



Cross-Border Pension Issues

New York University
International Tax Program
March 23, 2012

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Cross-Border Pension Issues

Agenda

Why worry about cross-border pension issues?

What is the concern?

Selected practice issues

Double taxation conventions

Recommendations?

Planning Opportunities?

- Not subject of this presentation

Taxation of „employer corporation“

Taxation of pension fund



Taxation of
employees

Cross Border Pension Issues

Why worry?



Cross-Border Pension Issues

- Increasing international mobility of individuals for personal reasons (e. g. emigration) or for work-related reasons (e. g. secondment) *
- The consequences might be cessation to qualify for tax relief in home country, and contributions to the pension scheme by the employer may be regarded as employee's income

* non-mobile employees are excluded from further considerations

Cross-Border Pension Issues

- Issues to be considered:
 - freeze the pension in home country and resume and recapture after return?
 - terminate the pension in home country and enter into new contract in host country?
 - transfer any accrued pension rights from one employment to another employment („portability“)?, or
 - continue pension contributions during the secondment!

Cross-Border Pension Issues

- Pensions continued during assignment
 - Queries to think about during the contribution period:
 - are contributions to the home country pension scheme taxed in the host country – as employment income?
 - does the host country grant tax relief to contributions made to the home country scheme (i. e. deductions, exemptions, non-taxation of benefits accrued)? If so,
 - „equivalent treatment with host country employees“? or
 - tax relief according to the home country tax regime?
 - See comments on issues to be considered in OECD commentary to Art. 18 §§ 31-36

Cross-Border Pension Issues

Queries to think about at retirement

- Emigration

payments from *foreign*
scheme

- application of national law in new country of residence
- qualification of foreign plan
- taxation of pensions? If so, dependent on whether pension payments would be exempt in former country of residence or strict application of national law?

- Secondment

payments from *home*
scheme

- at return: application of home country's national law
- n/a
- taxation of pensions dependent on whether contributions enjoyed tax relief or strict application of national law?

Cross Border Pension Issues

Concerns



Cross-Border Pension Issues

Intertemporal consistency

- immediate taxation of contributions („after-tax“)



no taxation of pension payments, except for imputed capital yields (TEE)

- no taxation of contributions, i.e. exemption/deduction („pre-tax“)



taxation of pension payments (EET)

Generally, income of pension scheme is not taxable in the hands of the employees

- no taxation of accrued rights („deferred taxation“)



taxation of payments (as employment income?)

Cross-Border Pension Issues

Distortions of intertemporal consistency in cross-border

situations (emigration)

- immediate taxation of contributions (TEE)



taxation of pension payments (EET)

double taxation (TET)

- exemption/deduction of contributions (EET)



no taxation of pension payments, except for imputed capital yields (TEE)

double non-taxation (EEE)

Cross-Border Pension Issues

Distortions of intertemporal consistency in cross-border

situations (emigration)

-
- The diagram consists of two columns of text. The left column lists four items, each preceded by a minus sign. The right column lists four items. Arrows connect the items: an arrow from 'immediate taxation of contributions („after-tax“)' points to 'no taxation of pension payments, except for imputed capital yields (TEE)'; an arrow from 'no taxation of contributions, i.e. exemption/deduction („pre-tax“)' points to 'taxation of pension payments'; an arrow from 'no taxation of accrued rights („deferred taxation“)' points to 'taxation of payments (as employment income?)'; and an arrow from 'taxation of accrued rights' points to 'no taxation of payments'.
- immediate taxation of contributions („after-tax“)
 - no taxation of contributions, i.e. exemption/deduction („pre-tax“)
 - no taxation of accrued rights („deferred taxation“)
 - taxation of accrued rights
- no taxation of pension payments, except for imputed capital yields (TEE)
 - taxation of pension payments
 - taxation of payments (as employment income?)
 - no taxation of payments

Cross-Border Pension Issues

Reasons for Double Taxation?

Host country/former country or residence

- Taxation of pension contributions
 - mismatching pension schemes:
„after tax“ (TEE) versus „pre tax“ (EET)
 - conflicting qualification of pension schemes
 - „lacking harmonization“: lower tax relief applies
 - „discrimination“: denial of tax relief for contributions to foreign pension scheme
- evidence of previous taxation

Home country/new country or residence

- Taxation of pension payments

double taxation occurs if isolated approach applies to taxation of pensions

effective?, in general?

Cross-Border Pension Issues

Reasons for Double Non-Taxation (Emigration)

Former Country of Residence

- Contributions/accrued rights
 - tax relief for contributions = pre tax pension scheme (EET) or
 - non-taxation of accrued rights = deferred taxation

New Country of Residence

- No taxation of pension payments (except for imputed capital yields) because of
 - mismatching pension schemes, or
 - conflicting qualification of former country of residence pension scheme and „isolated approach“ applies, or
 - „territorial approach“ applies: only tax relief based on domestic rules triggers taxation of pension payments

Cross-Border Pension Issues

Reasons for Double Non-Taxation (Secondment)

Host Country

- Applies EET scheme:
contributions enjoy tax relief

Home Country

- Applies „territorial approach“:
only tax relief
based on domestic rules
triggers taxation of
pension payments –
(partial) double non-taxation

Cross-Border Pension Issues

Selected practice issues

- Denial of tax relief in Germany for contributions to foreign pension plans („discrimination“)
- Ignoring foreign tax relief for taxation of pensions in Germany („territorial approach“)
- Lower German tax relief disregarding higher foreign tax relief and corresponding higher taxation of pension („lacking harmonization“)
- Qualification of foreign /German pension plan
- UK/U.S. pension trust not known in Germany

Cross-Border Pension Issues

- „Discrimination of contributions“ to foreign pension schemes
 - German administrative ordinance: tax relief requires that foreign pension plan is permitted by supervisory authority to offer its services to employees in Germany
 - no legal basis in plain wording of the relevant statutory tax provision
 - continuing contributions to home country pension plan for assigned employee cannot be regarded as offering services to German resident employees
 - German authorities discuss this issue and keep pending cases on hold

Tax privileges should not be denied for contributions to foreign pension schemes assuming all other preconditions are met

Cross-Border Pension Issues

- „Territorial approach“
 - Linking taxation of pension payments to tax relief provisions mentioned in conclusive catalogue contained in the German Income Tax Act if pensions were completely built up abroad
 - » annuities are (only) taxed with imputed capital yield portion
 - » one-off payments are generally (only) taxed with the difference between contributions paid and amount of pension paid out; under certain circumstances only 1/2 of the payment is taxable
- Note: amendment of this provision is planned

Cross-Border Pension Issues

- Double taxation through „lacking harmonization“
 - judgment of German Supreme Federal Fiscal Court (September 24, 2009):
 - no obligation to grant tax relief in Germany according to foreign tax law in order to take into account higher taxation of pensions abroad;
 - applies even within the EU

Equivalent treatment confined to tax relief applicable according to host country's national law

Cross-Border Pension Issues

Determination of Correspondence of Pension Schemes (1)

- Core criteria for German occupational pension schemes
 - voluntary, additional and via employer
 - protection against biometric risk
 - payments require occurrence of specific event, e. g. general retirement age, death etc.
 - claim/right is not freely heritable, except to dependents as defined by German law
 - as opposed to individual retirement schemes, mandatory pension schemes, private pension schemes
 - n/a to mandatory pension schemes and
n/a to non-qualified savings schemes
 - n/a to non-qualified savings schemes
 - n/a to non-qualified savings schemes
 - n/a to non-qualified savings schemes and possibly not to private pension schemes
- Comparability of core issues according to function and motivation of the scheme

Cross-Border Pension Issues

Determination of Correspondence of Pension Schemes (2) Five types of German Occupational Pension Schemes

Deferred taxation

- Accrued rights (pension promise) do not trigger taxable event if
 - claim/right for pension payments is directed against the employer, or
 - enforcement of claim/right requires employer's cooperation, e. g. for group pension schemes
- Applies to pension promise („Direktzusage“), relief fund („Unterstützungskasse“)
- Later pension payments fully taxed as employment income

Immediate taxation

- Employer contributions trigger taxable event if
 - employer contributions entitle employee to direct, own, separate claim for pension payments directed against the pension plan; generally, statutorily assumed
- Applies to life insurance, pension pool, pension fund
- Later pension payments taxed as „other income“ insofar as tax relief was enjoyed (EET)

Cross-Border Pension Issues

Determination of Correspondence of Pension Schemes (3)

- Foreign pension scheme to be compared by German tax authority with one out of five types of German occupational pension schemes
 - to determine – for seconded employee – whether contributions/promise triggers taxable event in host country
 - to determine how pension payments are taxed in home country
- German pension scheme to be compared by foreign tax authority with foreign of occupational pension schemes
 - to determine whether contributions/promise triggers taxable event
 - to determine how pension payments are to be taxed

Qualification conflicts especially experienced with regard to German company promise („Direktzusage“)

Cross-Border Pension Issues

Determination of Correspondence of Pension Schemes (4)

Foreign Pension Schemes with no Equivalence in German Domestic Law

- Application of general rules (see slide 19)
to UK/U.S. pension trusts
 - For German tax purposes: no occupational pension scheme because claim/right can generally be inherited to anybody (e. g. Battersea dogs home)
 - application of general principles governing taxation of (employment) income:
 - immediate taxation of contributions? or
 - deferral of taxation until pension payments are made?

Rosemarie Portner's view: employee does not acquire common law entitlement to pension claim; equitable ownership should not be viewed as an enforceable claim that would trigger immediate taxation
deferred taxation

if so, pension trust might be used in cross-border situations
to mirror German occupational pension promise

Cross Border Pension Issues

Double Taxation Conventions (Treaties)



Cross-Border Pension Issues

- Taxation of non-residents in German national law
 - definition of German source income as
 - pension payments made by German resident pension scheme and
 - pension payments made by a foreign pension scheme if contributions enjoyed tax relief in Germany
 - place of work is no criterion
 - see OECD commentary to Art. 18 § 19 where definition of country of source is discussed

Cross-Border Pension Issues

- Art. 18 OECD-MC

Taxation only in country of residence

- pros (OECD commentary Art. 18 § 1, 2, 17-20)
 - country of residence can tax employee according to the ability to pay taxes
 - employee must not deal with several governments
- cons
 - loss of tax revenue through shift of residence as
 - consequence of tax optimization (see slide 38 below)
 - consequence of emigration
 - if contributions enjoyed tax relief and taxation was deferred
 - double non-taxation if pension contributions were granted tax relief and remain untaxed in country of residence (see slide 13)

Cross-Border Pension Issues

- Examples of German treaty policy (1)
 - treaty with Turkey (September 19, 2011): limited withholding tax on pension payments exceeding € 10,000
 - treaty with Spain (3 February, 2011): limited withholding tax on pension payments if tax relief was granted for more than 12 years
 - treaty with US (Amendment Protocol of 1 June, 2006): introduction of withholding tax may be discussed (Joint Declaration attached to the Technical Explanations to the Amendment Protocol)

Cross-Border Pension Issues

- Examples of German treaty policy (3)
 - Treaty with UK (30 March, 2010) and treaty with Ireland (30 March, 2011):
 - shift of – exclusive – right to tax pension payments if contributions enjoyed tax relief in host country over a substantial period of time (more than 15 years/12 years)
 - subject-to-tax clause which permits taxation in the other country if country that is allocated the right to tax does not make use of that taxing right

Cross-Border Pension Issues

- Art. 17 (Pension etc.) US Model Treaty 2006 (1)
 - Paragraphe 1
 - lit. a): same as Art. 18 OECD-MC
 - lit. b): *„...the amount of any such pension or remuneration arising in a Contracting State that, when received, would be exempted from taxation in that State if the beneficial owner were a resident thereof shall be exempt from taxation in the Contracting State of which the beneficial owner is a resident“*
 - follows considerations in OECD commentary to Art. 18 § 23

Cross-Border Pension Issues

- Art. 18 paragraph 2 US-Treaty Model 2006 (pension funds)
 - equivalent taxation of contributions to foreign pension scheme with taxation of contributions to host country pension scheme in cases of employee secondment
- Follows considerations in OECD commentary to Art.18 §§ 37, 38

Cross-Border Pension Issues

- Art. 18 of the treaty with Germany (1 June, 2006):
 - following Art. 18 § 1 OECD-MC
 - Art. 18A treaty with Germany (1 June, 2006):
 - equivalent taxation of contributions to foreign pension schemes with taxation of contributions to the host country pension schemes in cases of employee secondment (following Art. 18 § 2 of the US-Treaty Model, see slide 27 above)
- No discrimination of contributions to foreign pension schemes but double taxation may occur through lacking harmonization

Cross Border Pension Issues

Recommendations?



Cross-Border Pension Issues

- Recommendations – mismatching pension schemes to be considered in cases of emigration (1)
 - assumption
 - new country of residence applies – generally – an EET pension system
 - country of source (former country of residence) applies – generally – a TEE pension scheme
 - allocation of right to tax pension payments to new country of residence
 - *but* exempt pension payments in country of former residence if the retiree would be exempted from tax with such payments in that country, were the retiree resident there, because that country applies an after tax pension scheme (TEE)
(new) country of residence gives up tax revenue

Cross-Border Pension Issues

- Recommendations – mismatching pension schemes to be considered in cases of emigration (2)
 - assumption
 - new country of residence applies – generally – a TEE pension scheme
 - country of source (former country of residence) applies – generally – an EET pension scheme
- allocation of taxing right for pension payments to country of source (former country of residence) that applies EET scheme

Cross-Border Pension Issues

- Recommendations – same pension scheme – EET – to be considered in cases of emigration (3)
 - allocation of right to tax pension payments to former country of residence that is country of source
 - which granted tax relief on contributions

Cross-Border Pension Issues

- Recommendations to be considered in cases of secondment (1)
 - allocation of right to tax pension payments to home country
but
in host country equivalent taxation of contributions
 - to home country pension scheme or
 - to third country pension schemethrough
 - tax relief according to host country tax law (see OECD commentary to Art. 18 § 55) or
 - tax relief according to home country tax law (see OECD commentary to Art. 18 § 56)
- Host country gives up tax revenue

Cross-Border Pension Issues

- Recommendations to be considered in cases of secondment (2)
 - alternatively:
allocation of right to tax pension payments to country of residence
but
 - contributions to home country pension scheme or
 - third country pension schemeare not taxed as employment income received for services exercised in host country;
amendment to Art. 15 OECD-MC?
Host country gives up tax revenue

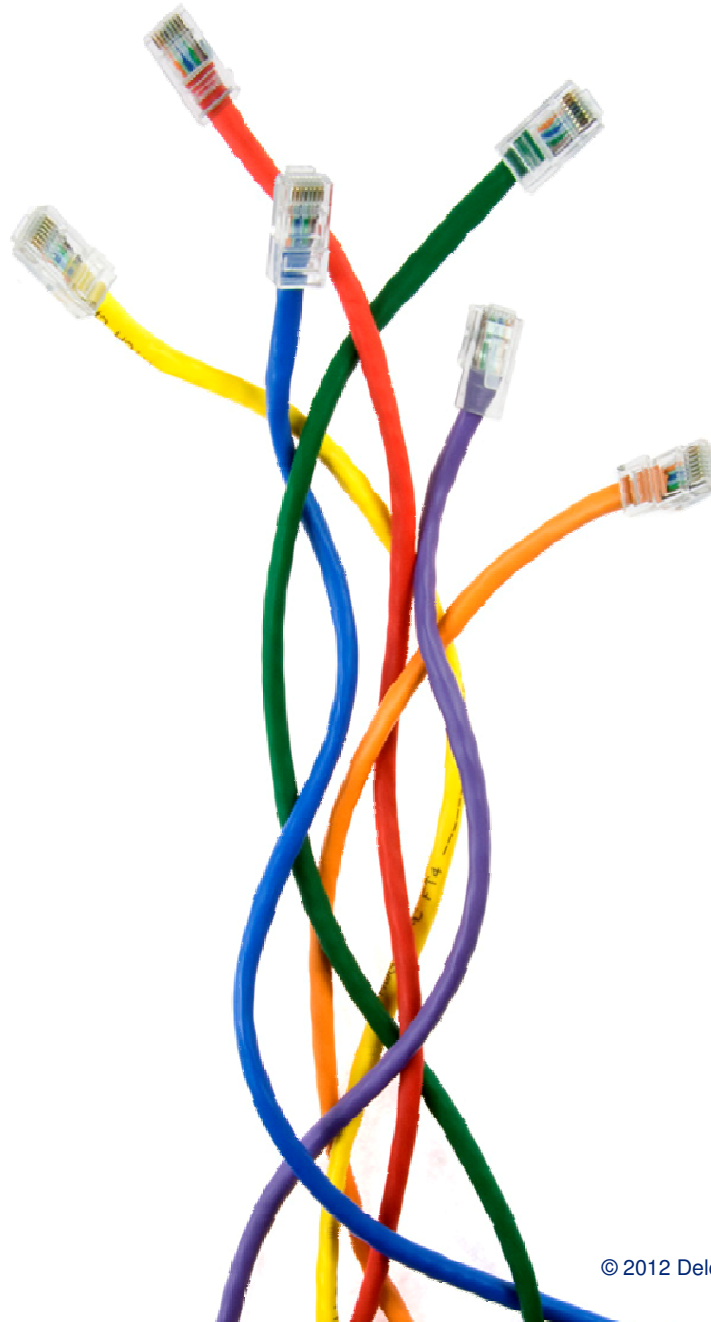
Cross Border Pension Issues

Planning opportunities?



Cross-Border Pension Issues

- Planning opportunities on the basis of Art. 18 OECD MC to be considered in cases of emigration
 - favourable tax regime in country of emigration
 - employee takes up residence in a country
 - which in general does not tax pension payments made from foreign pension schemes, or
 - because that country (of residence) applies a „territorial approach“ where pension payments are not taxed if they are not based on contributions which enjoyed a tax relief in that country
 - that might be optimized if the employee receives a one-off capital payment and then would be free to shift residence again
 - ideally, the foreign pension scheme that makes pension payments is established in a country that is not entitled to levy a withholding tax on pension payments



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