The Dutch tax on wages also distinguishes a split up in the pension schemes, in particular the final pay scheme, the average pay scheme and the disposable contribution scheme, based on art. 18a LB.

#### Old-age pension

The base of the old-age pension is that 70% of the final or average annual income is realized as benefit or payment. According to art. 18 paragraph 1 LB the pension build-up of the final pay scheme is maximized at 2% of the annual income the pension is based on. On the base of paragraph 2 an average pay scheme implies a

<sup>&</sup>lt;sup>7</sup> Kamerstukken II 2005/06, 30413, nr. 3, p.254,

2, 25 percentage. The reason for this lower percentage is that the average pay scheme does not have backservice. Mostly pension schemes deal with the average pay. The final pay scheme is expensive for the employers, especially when there are many older employees. With each wage increase the total sum of pension build-up must be heighten. Also the ageing deals with administrative costs, because it is a big task to administrate all the data of the previous years of all employees.

The build-up of the disposable contribution scheme is proportional by time, and it is aimed at a pension after a 35-years build-up on a maximized base of 70% of the income on that moment, according to paragraph 3. Herewith the contribution is actuarially determined by the age class with a maximum of 5 years. This is harmonized with the average age in that certain class.

#### Surviving dependant's pension and orphan's pension.

Like we said before the old-age pension build-up is maximized at 70% of the final pay or average pay. This percentage is lower concerning surviving dependant's pensions and orphan's pensions. The surviving dependant's build-up is maximized at 70% of the old-age pension, according to art. 18b LB and the orphan's pension is maximized at 14%, based on art. 18c LB.

All pension schemes define the 'pensionable salary'. This concept is the employee's annual wage on which the pension contribution is calculated. The wage a pension is based on will be decreased by the so called 'installation method and franchise method'. These methods differentiate a part of the wage on which is no pension build-up. The underlying taught is that this part is already filled by the social security contribution. Therefore the build-up is on a lower pensionable salary. <sup>8</sup>

#### **OECD Model Tax convention**

The right to levy tax is based on art. 18 and 19 of the OECD Model Tax Convention (OECD). According to art. 18 OECD the resident state of the employee has exclusively the right to levy tax on pensions.

#### **Treaty The Netherlands-Portugal**

The right to levy tax concerning the tax treaty between the Netherlands and Portugal is bases on art. 18 and 19 of the treaty. The treaty also determines an exclusive right to levy tax to the resident state of an employee, according to art. 18 of the treaty.

### <u>Article 18 & 19 OECD Model Convention / Tax Treaty Netherlands – Portugal</u> *M.G.L. (Maarten) Ceelen*

#### **Art. 18 OECD Model Convention**

Article 18 of the OECD Model Convention (hereafter: OECD) is applicable to pension payments that don't fall under the scope of article 19 OECD. This means that the

<sup>&</sup>lt;sup>8</sup> A.T.J.M. Jacobs, Pensioenrecht, de sociaalrechtelijke en sociaalpolitieke aspecten, Deventer: 2007, p. 85 en 86.

scope of art. 18 is limited to past employment that is not related to government service. In other words, art. 18 covers private pensions.

Art. 18 stipulates that the right to levy tax on these (private) pensions is assigned to the resident state (home state) of the employee. According to the OECD commentary, the state of residence is in a better position than any other state to take the recipient's overall ability to pay tax into account. This ability to pay mostly depends on worldwide income and personal circumstances such as family responsibilities. This solution avoids that the recipient of a private pension has the administrative burden of complying with tax obligations in other states than the state of residence.

It follows from the OECD commentary that art.18 not only includes pensions directly paid to former employees, but also to other beneficiaries (e.g. surviving spouses, companions or children of the employees) and other similar payments, such as annuities, paid in respect of past employment. The words "other similar remuneration" also cover non-periodic payments. It is important to keep in mind that art. 18 only applies to payments that are in consideration of past employment.

#### Art. 18 Treaty Netherlands – Portugal

Article 18 of the tax treaty between The Netherlands and Portugal includes special provisions that can result in source state (host country) taxation. There are two situations in which source state taxation can occur.

If the following conditions are met pension payments can be taxed in the source state:

- Tax incentives have been provided for the pension contributions in the source state e.g. in the form of tax deferral, so that the contributions are deductible or exempt from tax, and
- The pension is not taxed against the tax rate normally applicable in the state of residence, or less than 90% of the pension amount is taxed, and
- The total pension amount exceeds € 10.000

The other situation in which the source state retains the right to levy tax, is when the pension has a non-periodic character and is paid before the retirement date. This means that the source state may levy tax in case of lump-sum payments.

#### **Art. 19 OECD Model Convention**

The basic idea behind art. 19 OECD is that the state which has employed the civil servant is allowed to levy taxes. This is in conformity with the rules of international courtesy in the form of mutual respect between the sovereign states. The source state is allowed to levy tax on the income which has been paid to her own civil servants, unless the servants are nationals of the resident state.

The foregoing is also applicable to pension payments made to (former) civil servants by, or out of funds, created by the source state or a political subdivision or a local authority thereof. In other words, art. 19 concerns public pensions and entails source

state taxation. It doesn't matter whether the payments are made by the government themselves, or by an insurance company which the government contributed to. Not all public pensions are covered by art. 19. Pensions in respect of services rendered in connection with profit aimed businesses carried on by the source state fall under the scope of art. 18 instead of art. 19.

#### Art. 19 Treaty Netherlands – Portugal

Article 19 of the tax treaty between The Netherlands and Portugal follows the OECD Model Convention. No special provisions are made in this bilateral treaty.

#### Distinction between private (art. 18) and public (art. 19) pensions

According to the OECD commentary on art. 19, an issue arises where pensions are paid for combined private and government services. This issue may frequently arise where a person has been employed in both the private and public sector and receives one pension in respect of both periods of employment. This may for example occur because the person's pension rights were portable or in case of privatisation.

In some states pension payments are taxed only under article 18 in case a civil servant has transferred a right to a pension, from a public scheme to a private scheme. However, it follows from several Dutch supreme court cases (e.g. *Javasche Bank arresten*) and the OECD commentary that the Netherlands does not adhere this principle. The Netherlands apportions the (funded) pension payments based on the relative source of the pension entitlement, so that part is taxed under art. 18 and another part under art. 19.

An exception is made in the Netherlands for components that are financed on a PAYG basis. These PAYG payments follow the regime of the latest job. No apportionment is applied in these cases.

Suppose a person participated a couple of years in a private scheme, but participates in a public scheme upon (early) retirement. If he would receive a PAYG payment (e.g. a *VUT-uitkering*), this payment will follow the last job, so in this case the regime of art. 19 (public pensions) will be applicable. It is recognised that apportionment (or compartmentalisation) often raises significant administrative difficulties e.g. when there is a combination of public / private employment and funded / PAYG components.

#### **Dismissal compensation**

M. (Maurice) Smans

#### **Dismissal compensation in The Netherlands**

When an employee receives dismissal compensation this compensation may consist of various elements. Compensation received for immaterial damage is no wage as in art. 10 LB (Dutch tax on wages) and therefore not taxable9. Compensation received for performed activities on the other hand belongs to taxable wage and so is compensation for lose income. 10 Based on art. 10 LB these compensations shall be taxed with wage tax.

The Dutch legislator decided that these compensations should be taxed with an extra wage tax of 26% if the compensation is used as an early retirement benefit. 11 By January 1st 2011 this rate will be 52%<sup>12</sup>. Based on art. 9.2, paragraph 1 IB 2001 (Dutch income tax) this extra wage tax will not be deductable for the taxation of income tax while the normal wage tax is deductible.

To ascertain whether dismissal compensation can be used as an early retirement benefit should be considered by a quality test<sup>13</sup> and, if necessary, a quantity test<sup>14</sup>.

The basic rule of the quality test is that the dismissal may not be specific to dismiss elderly employees. If that's not in order the extra wage tax shall not be taxed in the next situations:

- Dismissal occurs because of reconstruction based on objective standards. The extra wage tax will be levied when all employees elder then a certain age can resign with financial support and the quantity test will not be passed.
- Single dismissal occurs on conditions which are not age-related, like dismissal because of dysfunction.

In case the compensation is paid in these situations it will not be considered an early retirement benefit. If the compensation doesn't fall within these situations it should be considered by the quantity test. This test consists of two mathematical tests. When the dismissal compensation doesn't exceed these tests it will not be considered an early retirement benefit.

The quantity test consists of:

- The 55-years test. In case the payment(s) of dismissal compensation will stop before the former employee will become 55 years old, the compensation is no early retirement benefit. Within this test lays down the condition that the compensation cannot be more than 100% of the employees annual pay.
- The 70% test. In case the former employee receives a steady benefit until 24 months before his 65<sup>th</sup> anniversary (or earlier retirement) and it doesn't exceed 70% of his final pay, the dismissal compensation is no early retirement benefit.<sup>15</sup>

<sup>9</sup> HR 29 juni 1983, BNB 1984/2\*

<sup>&</sup>lt;sup>10</sup> R.N.F. Zuidgeest, 'Ontslagvergoedingen na een internationale loopbaan, samenhang tussen heffing van inkomstenbelasting en werkgeverslast', *WFR* 2005/119.

11 Art. 32aa Loonbelasting 1964.

12 G. Dietvorst e.a., *Toekomstvoorzieningen en fiscus*, Deventer: Kluwer 2007, p.149.

<sup>&</sup>lt;sup>13</sup> Besluit van 8 december 2005, nr. DGB2005/6722M, BNB 2006/118

<sup>&</sup>lt;sup>14</sup> Besluit van 26 mei 2005, nr. DGB2005/3299M, BNB 2006/119

<sup>&</sup>lt;sup>15</sup> G. Dietvorst a.o., *Toekomstvoorzieningen en fiscus*, Deventer: Kluwer 2007, p.149-150.

Taxable dismissal compensation can be paid in two different ways. The employer can pay the whole compensation directly at once to the employee or the compensation can be used to stipulate a periodically paid benefit. In case the dismissal compensation is not an early retirement benefit and is paid directly at once to the employee, the employer should hold back wage tax.<sup>16</sup> In addition to that it will be deducted from the Dutch income tax.

If the dismissal compensation is considered an early retirement benefit the extra wage tax of 26% will be levied besides the normal Dutch tax on wages and will not be deductible.

In case the dismissal compensation is not an early retirement benefit and is used to stipulate a periodically paid benefit the contribution is exempt while the outpayements will be taxed. If it is considered an early retirement benefit the extra wage tax will be levied as well.

#### **Dismissal compensation in the OECD Model Convention**

The terms 'pension' and 'other similar remunerations' have not been defined in the OECD Model Convention (hereafter: OECD). Art. 3, paragraph 2 OECD stipulates that domestic tax law should explain undefined terms unless the context requires otherwise. This means the Dutch explanation of these terms can be used and dismissal compensation can be part of the term 'other similar remunerations'. When dismissal compensation is not an early retirement benefit and is paid directly at once to the employee, it falls under the scope of art. 15 OECD because it is explained as income from employment. This means that the employee's dismissal compensation shall be taxed in the source state unless paragraph 2 applies. Then the right to levy tax on the dismissal compensation is assigned to the resident state of the employee.

If the directly paid dismissal compensation is considered an early retirement benefit art. 15 OECD is not applicable, but art. 18 OECD, because the compensation then is remuneration similar to pension. This means that the right to levy tax is assigned only to the employee's home state.

The right to levy tax on dismissal compensation used to stipulate a periodically paid benefit is assigned the same way as dismissal compensation that is paid directly to the employee. Most important is the determination whether dismissal compensation can be considered an early retirement benefit and therefore remuneration similar to pension or income from employment.

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<sup>&</sup>lt;sup>16</sup> Art. 10 Loonbelasting 1964

#### Dismissal compensation in the Tax Treaty Netherlands – Portugal

As in the OECD Model Convention the terms 'pension' and 'other similar remunerations' have not been defined in the tax treaty between The Netherlands and Portugal (hereafter: the tax treaty) and should be explained by domestic tax law. Art. 15 of the tax treaty follows the OECD Model Convention. The right to levy tax on dismissal compensation that can be considered income from employment is assigned the same as in the OECD Model Convention. The source state may tax the compensation unless paragraph 2 applies.

Art. 18 of the tax treaty however differs from art. 18 OECD. The right to levy tax on dismissal compensation that is considered an early retirement benefit and used to stipulate a periodically paid benefit is assigned to the resident state of the employee. So far the right to levy tax on dismissal compensation is assigned the same as in the OECD Model Convention.

The difference occurs when dismissal compensation is paid at once while it's considered an early retirement benefit. Then, according to art. 18 paragraph 3 of the tax treaty, the right to levy tax on dismissal compensation can be assigned to the source state as well.

#### The Third Pillar

#### 1. The Dutch law

#### 1.1 The three pension pillars

It is common practice to distinguish three pension pillars. <sup>17</sup> The first pillar consists of the state pension. The second pillar is formed by the supplementary or occupational pensions and the third pillar refers to private pensions. <sup>1</sup> In the Netherlands the third pillar is a compensating layer. The essence of a multi pillar pension system with a compensating layer is that any tax relief for pension contributions in the third (or second) pillar depends on the pension already built up in the other pillars. <sup>1</sup> More tax relief is available to those who without paying extra contributions would not get a pension that is deemed reasonable by the Member State concerned. <sup>1</sup>

The Netherlands provide tax relief for the contributions under the EET system in the third pillar. The EET system means contributions are exempted, investment results of the funds are exempted and benefits or out payments are taxed.

Annuity provisions, bank savings and life-course savings are based on a funded pension scheme. In the third pillar contributions are paid by the individual on a voluntary basis. Annuity provisions, bank savings and life-course savings will be separately discussed in the next chapters.

#### 1.2 The goal of the multi pillar pension system

The goal of the multi pillar pension system with a compensating layer is to help people achieve a fair standard of living after retirement. There is an extra tax relief for contributions to second or third pillar pensions in situations where a person's combined state, employment and private pension would not be sufficient to achieve a fair replacement rate. Citizens are stimulated to compensate their inadequate pensions. The responsibility for the old age provision decreases the financial dependence on others and reduces the probability of ending up in poverty at old age.

The goals of tax deductible contributions are the closing of pension's gaps and maintaining the same standard of living after retirement as one had during their working life. In the Netherlands the target level of total pension income is 70% of pre retirement income. The compensating third layer provides for tax relief for payments in the third pillar to taxpayers who can prove that their combined pensions of the first, second and third pillar would otherwise remain below 70% of their last-earned wages. Taxpayers who do not have such a pension gap are allowed to add their pension to the target level, but contributions will not be deductible from their taxable income.

#### 1.3 OECD Model tax Convention

<sup>&</sup>lt;sup>17</sup> Dietvorst, G.J.B., 'A multi pillar pension model with a compensating layer', Tilburg: Competence Centre for Pension Research, 2007.

Article 18 of the OECD Model says: 'Pensions and other similar remuneration paid to a resident of a Contracting State in consideration of past employment shall be taxable only in that state'. In the next chapters we will discuss the relevance of article 18 OECD regarding to the separate subjects: annuity provisions, bank savings and life-course savings schemes.

#### 1.4 Convention between the Netherlands and Portugal (20 September 1999)

On the basis of article 18, paragraph 1 of the Convention pensions and other similar remunerations paid to a resident of a contracting state in consideration of past employment, as well as annuities paid to a resident of a contracting state, are taxable only in that state. This article corresponds to article 18 of the OECD Model, with the exception of the regulation of annuities and social security payments.

Customary, the source state wished to tax the payments, because this state had previously given a tax benefit during the building of the annuity rights. In the OECD Model this is not how it works. A good alternative would be the right of the state of residence to tax the payments as well as a right for the source state to have a withholding tax. In the Convention between the Netherlands and Portugal such a withholding tax exists for the source state, but only under certain conditions.

The following requirements must be met:

- 1. In the source state, there was a tax profit during the time of building the payments rights. This could have been an exemption, a deduction of contributions when calculating taxable income or another tax relief.
- 2. In the state of residence, the annuity is not taxed at the generally applicable rate for income derived from dependant personal services, or less than 90 % of the gross amount of pension or other similar remuneration or annuity is taxed.
- 3. The total gross amount of the pension and other similar remuneration and annuities and any pension and other payment paid out under de provisions of a social security system, in any calendar year exceeds the sum of € 10.000,-.

All these requirements must be met for allowing the source state to tax. As mentioned above we can conclude the following rule; when the annuity is not taxed sufficiently in the state of residence, the source state may tax the annuity as well.

#### 1.5 Remove double taxation according to the Convention.

Article 24 of the Convention is about the avoidance of double taxation. The basic rule is: 'Where a resident derives income which may be taxed in the other state, the first-mentioned state shall allow a deduction from the tax on the income of that resident an amount equal to the tax paid in that other state. Such deduction shall not exceed that part of the tax, as computed before the deduction is given, which is attributable to such items of income derived from that other state.' Therefore, the state of residence has to give an exemption for the tax paid in the source state.

#### 2. An annuity provision

#### 2.1 Definition

This voluntary pension can be built up through an annuity provision on the basis of article 3.125 of the Dutch Income Tax Law. The annuity provision is a life insurance policy, through which the taxpayer is guaranteed of extra income at one fixed moment. It builds up an amount of capital, usually for pension purposes. The contributions must be paid to a qualified insurer and the date at which the taxpayer starts receiving out payments must be determined beforehand. It is a periodic social security dependant on the taxpayer's life. Annuity rights are built up on the initiative of the taxpayer and have nothing to do with the taxpayer's employment; the payments are funded by the individual.

On the basis of article 3.127 Dutch Income Tax Law the voluntary contributions are tax deductible as a spending for income facility. The pension rights already built up in the first two pillars are taken into account when calculating the maximum amount of contributions that qualify for tax relief.

There are more kinds of annuities. Among others, the EET system applies to the following annuities:

- 1) Old day annuity: an annuity till death. The annuity can be started at each preferred date, but not after the age of seventy.
- 2) Relative annuity. Relatives will receive an annuity when one of the two partners dies.
- 3) A temporary old day annuity. You receive annuity payments for at least five years. These payments will not start before the age of sixty-five and not later than at the age of seventy. Payments will end at a determined date, for example at the age of eighty.

#### 2.2 Yearly allowance

The yearly allowance for the tax relief must be calculated. The already built up pension rights must be calculated too. The more rights exist or have been built, the less deduction is allowed. The yearly allowance is adjusted to the taxpayer's income of a certain year. The taxpayer, who has not used up the complete amount allowed for tax relief, is allowed to use the remaining amount in a next year. This is a correction.

#### 2.3 OECD Model tax Convention

As mentioned in paragraph 1.3., article 18 of the OECD Model says: 'Pensions and other similar remuneration paid to a resident of a Contracting State in consideration of past employment shall be taxable only in that state'.

However, a life insurance policy is not related to past employment. So the life insurance payments come under article 21 OECD: other income. Article 21 says: 'items of income of a resident of a Contracting State, wherever arising, not dealt with in the foregoing

articles of this Convention shall be taxable only in that state'. The payments will be taxable in the state of residence.

#### 2.4 Convention between the Netherlands and Portugal (20 September 1999)

When a person works in the Netherlands and receives payments from Portugal or vice versa, you have to deal with the income tax of two countries. You can be taxed both on the basis of the residence principle and the source principle. To avoid double taxation, a Convention has been drafted between both contracting states.

Especially for a lot of old age pensioners who are enjoying life in Portugal, some disadvantages will be taken away. No longer will there be double taxation of their pension. Portugal will tax the pension or annuity. When Portugal will not tax at the generally applicable rate for income, the Netherlands are allowed to tax the payments as well.

On the base of article 18, paragraph 1 of the Convention life annuity payments shall be taxable in the state of residence. This is the standard rule. By way of exception the annuity payments shall be taxable in de source state too, according to article 18, paragraph 2 of the Convention. The source state will tax the payments if they meet the certain requirements as mentioned in paragraph 1.4.

If a lump-sum payment is made in lieu of the right to an annuity before the date on which the annuity commences, the payment of this lump-sum may also be taxed in the state from which it is derived (the source state) on the basis of article 18, paragraph 3.

#### Example:

Person X, living in Holland, received annuity payments from Portugal in a certain year. The yearly annuity amount is € 8.000,-. During the building of this annuity right, contributions are deducted from the taxable income in Portugal, but the payments are taxed in Holland at the usual income tax rate. Consequently, the payments are only taxed in Holland. There is no withholding tax accepted in this case.

#### 2.5 Portuguese tax and decisional law

In Portugal, pensions and annuities will be taxed at a rate of 32%. Aside from that, there is an exemption for such income of €8.500,-. According to decisional law the high exemption does not result in the conclusion that income will be taxed for less than 90% in Portugal (V-N 2008/7.8 and Protocol XVI). Furthermore, whether Portugal in fact actually taxes the income does not matter.

#### 2.6 Remove double taxation according to the Convention

As mentioned in paragraph 1.5 the state of residence has to give an exemption for the tax paid in the source state.

For lump-sum payments there is a different treatment. For lump-sum payments in lieu of the right to an annuity before the date at which the annuity commences, Portugal accepted a source tax in the Netherlands. However, Portugal did not want to give up their own right to tax as the state of residence. On the basis of article 18, paragraph 6, they have come to an agreement by which the Netherlands will tax the rights and deduct the amount of taxation in Portugal. The Netherlands gives a credit.

#### 3 Bank savings

#### 3.1 Introduction

The third pillar refers to private pensions, these pensions have nothing to do with employment of the individual and the contributions are paid voluntary. For bank savings applies that the paid contributions are tax deductible if you meet the conditions. One of the most important conditions is that the taxpayer must prove that the combined pension of all pillars is below 70% of their last earned wages, a pension gap, to acquire the fiscal facilities. As mentioned before the Netherlands uses the EET system; the contributions and investment results are exempt and the benefits will be taxed.

These private pensions are usually provided by insurance companies, but since the first of January 2008 also banks offer a kind of annuity provision that can be tax facilitated. The bank savings scheme is an example of a funded pension scheme. Via a blocked savings account it is possible to save up financial means to provide for a decent living standard after retirement. It is private capital and after years of savings you build up a specific amount of money which you can use to acquire an annuity provision at an insurance company or a bank.

#### 3.2 Variants and conditions

of thirty)

The commencing date and whether the account holder is alive or not determine which conditions apply:

- Commencing date of payout periods before 65<sup>th</sup>.
   Fixed and equal periods with a minimum of twenty years. (Excluding the years before 65<sup>th</sup>.)
- Commencing date of payout periods after 65<sup>th</sup> and before 70<sup>th</sup>.
   Minimum duration period of 5 years.
   If a period shorter than 20 years is used, the annual payments may not exceed 19.499 (2008)
- 3) Entitlement after death of account holder
  - a. Account holder dies at advancement stage.

The heirs obtain the annual payments, these payouts start directly.

\*Heirs in the straight line or in second/third degree sideline.

>30years: minimum duration of twenty years

<30years: they can choose for a lifelong variant (minimum of twenty years) or a

temporarily variant (minimum of five years or ending at age

\*Other kind of heir. Minimum duration of five years

b. Account holder dies after the payout periods started.

Right proceeds one on one on the heirs and they continue the periods.

c. Partner of the account holder dies at the advancement stage.The periods go in directly, with a minimum duration of five years.

#### 3.3 Fiscal law

To qualify for the tax facilities some additives where necessary in the Dutch Tax law. In article 1.7 Income Tax all approved forms of annuity provisions are listed and since this year also (blocked) bank savings are mentioned. The main article for bank savings is article 126a Income Tax. The rules in this article are as well as possible synchronized with rules of annuity provisions. The advancement stage of bank savings seems to be in line with the advancement stage of an annuity provision, but for the run-down period there are differences.

#### 3.4 Advantages of an 'annuity provision' at a bank:

First of all it is an advantage that we have an extra choice; it is an opportunity to use the product that suits best our personal goals and circumstances. Secondly, the prices of insurance companies (and banks) will probably fall and costs will be more transparent as a result of the competition. A third advantages is that more tenders results in more savings. We expect that individuals will be extra stimulated to compensate their inadequate pensions. Finally there is no need to arrange for a surviving dependant insurance, because the rights stay at the heirs.

#### 3.5 Disadvantages of an 'annuity provision' at a bank:

- Lifelong in terms of an annuity provision at the bank means twenty years at least. If your contract is formulated to pay out in a period of twenty years and you live longer than that period, there will be no money left in the third pillar.
- It is private equity, which means that creditors can break into your capital.
- A period of at least twenty years is compulsory, therefore you need to save a lot to have a reasonable supplement on your pension.
- Insurance for an exemption of contributions in case of incapacity is not possible.

#### 3.6 Bank saving, the better alternative?

This is not right away true. There are several things you have to take into account; the potential capital you want to achieve, your age, do you want to save or invest and costs.

A big problem is that the costs are not known yet for all bank products and costs of insurances can fall, because of the competition with banks. Furthermore your personal goals and circumstances are crucial for the decision whether to choose for an insurance company or a bank.

#### 3.7 Convention between the Netherlands and Portugal (20 September 1999)

Social benefits, pension and annuities are incorporated in art. 18 of the Convention. The annual payments are taxable in the country of residence unless the requirements are met, as mentioned in paragraph 1.4.

Court Arnhem (VN 2008/7.8) judged that it is important that the annuities are taxed in the residence state at the generally applicable rate for income but there is no need to check if effectively a reasonable amount of tax is raised. This is questionable! Why did we document in this Convention that the annuities should be taxed at the generally applicable rate for income?

Further the court decides that not 'or' but 'and' should be used between the two rules in the second condition. This is also questionable, but the State Secretary did not give any notice of appeal! This means possibilities for tax planning.

#### 4 Life-course savings scheme

#### 4.1 Life-course savings scheme and the Dutch law

The life-course savings scheme is implemented in article 19g Dutch Salaries Tax Law 1964. It's an arrangement that gives employees in the Netherlands the opportunity to save a part of their gross salary in order to be able to have a period of unpaid leave. The saved part of the salary is tax free. Each form of unpaid leave (sabbatical year, study leave, carer's leave, part-time leave etcetera) is permitted. Main goal of the arrangement is to create an opportunity for employees to make provision for extra leisure time. However this doesn't mean people can take time off whenever they want; the employer needs to give permission for the extra time off and making use of the arrangement. The government hereby enables people to find a better balance between their work and private life. The life-course savings scheme is partly implemented to fill the gap that arose with the abolishment of the VUT (early retirement) and the prepension.

From 1 January 2006 employees are able to deposit money in the life-course savings scheme. Every employee has the right to take part but is not obligatory to do so. It's a typical Dutch arrangement. Both in European and International law the life-course savings scheme is unknown. Only the Scandinavian countries have similar facilities embedded in there national law.

#### 4.2 Main elements

Every year an employee can save up to 12% of his gross salary for leave. An exception is made for people who are born after 1949 and before 1955. In this case you can save more than 12% every year. The maximum a person can save is set at 210% of the gross year salary.

An employee can choose at which financial institute he will place his life-course account or insurance. The advantage of this system is that the employee is able to maintain the life-course account or insurance when he changes employer. The employer will deposit the amount of money onto the account or insurance. The life-course credit is not taxed in box 3 because it's not considered as capital.

#### 4.3 OECD model tax Convention

In the European and international content there are more questions regarding the life-course savings scheme. This is because the scheme is a purely national arrangement. A similar scheme is unknown in International and European law. Therefore tax treaties do not mention anything regarding the arrangement. The arrangement must be individually applied to European and International law. Employees from abroad can also make use of the life-course savings scheme. Withdrawal of the life-course credit is seen as remunerations employment in the Netherlands and therefore article 15 OECD model regarding Income from employment applies. Article 15 OECD model states '..by a resident of a Contracting State in respect of an employment shall be taxable only in that State unless the employment is exercised in the other Contracting State. If the employment is so exercised, such remuneration as is derived therefrom may be taxed in that other State.' Overall can be said withdrawal of the life-course credit is taxable in the Netherlands. The money deposited onto the account must be done regarding income from employment in the Netherlands as in article 15, 16, 17, or article 19 OECD model.

Another possibility regarding the withdrawal of the life-course credit is article 18 OECD model. Article 18 OECD model (Pensions) states '.. pensions and other similar remuneration paid to a resident of a Contracting State in consideration of past employment shall be taxable only in that State.' The State of Residence generally has the right to tax. Life-course savings scheme can be seen as a pension as meant in article 18 OECD model when the life-course credit has been introduced in a pension scheme. In some cases, when the position has ended and the height of the entitlement is intended for bridging the period between the ending of the position and the pensionable age, it's possible the withdrawal of the life-course credit will be seen as pension and article 18 OECD model applies. In this case the life-course credit should be paid lump sum. The advisory committee regarding Pensions thinks article 18 OECD model could also apply when the employee stops working (while there is still a position) and uses his life-course credit to support life from the beginning of that day until pensionable age is reached. Especially when using your leisure time preliminary your pensionable age article 18 OECD model could be applied. The parliamentary undersecretary of state thinks otherwise about this matter. He states; as long as there is a position whereof withdrawal of the life-course credit takes place. it's not possible to speak of a pension as meant in article 18 OECD model.

4.4 Convention between the Netherlands and Portugal (20 September 1999)

#### 4.4.1 Definition

There is no definition of the life-course savings scheme in the Convention and in the OECD model. This is because the arrangement is typical Dutch and unknown in the European Union. As stated above, the arrangement must be individually applied to European and International law.

#### 4.4.2 Articles that could apply to the life-course savings scheme

In the Netherlands withdrawal of the life-course credit is seen as remunerations employment and therefore article 15 Convention regarding Income from employment applies. This article is the same as article 15 OECD and therefore, in this case, taxation is the same in the Convention between the Netherlands and Portugal as it would be in the OECD model. Overall can be said withdrawal of the life-course credit is taxable in the Netherlands. The money deposited onto the account must be done regarding income from employment in the Netherlands as in article 15, 16, 17, or article 19 Convention.

Article 18 Convention could apply to the life-course credit when the employee's position has ended and the height of the entitlement is intended for bridging the period between the ending of the position and the pensionable age. In this case the life-course credit should be paid lump sum. When the life-course savings scheme has been introduced in a pension scheme article 18 Convention applies for sure. In paragraph 1.4 this article is further explained.

When the requirements are met as stated in paragraph 1.4, the source state has the right to tax. As mentioned above we can conclude the following rule; when the lifecourse savings credit is not taxed sufficiently in the state of residence, the source state may tax the credit as well.

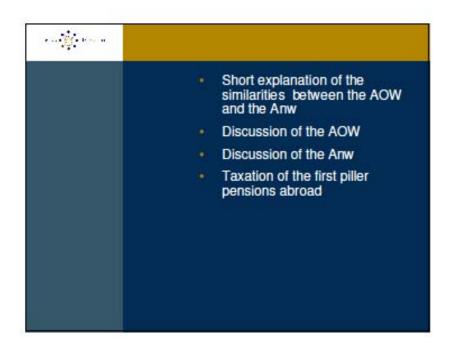
I. (Inge) Wouters
P.J.M. (Paul) Straetemans
T.J.C.P. (Tim) Maas

#### **Assignment 1b: Introduction**

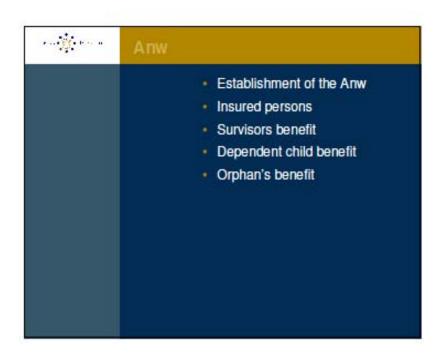
The main assignment was divided in two parts. The first part was to write a short thesis in English about a particular part of the national Pension system. The second part was to prepare a presentation (Thematical presentations of the papers).

- time 20-25 minutes
- sheets max 6



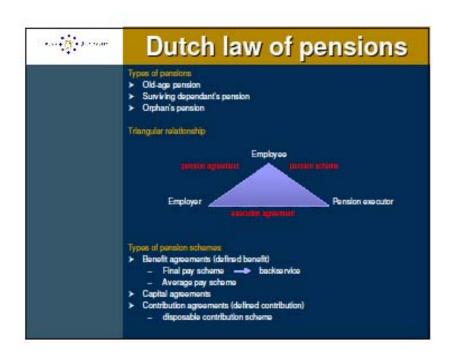


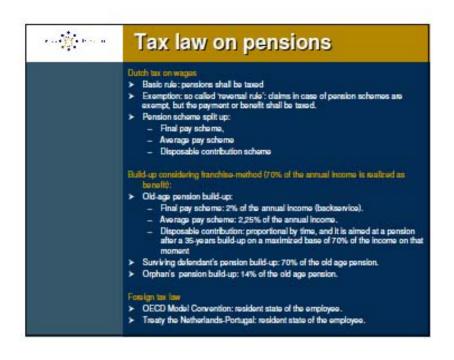








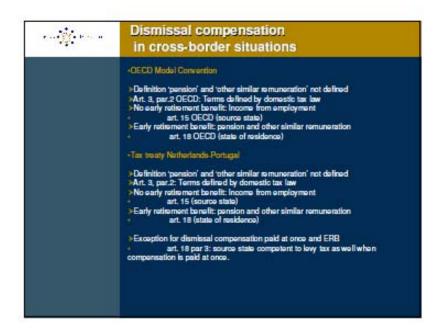




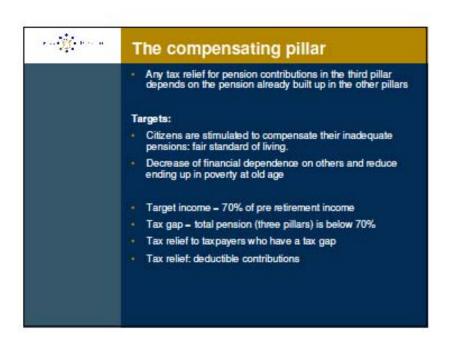
#### esse Medican Art. 18 & 19 OECD / NL-Port . Art. 18 OECD Model Convention Private pensions Home country taxation . Art. 18 Treaty (1999) Natherlands - Portugal Special provision I: host country taxation if Host country exempted pension premiums, and > Taxed against lower % or < 90% amount is taxed, and Pension > € 10.000 Special provision II: host country taxation in case of lump-sum payments - Art. 19 OECD Model Convention Public pensions (government service) Host country taxation Exception: payments to residents/nationals home country Art. 19 Treaty (1999) Natherlands - Portugal Follows OECD Model Convention









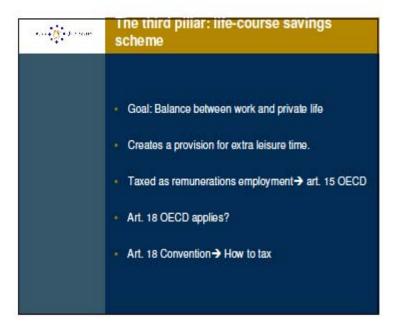


# The compensating pillar Tax relief for the contributions under the EET System (Contributions Exempted, Investment to suits Exempted, Out payments Taxed) Savings are based on the funded pension scheme Art. 18 OECD: pension is taxable in the state of residence Art. 18 Convention: OECD article including annuity When the annuity is not taxed sufficiently in the state of residence, the source state may tax the annuity as well. Requirements: tax profit in source state, generally applicable rate / <90%, total pension amount >10.000 euro. Art. 24 convention: avoidance of double taxation; exemption in state of residence.

# The third pillar: an annuity provision A voluntary pension: a life insurance policy Deductible as a spending for income facility. Calculating the maximum amount of contributions that qualify for tax relief The more rights exists (three pillars together), the less deduction is allowed. Art. 21 OECD: other income: taxable in state of residence

## Convention The Netherlands-Portugal Art. 18 OECD: taxable in state of residence Art. 18 Convention: annuities are taxable in the state of residence as well (under requirements). Art. 24: avoidance of double taxation. Basic rule: 'Where a resident derives income which may be taxed in the other state, the first-mentioned state shall allow a deduction from the tax on the income of that resident'. Lump-sum payments: art. 18, par. 6

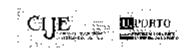
## The third pillar: bank savings A funded pension scheme – the EET-system Tax facilitated if met requirements -pension gap -variants Rules of bank saving in line with annuity provision rules? Advantages choice, costs, more binders, surviving dependant insurance. Disadvantages Lifelong, private equity, period of twenty years, incapacity insurance. Bank savings; the better alternative?



#### Portuguese presentations:



Faculdade de Direito da Universidade do Porto 16-19 November 2008



Glória Teixeira FDUP/CIJE Associate Professor



Interaction with the Social Security Regime

- Mandatory contributions fully deductible from the tax base
- Pension income taxable at the time of retirement

## The 2009 Financial Budget

- The new rules applying to EU and EEA resident. employees, professionals or traders and pensioners: the conditions
- . The criteria of minimum 90% income derived in Portugal or from outside source;
- . The existence of exchange of information agreement.



## • \* - The 2009 Financial Budget

The new rules applying to EU and EEA resident employees, professionals or traders and pensioners:

If the above conditions are met, those residents may elect to be taxed under the rules applying to residents and become entitled to the same tax deductions available to residents.

## • • Tax deductions

- -Mandatory social security contributions;
- Personal deduction;
- Health deduction:
- Education and training deduction;
- Elderly expenses deduction;
- Residential loan expense or rental deduction;
- Life or Personal Insurance premium deduction;
- Other deductions available under the Tax Benefits Code

## ● ● The 2009 Financial Budget

 In the circumstances mentioned above, non-resident income is subject to the same withholding tax rates applicable to non-residents unless a Double Tax Treaty applies.

47

## The 2009 Financial Budget

Tax compliance requirements applicable to non-residents, for the above mentioned situations:

- . Submission of the annual tax return;
- . Deadlines: as applicable to resident taxpayers

International Winter Course On Pensions







## IRS Tax for Foreign citizens in Portugal: The Impact of Finance Budget 2009

#### International Winter Course on Pensions Faculty of Law , University of Porto

November 17-19, 2008

Amanda Sachetim Marçal Rigo André Miguel Santos Silva FDUP/CIJE



## ● ● ● Key concepts

Personal Income Tax (IRS)

Foreign Citizens

2

New additions in Finance Budget 2009

## → Introduction

Personal Income Tax (IRS) for Foreign residents in Portugal.

All Foreigners who work in Portugal are entitled to pay their IRS in the same jurisdiction.

## • \* • New IRS Code 2009

With the new provisions of the IRS Code, for 2009, there will be a new optional regime for residents in Portugal or others residents of the EU or the EEA.

## New provisions of the IRS Code - 2009

The optional regime for non-residents allows that IRS is levied on the value of the following categories of Income:

Category A: Labour Income

Category B: Income from Business and

Professional Services

Category H: Pensions

For tax purposes, a foreign citizen is considered resident, and so liable to pay income tax (IRS) on the present year.

## Bibliography and relevant web pages

www.dgci.min-financas.pt www.dgo.pt

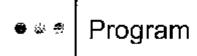
Glória Teixeira, Manual de Direito Fiscal, Almedina, 2008.



# EU perspective on taxation of pensions

Internacional Winter Course on Pensions Faculdade de Direito da Universidade do Porto November 2008

> Francisco Pimenta Francisco Matos FDUP/CIJE

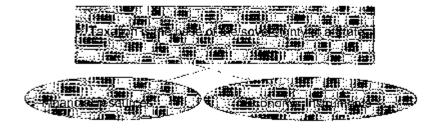


- o European Perspective on Pensions
- o Double Taxation
- Double Taxation Conflicts
- How to solve double taxation conflicts
- o Individual retirement plans
- The Portuguese pension system.

• • • Main Concepts

- Mon-deductibility
- Double Taxation

European Perspective on Taxation of Pensions



On tax policy, it is convenient for EU States to work together, not in opposite directions.

**a** 🍪 😤

#### **Definitions**

- Double-taxation taxing the same income twice.
- Deductible What can be deductible from income

## • • • Main Problems

- The costs of deductibility to the States finances.
- Lack of coordination between EU states.

External problems of individual retirement plans (IRP)

- Incomes from IRP
- Double-taxation or non deductibility

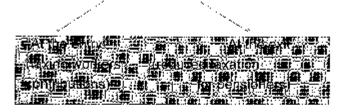
Basic Structures of the Portuguese pension system

- EET structure Exempted contributions /Exempted Pension Funds / Taxable Pension,
- TER structure Taxable contribution/ Exempted Pension Funds /Reduced Taxation of Pension.

#### Solution proposed

The TER structure should be adopted in the EU, in order to achieve more coordination.

Taxing/Exempting (partially)



The revenues will be divided between the source and the residence states.

## ● ♣ € IRS Code –main provisions

- Art. 13, 1 Everyone who resides in Portugal, and those who do not reside in Portugal but have incomes from here are taxed under the IRS.
- o Art. 71, 2, f Pensions earned by non-residents in Portugal are taxed at a 20% rate.
- Art. 81 Tax credit by international double taxation.

#### • • •

#### Bibliography

- Glória Teixeira, Manual de Direito Fiscal , Almedina, 2008
- Glória Teixeira (coord.), Tributação dos Rendimentos de Trabalho Dependente – relação com as contribuições para a Segurança Social, Vida Económica, 2000
- A política fiscal na UE, Serviço das Publicações
   Oficiais das Comunidades Europeias, 2000

11

#### **#** # 9

#### Recomended Internet Sites

- o http://www.min-financas.pt
- o http://curia.europa.eu/
- o http://ec.europa.eu/
- o http://www.direito.up.pt



## Portuguese Social Security System

International Winter Course on Pensions Faculty of Law , University of Porto November 2008

> Daniel Almeida António Maia



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- Increase of life expectations;
- Rise of the retirement age to 65 years;
- Many pensioners;
- o Increase of the costs with the National Health Care System;
- Low birth tax (one child by couple);



Less contributions.

## • • Introduction

- One worker to sustain two pensioners;
- D Budget: Costs higher than the gains;
- A needed increase of the birth rate;
- National Social Security law 4/2007, published in January 16<sup>th</sup>:
   ✓ Main articles – 2°,26°, 81°.

3

## • \* Three main pillars

- The Portuguese social security system has three main structures;
- Public System;
- Alternative schemes of social security:
   Company pensions and public pensions fund;
- Individual retirement saving plans.

## ● ™ Public System

- o Main base of the social security;
- Universal (all citizens included have the right to a pension irrespective of their contributions to the system);
- Own budget inside of the general state budget;
- Organized and managed by the State.

## € ● ■ Public System

- The contributions are calculated based. in the employees wage and paid by both employer and employee;
- o Distribution financial scheme organized as a fund of stabilization;
- Supported by the mandatory contributions of the employers, employees and by the transfers from the general state budget.

#### Public System

- The pension system is divided in two schemes: General scheme or contributory and the non-contributory scheme;
- The general scheme is an obligation either to dependent workers or to independent workers;
- Non-contributory scheme; includes all the citizens that are not in the general scheme or in other one legally established scheme.

#### 3 4

## Taxation of employees

oThe dependent employees are taxed under IRS;

- In case of residents in Portugal, they are taxed on their wages and other possible profits;
- Progressive taxation applies after being made the allowed deductions (IRS code);
- Foreigners working in Portugal are taxed in their income derived from the country.
- Impossibility of deductions, with 2009 FA exceptions.
- Contribution to the Social Security System aren't deducted to taxable income except under new provisions of the 2009 Finance Act.

#### **9** 7 6

#### Taxation of employees

- The residents in Portugal are bound to contribute to the Social Security System;
- The interaction between the IRS and the Social Security System;
- Taxation of wages under the IRS Code;
- Other employees benefits.

#### 9

#### 争作者

## Taxation of employees

o The importance of the regulation Decree no 12/83, February 12th.











## Taxation of employees and taxation of the pensions

- Definition of income for contributions purposes. The criteria of periodicity;
- For tax purposes, the deduction is always allowed to the gross income of resident workers;
- Taxation of pensions: Article 53 of the IRS code (annually updated);
- Taxation and the relation with residence of the taxpayer.



## Alternative schemes of social security

- The importance of the development of this second pillar is related with the difficulties that the Social Security System faces;
- The pensions plans are from three different types:
  - ✓Plans with defined benefit:
  - ✓Plans with defined contribution;
  - ✓ Plans mixed.
- Definition of professional and additional schemes of pensions.



## Alternative schemes of social security

- The additional professional schemes for dependent workers have to follow some standards:
  - √ The schemes have to be managed by independent institutions with financial autonomy;
  - Financed by the employers and employees;
  - Created by free initiative by the enterprises. and their employees by means of an agreement in which there are defined the objectives and the content of the professional complementary scheme.



## Alternative schemes of social security

- The contributions made by the employer are considered for tax purposes as deductible costs;
- Incentive to these alternative schemes:
- The problem of the national legislation in the case of foreigners, the immediate taxation;
- The contributions as acquired rights and personal rights;
- The IRC (corporate income tax article 40° IRC code).



## Individual retirement saving plans

- Voluntary participation and the acceptance is only conditioned by the financial institution that manages the retirement saving plan.
- Supervision made by the institutions.
- The tax benefits of these plans.
- Three forms: investment fund, pensions fund or a similar fund.
- There are certain rules that have to be respected.



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- Without the Teach.
- **0** 19<u>07 0</u>00**5**5.803.433
- o [12, 1079, 46M.S. (3-2) (48) (4)

## The International

View on Pensions:

A Comparative Perspective Between
Portugal and Netherlands

International Autumn Course on Pensions Faculdade de Direito da Universidade do Porto November, 2008

> Ana Rita Pereira **Hugo Cabral**



## Presentation's Structure

- 1. Advent and Evolution of the Social Security System in Portugal;
- Analysis on the Convention Between the Portuguese Republic and the Kingdom of the Netherlands for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and on Capital (from now on referrer) as "the Convention");
- s. Organisation for Economic Co-operation and Development;
- Private Pension Savings;

2

s. Analysis of a Case Law of the Supreme Administrative Court;

● # #

# Advent and Evolution of the Social Security System in Portugal;

- a Definition:
- Christian influency, Mercy Brotherhood, Casa Pia and other institutions;
- 1935 Approval of the general basis above which the Social Security would be organised;
- o 1962 A first reform;
- 1977 A new structure;
- The 80's The Law 28/84, from August 14.<sup>th</sup> and other legislative measures;
- The 90's Increase of the financial pressure, but still some measures;
- The 21st Century The present and the future challenges;

3

■ 48: 4h

- 2) Analysis on the Convention Between the Portuguese Republic and the Kingdom of the Netherlands for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and on Capital
- The Convention main questions to discuss:
  - Adoption of the Residence Criteria;
  - Measures taken to pursuit the agreed goals;
  - Can pensions be transfered?

-1

## Analysing the Convention between Portugal and the Netherlands

A convention is a <u>bilateral treaty</u> and it is written and comes into force in both languages.

This convention is also applied in English.

According to Article 2 of the Vienna Convention on the Law of Treaties...

"(...) "treaty" means an international agreement concluded between States in written form and governed by international law, whether embodied in a single instrument or in two or more related instruments and whatever its particular designation (...)."

5

#### **4** C 4

## The Existing Taxes Covered by the Convention (in 1999)

#### o In Portugal:

- Imposto sobre o Rendimento das Pessoas Singulares (IRS);
- Imposto sobre o Rendimento das Pessoas Colectivas (IRC):
- Derrama;

#### o In the Netherlands:

- Inkomstenbelasting;
- 2 Loonbelasting;
- Vennootschapsbelasting;
- Dividendbefasting;
- Vermogenbelasting;

В



#### Article 4 - "Resident"

- Article 4 establishes in its first paragraph that a "<u>resident of a State</u>" is any person who, on account of that State's legislation, is submitted to a tax due to his or her residence.
- o But what if the individual resides in <u>both</u> of the Contracting States?

The second paragraph of article 4 provides several solutions.



## Avoiding double taxation: Paragraph 2 of article 4

- The individual may be considered resident only in the State in which he possesses a
  permanent home, if he has it in both States, it shall only be considered the one where his
  economical and personal relations are more significant.
- The individual will be thought as resident of the State where he usually lives if there is no
  possibility to ductio where the centre of his or her vital interests lies or if he or she does not
  possess a permanent home in any of the States.
- The individual's nationality will be taken as a criteria if he or she lives permanently in both States or if the contrary is noticeable. Among us, consult the article 4° of the Constitution, which points to the organic law n." 2/2006, dated from April, 17th
- c The authorities of the Contracting States are to decide by mutual agreement, if he is national of both States or of neither of them.

Paragraph 3 of the same article refers to companies saying that if the resident considered is a company established in both States, its residence shall be that of the State where its effective management is located.

## Article 18 – "Pensions, Annuities and Social Security payments"

#### Pensions and other similar remunerations...

- a) Of a past employment \*\*\* Taxable only in the State where the resident was paid.

#### However, the pensions paid by a security system may also be taxed in the other Contracting State if...

- The entitlement to that poisson is exempt from tax in the State where it would be taxable or when there has been a deduction (tax refer).
- That pension is not taxable by the internal laws of the State where the recipient is resident.
- $\sigma$  . The total gross amount of pensions exceeds the sum of 6 10 000.



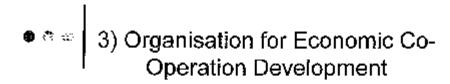
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#### Article 19 "Government service"

The main principle states that the salaries, wages and other remunerations are to be taxed only in the Contracting State who paid them.

The same may be taxable only in the other State if the services were rendered within its territory and if the individual resides there, being its national or if he or she has not become its national only for the purpose of rendering those services.

As for the pensions concerning government services, they may be taxed in the other Contracting Stato if the individual is its resident and national.



 The OECD is compelled to bring together the governments of its 30 member countries; it also invites non-members to membership talks.

Its main missions are to support economic growth, to boost employment and to assist countries' economic development.

 To reach an ideal economical stability, the OECD encourages its members to conclude agroements such as the conventions to avoid double taxation and, more recently, it has promoted the private pension savings.

www.oecd.org



## 4) Private Pension Savings:

- Reminding the Social Security System current problems;
  - Its relations with Private Pension Savings:
- A mathematical inevitability;

11

- The Private Pension Savings in Portugal:
  - The "Planos de Poupança Reforma" (PPR's);
  - €12,7 billion and €150 billion (11,8%);
- The future will judge on the rightness of this product;

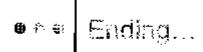
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# 5) Case Law of the Supreme Administrative Court (Portugal)

- An example from Comparative Law: Sentence dated from 18-10-2006.
- Main Problem: Two finish citizens, currently residing in Portugal, developed an activity in our country which was ordered by Finland and the earnings of their work were taxed both in Finland and Portugal.

The daine of the applicants:

The judicial actions from the Court;
 The law in the Conversion and in the Purtuguese IRS Code;



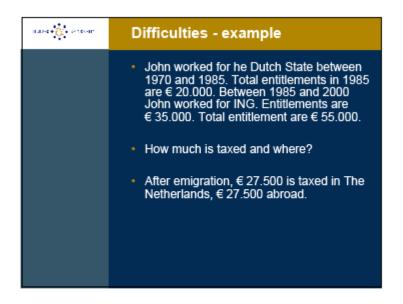
- o Hope you have enjoyed...
- We would be grateful to answer all your questions;

#### Presentation Helga van Bijnen





| Transce + 2 + unines in | Difficulties   |
|-------------------------|--|
|                         | <ul> <li>Pensions not being government pensions</li> <li>OECD: taxation at home state most desirable</li> <li>Because of mobility of pensioners, mostly 'cold' countries lose tax income</li> <li>Dutch policy: taxation at home state no longer the standard</li> <li>Transfer of capital</li> <li>Voluntary build up of extra pension</li> <li>The Netherlands: split by years of service, not actuarial</li> <li>Conflict of interest between States</li> </ul> |

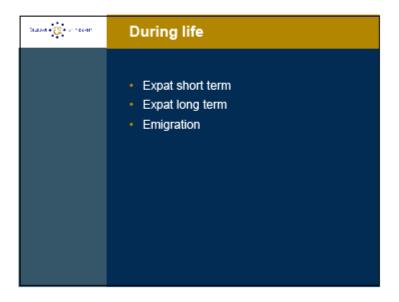




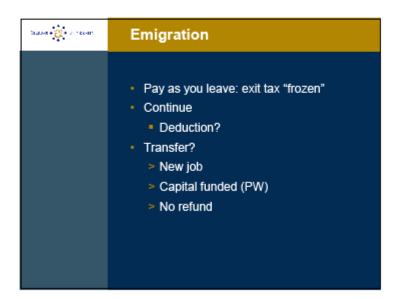
#### Dutch tax treaty policy

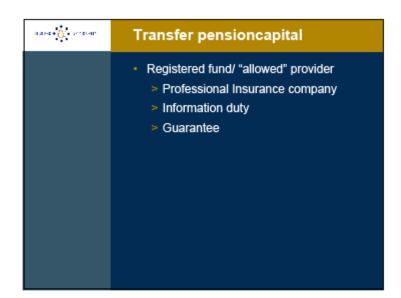
- The Netherlands lose tax income rapidly because of immigration to sunny countries
- As from 2000: new policy
- New or updated tax treaties: also taxation at source
- Belgium, Portugal, Poland, South-Africa, Jordan
- UK: state of residence (18 = 19)

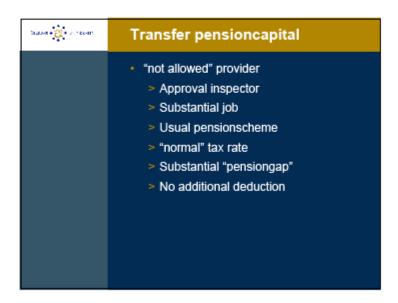


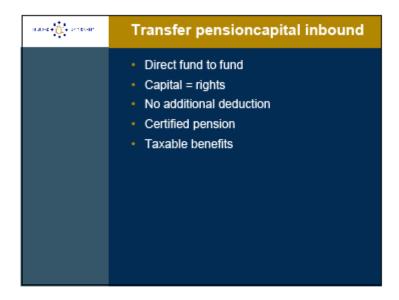




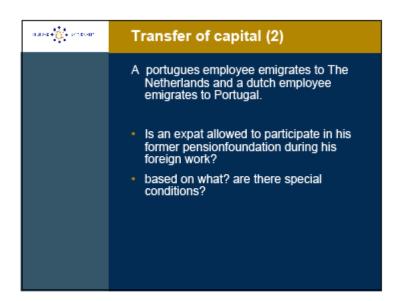




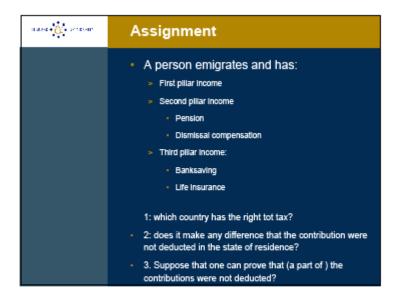


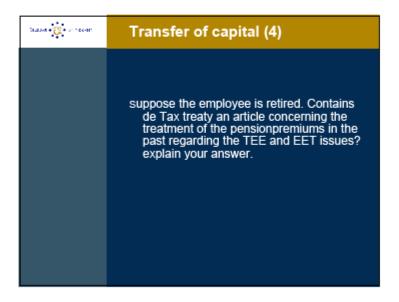










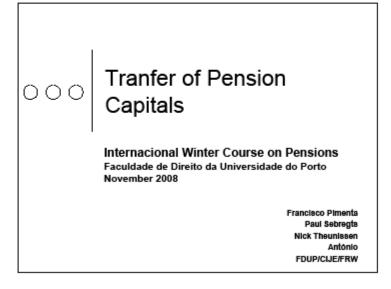




#### **Assignment 2a: Transfer of capital (1)**

A portugues employee emigrates to The Netherlands and a dutch employee emigrates to Portugal.

- Is it possible to transfer the pension capitals?
- based on? are there special conditions?



# Transfer of pensioncapitals o In case of Portugese employee o In case of Dutch employee

#### 000

#### Approved pension executor

- o Conditions (CPP 2007/98M):
  - Approval by inspector.
  - · Employee is participant of a pension scheme of EU or ECB.
  - Restrictions on further transfer of pension capital.
  - · Employee gives a copy of the new regular pension scheme.
  - Direct transfer.
  - No deduction.
  - · Demands to emigration.
  - Take over accountibility.

## Non-approved pension executor.

- o Conditions (CPP 2007/98M):
  - · Approval by inspector.
  - · Substantial employment.
    - · Proved employent of min. 5 years.
  - · Demands to the pension executor.
  - · Employee gives a copy of the new regular pension scheme.
  - Direct transfer.
  - No deduction.
  - Demands to emigration
  - · Take over accountibility

#### OOO Tax claim

- o Emigration and EET: loss of capital in the
  - · Build-up pension becomes wage.
  - Tax claim by emigration.

Netherlands.

- No claim on tranfer to an approved pension executor.
- In contrary to non-approved pension executor, there will be a claim.
  - No taxation after 10 years, if don't take na action (buy-off etc.)

#### **Assignment 2b: Transfer of capital (2)**

A portugues employee emigrates to The Netherlands and a dutch employee emigrates to Portugal.

- Is an expat allowed to participate in his former pensionfoundation during his foreign work?
- based on what? are there special conditions?

#### Assignment 2

Is an expat allowed to participate in his former pensionfund during his foreign work? Based on what? Are there special conditions?

Francesco Daniel Tim Maas Maarten-Ceelen

# Continuation of a Portuguese pension in The Netherlands

- Facts & Circumstances:
  - Portuguese employee participates in a Portuguese occupational (second pillar) pension
  - He is assigned to The Netherlands (temporarily)
  - Wants to continue his Portuguese pension plan
  - Are the employee contributions still tax deductible and are the employer contributions still tax exempt?

## Continuation of a Portuguese pension in The Netherlands

- Portuguese pension ≠ real Dutch pension according to Dutch law
- Main rule: reverse rule not applicable. No tax incentives
- Exception: corresponding approval (aanwijzing)
   Portuguese pension (art. 19d Dutch Wage Tax law & art. 97 Pension Act)

#### Corresponding Approval of a Portuguese pension

- Dutch decree (CPP 2007/98M) applicable
- Corresponding approval granted → taxincentives
- Distinction in the decree:
  - Corresponding approval EU pension plan
  - Corresponding approval non-EU pension plan
- Approval granted for ≤ 5 years

#### Corresponding Approval of a Portuguese pension

- Light corresponding approval (lichte aanwijzingsprocedure)
   The Netherlands adheres all EU pensions plans

  - Dutch tax incentives provided in accordance with Portuguese tax law!
  - Conditions to get corresponding approval
    - Continuation of Portuguese pension plan
    - Occupational (second pillar) pension plan
    - Portuguese pension executor
  - Employer and employee must declare conditions are met
- Heavy corresponding approval (zware aanwijzingsprocedure)
  - Dutch Tax authorities will check Portuguese plan themselves
  - Send copy Portuguese pension plan
  - Procedure followed when full certainty is desired

#### Corresponding approval of a Portugese pension plan (continued)

- Advantages:
  - Tax incentives
  - Prevents pension build up in multiple countries
  - Acquinted with home country pension
- Disadvantages
  - Corresponding approval impossible for > 5 years
  - Administrative burden
  - Deferred (protective) tax assessment upon remigration
     Incurred in case of e.g. lump sum payment / full buy off

    - Deferred tax assessment in accordance with Vienna convention?
       Treaty override? (unilateral expansion of the right to levy tax) (strijd goede verdragstrouw?)

#### **Assignment 2c: Transfer of capital (3)**

A portugues employee emigrates to The Netherlands and a dutch employee emigrates to Portugal.

- Is an expat allowed to participate in his former third pillar provision?
- Based on? Rules?

Is an expat allowed to participate in the former third pillar provision?

#### The third pillar and expats

- A Dutch employee moves to Portugal (no longer resident of the Netherlands)
- Art. 15 OECD: wage taxable in Portugal
  - (working > 183 days in Portugal, payments are not derived from Dutch company or permanent establishment) No income in the Netherlands > no
- opportunity to be treated as a Dutch resident No Dutch income = no deductibility of annuity
- contributions in the Netherlands

### Return to NL after five years (existing law)

Income Tax or Capital Tax? ('seperation-method')

- Before moving to Portugal: Deductible in box 1 (Income Tax), benefits taxable in box 1

- Living and working in Portugal: Not deductible in box 1, benefits taxable in box 3 (Capital Tax)

After return to the Netherlands:
 Deductible in box 1, benefits taxable in box 1

### Proposed changes for annuities (Tax Plan 2009)

- · Removal of the 'seperation' method
- Introduction of credit method:

Income Tax or Capital Tax?

The same as under seperation method, except for:

 Period of living and working in Portugal: Exemption from taxable benefits of € 2.269,- for nondeductible contributions

Conclusion: disadvantage for taxpayers > higher tax rate in box 1 when receiving benefits starts

#### No return to the Netherlands

#### Where taxable?

- Art. 18 Convention: annuity taxable in the state of residence (Portugal).
- No source state in the Netherlands, only annuity contributions.
- Deductible contributions in Portugal (>90% of income derived in Portugal)

#### Assignment 2d:

A person emigrates and has:

- > First pillar income
- > Second pillar income
  - Pension
  - Dismissal compensation
- > Third pillar income:
  - Banksaving
  - Life insurance
- 1: which country has the right tot tax?
- 2: does it make any difference that the contribution were not deducted in the state of residence?
- 3. Suppose that one can prove that (a part of ) the contributions were not deducted?

#### **Assignment 4**

A Dutch person emigrates to Portugal and a Portuguese person emigrates to the Netherlands.

-1st pillar income

-2nd pillar income: - Pension

- Dismissal compensation

3rd pillar income: - Bank savings

- Life insurance

#### Which country has the right to levy tax?

- 1) Art. 18, par. 1 Tax treaty: state of residence.
- 2) Pension:
  - Art. 18, par. 1 Tax treaty: state of residence.

Unless: requirements of par. 2 are applicable.

Dismissal compensation:

- Art. 15, par. 1 Tax treaty: source state.
- Art. 18 Tax treaty: state of residence. (in case of an ERB)
- 3) Bank savings as well as life insurance:
  - Art. 18, par. 1 Tax treaty: state of residence.

Unless: requirements of par. 2 are applicable.

# Does it make any difference that the contributions were not deducted in the state of residence?

- EET system: Contributions exempted and outpayments taxed.
- · Cross-border situation.

# Does it make any difference that the contributions were not deducted in the state of residence?

- State of residence is Holland:
  - Deductions in Portugal exempted: outpayments are taxed. (EET)
- State of residence is Portugal:
  - Deductions in Holland exempted: outpayments should be taxed because of EET.
  - Question made by Dutch tax administration:

Is it right that the Portuguese tax administration only checks whether Portugal gave exemption or not. And if Portugal didn't gave an exemption (because it was exempted in Holland) there will be no taxation.

## Suppose that one can prove that the contributions were not deducted.

- Art. 63 AWR: minister can make exceptions to avoid unwanted situations such like double taxations.
- Decree by State Secretary
   January 31<sup>st</sup> 2008 nr. CPP2007/98M, Stcrt. Nr. 27
   Paragraph 2.4
- · Portugal?

#### **Analysis Pensionsystems**

The Summercourse 2008 is concluded with an analysis of both the pension systems. A discussion about the information which was shared the days before resulted in the following results:

| Analysis Dutch pension system                           |   |
|---|---|
| positive  | negative  |
| Open discussion about pensions to                       | Non funded first pillar; fast aging                 |
| reach a better level of awareness                       | population  |
| <ul><li>Well balanced (funded)</li></ul>                | Limited portability                                 |
| Fiscal Framework (possibility to raise                  | <ul> <li>Non integration between tax and</li> </ul> |
| 70%)  | social administration                               |
| <ul> <li>Income deductability</li> </ul>                | <ul> <li>Lack of transparency</li> </ul>            |
| <ul><li>Portability</li></ul>                           | Funded system vulnerable to inflation               |
| <ul><li>(almost) EU-proof</li></ul>                     | High taxation pensions                              |
| <ul> <li>Introduction pensionregister (2011)</li> </ul> | Fiscal framework differtent for the                 |
| <ul> <li>Different tax rate above 65</li> </ul>         | second and third pillar                             |
| EET-system  |   |

| Analysis Portuguese pension system                         |   |
|--|---|
| positive   | negative  |
| Legal changes progress:                                    | Less social security protection                           |
| - national   | <ul><li>Heavy tax system (combination with</li></ul>      |
| - tax treaty   | social security)  |
| Change mentality (grow third pillar in                     | No portability (second and third pillar                   |
| short time)  | as wel domestic as international)                         |
| <ul> <li>Less discrimination reagering non-</li> </ul>     | Non integration between tax an social                     |
| residents  | security administration                                   |
| Dedutability of foreign                                    | <ul><li>Lack of transparency</li></ul>                    |
| pensionscheme without limits (ic                           | <ul><li>Finance first pillar; also VAT</li></ul>          |
| continuation foreign scheme)                               | <ul> <li>Reliability of first pillar (budget)</li> </ul>  |
| <ul> <li>National public pension register</li> </ul>       | <ul><li>Joined taxation family; higher rate for</li></ul> |
| <ul> <li>Participation level of third pillar is</li> </ul> | pensioners  |
| increasing (now 20%)                                       | <ul> <li>Non funded first pillar; fast aging</li> </ul>   |
| <ul> <li>Partly funded; towards more</li> </ul>            | population  |
| balanced pensionsystem                                     |   |
| Generous third pillar                                      |   |
| ■ EET-system   |   |
| Social benefits pensioners                                 |   |

The results of the ananlysis were discussed by the group and together they formulated several recommendations.

#### **Recommendations ISOP 2008:**

- 1. All member states should introduce a national pensionregister (containing the information of the first, second and third pillar)
- 2. Portability Portugal:
  - Fase I: lose company pension at dismissal
  - Fase II: stimulate (fiscal framework) domestic transfer of company pensions
  - Fase III: international transfer
- 3. Introduce an European pensionplan
- 4. Portability: equal treatment portability second and third pillar
- 5. Stimulate the mobility of employees
- 6. End the discrimination of non-residents
- 7. Lower tax-rates pensioners: stimulate the working class to save for pensions
- 8. Introduce more tax incentives for families
- 9. All member states should have an EET-system