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INDIVIDUAL INCOME TAX ON PENSIONS, A DECISIVE FACTOR FOR MOBILE PENSIONERS? The case of Sweden

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Abstract

This paper deals with institutional differences as a mobility hindrance for the elderly. More concretely, the individual income tax system is presented as a potential decisive factor to remain active on the labour market or not. From a public policy perspective, the economic decision to retire should be postponed until the latest possible moment. However, from a tax legal perspective, this decision is biased by the tax rules, which is even more obvious when a cross-border mobility dimension is present. The case of Swedish retirees moving out of Sweden will be used to illustrate this statement, as Sweden is a high tax country, and has a vast network of tax treaties where rules differ to a large extreme, which may impact the decision to retire even more.

From a public finance perspective, pensioners on the move pay taxes on their pensions in another State than where they worked, leading to tax base erosion in the State where they constituted their pension rights. States such as Sweden tend therefore to tax upon exit mobile pensioners, especially because the first retirement years are those with the highest income. However, within the EU, the right for pensioners to retire anywhere in the EU shall not be hampered by restrictive tax provisions or obstacles for the portability of their pension rights. Even though EU law provides for both positive and negative integration of labour markets from tax and social security perspective, some obstacles to mobility still exist which result from the EU member States' institutional differences. How these domestic law provisions and bilateral tax treaties reconcile with EU law's requirement is also addressed in this paper.

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1 Introduction

1.1 Background

The existence of a right to choose retirement or activity is dependent upon the features of the welfare system, which has to be reliable and appropriate at the moment individuals decide to retire. In other words, the sustainability of a pension system is both decisive and vital for an individual to make this private decision. While this paper examines the case of Sweden, it is to a large extent generalizable to the rest of the European Union. The fact that taxation of pensions imposes a de facto obstacle to mobility is not specific to Sweden. The fact that taxes on pensions restrict mobility after retirement implies that they may also restrict mobility during the working life as well, since individuals may have preferences to retire in their home countries, and the obstacles discussed in this paper are then equally applicable to the decision to relocate to another EU country during economically active years.

It has been suggested in legal research that the decision to retire and become dependent upon social welfare should be postponed to some extent, and that the individual should be empowered to choose activity and to plan for independency upon ageing. Moreover, this autonomy could also extend to cover aspects of cross-border mobility of retirees. However, welfare systems are not neutral towards the economic decision to either remain active or to retire. In social and medical sciences, researchers find that economic incentives have an impact on the decision to retire. In general, the literature shows that if benefits programs are equally or more beneficial than work, the individual is voluntarily pulled out of working life. Whereas poor health and hard working conditions induce early retirement decisions, economic reasons such as the fear of decrease in pensions or the high compensation for retiring due to long working periods are also important.

Moreover, the decision involves even more parameters in cross-border situations where the interaction between all rules applicable depends on two States' legal frameworks. This paper is dedicated more specifically to the individual tax rule

applying to income from retirement as a potential incentive or hindrance to the decision to retire in another country than where the pension rights were acquired. Both the tax treatment of payments contributing to subsequent pension rights, and the benefits constituted under the working lifetime differ from one State to another, and are not coordinated. The symmetric tax treatment of contributions to pension schemes and of the benefits paid upon retirement is not guaranteed when the elderly moves from one State to another. Within the EU, however, the Treaty on the Functioning of the EU (TFEU) guarantees the elderly's right to mobility. EU Member States' duty of cooperation in the European Union also sets limits to their fiscal policies.

But why is mobility so important? According to the European Commission's policy to tackle demographic and skills challenges, and address the effects of population ageing, the EU will need to close the gender gap, increase the participation of young and older workers in the labour market, and facilitate intra-EU mobility and international migration. Among the obstacles to cross-border mobility, some studies have identified language issues as most important, followed by a lack of information, and, finally the tax systems. In a specific cross-border situation (Luxembourg/Belgium) where many workers commute on a daily basis, the difference in tax and social security systems for pensions has been problematic.

Using Sweden as a starting point, this paper focuses on identifying the economic distortions with potential effects on retirement decision arising from the tax legal framework for pension rights of several member States of the EU. They originate in institutional differences between EU member States and the limited portability of pension rights in EU.

1.2 A two-sided problem

The economic problem of pensioners on the move is twofold. Firstly, pensioners that migrate within the EU pay taxes on their pensions in another State than where they worked, leading to tax base erosion in the State where they constituted their pension rights. As a result, some States, such as Sweden, one of the countries with the highest individual income taxes, tend to tax upon exit mobile pensioners

since the State subsidised the constitution of pension rights through tax deductions and tax credits. Limiting domestic welfare to pensioners who have not reached the minimum level of contributions elsewhere before moving is also problematic in respect of EU law. However, the right for pensioners to retire anywhere in the EU shall not be hampered by restrictive tax provisions or obstacles for the portability of their pension rights. Yet, obstacles to mobility still exist as revealed by the European Court of Justice (ECJ's) case law.

Secondly, the EU legal system lacks coordination in social security and tax laws. Both States' (exit and host) welfare systems are coordinated by EU regulations, which is not the case for individual tax systems. Whereas social security rules clearly determine where the pensioner will be covered for contributing to and obtaining social security benefits, tax rules in bilateral tax treaties are not coordinated. They are limited to allocate the right to tax pension income to one or the other State. This results in a potential double levy during the time of constitution of pension rights, as well as a breach of the social security coordination, when two member States are taxing mobile pensioners on their retirement income. Pensioners on the move may well encounter mobility hinders in this area, as revealed in literature, and which will not be treated here.

This contribution focuses on the Swedish tax and social security legal framework in respect of cross-border situations, with focus on the income pensions (as opposed to insurance pensions). Sweden is interesting as this country provides for a high welfare standard, financed primarily through one of the world's highest individual income tax rate (Pension income is also taxed at the same rate). In order to keep up to this level of welfare, Sweden tries to avoid situation where net-payers (high-income pensioners), capital and corporations leave the country. How this required to finance welfare raises mobility issues is explained hereafter.

The problem is not hypothetical, and this is what the next section deals with. The third section analyses the situation of exiting pensioners, while the fourth one deals with some EU-tax law related issues. The conclusions are exposed in the last section and formulate recommendations for further research.

2 Sweden's pensioners on the move

The purpose of this section is to understand the pattern of mobility in Sweden. While researchers in economics consider the mobility as a minor problem, and rather focus on the need for Sweden to finance its welfare system through a series of measures (increase the tax bases, increase the numbers of working hours, delay of the retirement decision, avoid capital flows away from Sweden), statistics from the Pension authority shed some light on the severity of the emigration of pensioners from Sweden.

According to the Swedish Agency for pensions (Pensionsmyndigheten) 6.8% of pensions are paid to retirees living outside Sweden in 2015. The average monthly amount of the pension paid to these retirees living outside Sweden is around 3.000 SEK per month (around 300€), and the statistics show that around 4 billion SEK (around 400 million €) are paid yearly in the pillar 1 (income pensions) to non-Swedish residents. The largest amount of pensioners benefitting from this public pension are in Finland (around 50.000), Germany (around 17.000), Norway (around 11.000), Denmark (around 9.000), USA (around 6.000), Spain (around 6.000), Greece (around 5.000), France (around 3.300), the UK (around 3.000), Austria (around 2.700), etc. for a total of 143,564 pensioners.

These figures indicate a higher mobility within Scandinavia than towards other parts of the world. Additionally, a low average monthly payment of public pensions could be explained by the fact that migrant workers came to Sweden (especially from Finland where Swedish is also spoken) to work and constituted pension rights during their career in Sweden and then moved back upon retirement. The number of Swedish pensioners who remain residents of Sweden for tax and social security purposes but live abroad, on a part time basis, is however unknown officially. Some indications suggest roughly 50.000 Swedish pensioners live in France, for instance, whereas only 3.332 have officially transferred their residence there. Similarly, around 1.000 Swedes move to Spain each year, yet there are already around 6.000 Swedish retirees there. Therefore, the actual number of retirees living abroad should not be underestimated although from a purely statistical

perspective, the numbers do not show a massive exit of pensioners out of Sweden after retiring.

The emigration pensioners means a loss of tax revenue for any State, for two reasons. Firstly, the State financed partly the constitution of pension rights inasmuch as part of the pension contribution was tax deducted by the employee and the employer. When pensioners stay in the same country, this financial burden is compensated by the taxes levied by the State on pensions, and this does not happen when they move out, unless an exit tax is levied on outgoing pensions. Secondly, the exiting pensioners may have a strong purchasing power during the first years of retirement, which will be lost for the exiting State. Indeed, the second and third pillars of the pension systems usually offer a maximum replacement of income during the seven to ten first years after retirement. This is the case for Sweden.

Inversely, immigrants coming to Sweden are entitled to some elderly care and healthcare even though the constitution of their pension rights may look quite different from that of an exiting Swedish pensioner. The Swedish welfare state grants a guaranteed pension to the elderly (above 65 years old) who are not entitled to any other pension income (accumulated along employment years and through an employer's contribution), and a full amount (around 800€ per month) requires that the pensioner has lived 40 years in Sweden. The state pension decreases of 1/40th for every year of life out of Sweden between 16 and 64 years except in certain situations (EU migrants). Pensioners moving to Sweden without their own pension rights from abroad do not enjoy the full benefit of this welfare measure, although other forms of welfare may be available.

All in all, the pensioners' migration does not seem to be a peripheral economic problem, as researchers tend to assume. Before analysing what problems arise from the tax systems for pensions, it seems relevant to explain the features of the Swedish pensions.

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3 Retirement out of Sweden

3.1 A brief overview on the Swedish pension system

Sweden has a typical three-pillar system with compulsory pension (pillar one) supplemented by occupational pensions (pillar two), funded and individual voluntary (pillar three) schemes. The pension system originating in 1913 has evolved from a defined actuarial compulsory contribution of less than 20% of an average rate, to a defined-benefit, pay as-you go, price indexed system based on the 15 highest paid years on a 30 years contribution period, applicable from 1960 to 1994 ("ATP system") supplemented by occupational and private pensions. At the same time Sweden joined the EU (1 January 1995), a major reform of the first pillar was carried out in order to take into account demographic changes and inter-generation distribution problems. Today, unfunded pay-as-you go systems are put under strain when the number of workers financing pensioners decreases and need to be replaced. Today, the Swedish first pillar is financed by a contribution of 18.5% on employment income or alike, out of which 2.5% feeds a "premium pension account". The defined-benefit is price-indexed and ear-marked, and the "accumulated wealth" during working life time is divided by the number of years the wealth has to last at the moment of retirement. The sum of expected benefits never exceeds the sum of expected contributions. This system is meant to induce people to work longer hours and retire later. According to the Swedish pension authority, in 2014, the first pillar (compulsory public pensions, either the employment-based or the guarantee pension) reached 42% of all pensions paid by the State, whereas the employers' share of occupational pensions (pillar 2) amounted to 58%.

Upon retirement, the decision to move out of Sweden has no direct incidence on the amount of income pension (pillar one) pensioners are entitled to. However, there are other issues in respect of cross-border pensioners.

3.2 The Elderly's decision to retire outside Sweden

3.2.1 Issues

Globally, the financial sustainability of public pension systems is under pressure.. According to the EU Commission, greater flexibility in job mobility supports the adjustment capacity of the economy and unleashing the full potential of the single market could bring significant benefits for all citizens. Mobility, therefore, needs to be organised during the period of constitution of the pension rights as well as during pension itself.

EU law in the field of social security provides for the co-ordination but not the harmonisation of social security schemes. This means that each member-state is free to determine the details of its own social security system, including which benefits are to be provided, the conditions of eligibility, how these benefits are calculated and what level of contributions should be paid. EU law provisions, in particular Regulations No 883/2004 and No 987/2009 (replacing Regulations No 1408/71 and No 574/72 since 1 May 2010), establish common rules and principles which must be observed by all national authorities when applying national law. These rules ensure that the application of the different national legislations respects the basic principles of equality of treatment and non-discrimination and persons exercising their right to free movement within the EU are not adversely affected by the application of different national legislations.

With regard to pensions, the EU Coordination Regulations cover old-age pensions, survivors' pensions and invalidity pensions. In general, only statutory schemes are coordinated. The EU Coordination rules provide for the aggregation of periods of insurance or residence completed under the legislation of another member State for entitlement to a benefit. They also waive the exclusive obligation of the State of residence to provide pension. Furthermore, each member-state where a person was insured for at least one year pays a pension. And finally, there is no 'transfer' of pension rights to the pension system of another member-state . So the systems need to be improved at two moments, upon constitution and during retirement. This holds also true for income tax purposes too.

3.2.2 Domestic tax rules of mobile pensioners

Pensioners on the move may remain resident for tax purposes of the country where the pension rights were constituted, while they were employed. This occurs when pensioners own a real estate abroad or visit families for a longer time in another state, but do not move out, and they keep their worldwide tax liability in that state irrespective of their time spent abroad. However, when pensioners move out, they become non-resident for tax purposes of the state paying the pensions and the host state tax system applies to their income.

From a Swedish tax law perspective, pensioners who remain on the population register (folkbokföring) are taxed as residents, and otherwise, they do not keep their link with Sweden, and register in another State, where they become resident for tax purposes. In this situation, they become non-resident of Sweden and all their Swedish income is liable to source taxation in Sweden (SINK).

The pensioners' tax treatment of Swedish sourced income can be dramatically different, as a resident is taxed on a net basis at a progressive rate of 30% up to 57%, whereas a non-resident is taxed on a gross basis at a standard rate of 20%. So already at this point, and depending upon the possible deductions from the gross basis (interest rate for mortgage for instance), the choice of staying or leaving Sweden for economic reasons is biased.

An additional layer of tax rules needs to be taken into consideration too, the tax treatment in the other State. When pensioners are exiting to another State where they become residents, they will have to pay an income tax on their worldwide income, including the Swedish pensions, unless they can benefit from a tax holiday there. Within the EU, income from retirement is taxed as labour replacement income and usually does not benefit from special treatment, unless some specific allowances exist. This means that moving out of Sweden entails a risk of double taxation, unless Sweden and the host State have signed a convention for the avoidance of double taxation, according to which the host state will either exempt Swedish pensions, or tax them but give a credit for the Swedish taxes paid at source.

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3.2.3 Double tax treaties-OECD Model Treaty

OECD Members are invited to negotiate their bilateral (or multilateral) tax treaties on the basis of the OECD Model Treaty (OECD MT). According to this model, the pensions of past private employment should be taxed in the Residence State only (article 18 OECD MT), while social security payments unrelated to previous employment, pensions of past public employment and public pensions should be taxed at source exclusively (article 19-2 OECD MT). There are several problems with respect to articles 18 and 19-2 OECD MT, in as much as pensions are not defined clearly in the text of the treaty, but in the Commentary to the model treaty, and these comments change often, while double tax treaties do not. So the first question is to know how to address the huge variety of pension payments in domestic laws in a cross-border dimension.

Additionally, and according to the OECD MT (article 19-3 OECD MT), states may also negotiate to reserve the exclusive right to tax public pensions at source, depending upon the nationality of the beneficiary. Therefore, nationals who were state-employed and retire in another State usually pay tax in the state where they were employed. However, the state financing the public pension loses its right to tax at source the pensions paid to a non-national who worked for public service and leaves to returns home for retirement. This tends to be especially important for States where immigration of labourers was promoted in order to mitigate the negative demographic effects of fertility decline.

However, a number of double tax treaties derogate from the OECD model convention and authorize the source State to levy a tax at source even for private pensions especially when the constitution of the pension rights was subsidised by the State where deductions from income tax were granted. The OECD actually acknowledges therefore the possibility for States to levy at source a tax on exiting pensioners, in so far as the residence state will alleviate the resulting juridical double taxation arising from this source taxation. Several divergent practices have been exposed in international tax law debates. For instance, Germany and the Nordic States negotiate source taxation of pensions either as a general rule

for all pensions, or for at least social security payments. Also for instance, none of the Scandinavian countries have succeeded to negotiate with France to keep their source taxation for private employment pensions.

Before being amended in 2005 to include social security payments made in relation to past employment in the scope of article 18 and 19 (exclusive right to tax in the residence state), the OECD model treaty on the basis of which many double tax treaties were negotiated excluded pensions arising from the social security system from the scope of article 18. Given that clear position, the old treaties must be interpreted as excluding social security payments. Recent treaties (after 2005) should be interpreted the other way round and allow the social security pensions to be included into the scope of article 18, and should normally be taxed in the residence state of the beneficiary only. When pension payments fall out of article 18 and 19, they fall either under article 15 (employment income) or under article 21 OECD MT ("Other income"). The outcome of this qualification can be quite different, as article 15 allows a split right to tax the income between States, whereas article 21 allows an exclusive right to tax in the residence state.

However, when source taxation occurs, and juridical double taxation results from the application of two taxes on the same pension income, the residence state has to provide for a relief for the double taxation arising from the application of the source tax and of the domestic residence tax, unless the treaty provides for taxation in one state only. The host state will accordingly have to decrease its own tax on residents in proportion of the tax levied at source (art. 23 B OECD MT).

In other words, the mobile pensioner's tax situation may be dependent on which level of taxation the host state applies, as well as his/her nationality.

3.2.4 Swedish practice in Double tax treaties

The Swedish pension system offers an incentive to save for retirement along the working life, while taxing the yield of these savings at a lower rate than standard capital income, and deferring taxation of pensions until retirement. The Swedish state has always expressed its concern over protecting its own tax bases, and in

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this respect, the need to confine the deferral to Swedish taxpayers. In other words, most tax treaties negotiated by Sweden provide for the levy of the non-resident tax (SINK) at an effective rate of 20% to ensure the taxation of pensions in Sweden.

As a result, the residence State may have to credit this tax on its own resident tax, which may be lower than 20%, and therefore, the pensioner on the move cannot enjoy the full value of an attractive tax incentive to pay lower taxes in the host country (as there is not enough tax to offset the Swedish tax in the host State). The exiting pensioners end up with an effective tax burden of 20% of their pensions, which can be higher than the applicable tax rate of pensions in other EU States. Additionally, most EU member States provide a lower level of taxation of pensioners than Sweden, when taxed as residents, due to progressivity of income tax and to incentives (lower tax rates, no social security fees, larger ground allowance). In other words, the taxation at source of pensions in Sweden may have restrictive effects on exit, in a similar way as to that of exit taxation, which the ECJ may find restrictive.

The study of the double tax treaties signed by Sweden with the States where pensioners move to shows a diversity of rules, which does not allow drawing general conclusions at the outset. However, according to double tax treaties signed by Sweden, pensions from past private employment are mostly taxed either at source or in the residence state, whereas public pensions and minimal guaranteed pensions can be taxed in the residence and the source state, sometimes nationality being decisive. This means that when the right to tax is allocated to both States (such as in the Nordic Multilateral tax treaty), the effective tax rate of residents in the host State is decisive: when it is lower than the Swedish SINK tax rate, the lower tax rate in the host State is not an incentive to move out, as the whole offsetting of the Swedish tax is not possible. That may be the case for the UK for example in respect of other pensions than those from private employment, since residents enjoy a large income tax ground allowance on pensions and/or family allowances which decreases the effective tax rate.

Additionally, the tax treatment of some kinds of pensions paid varies to a large extent from one Treaty to another. In some double tax treaties, the minimum and guaranteed state pensions are included in article 19 (pensions arising from past public employment) and sometimes are treated separately, where the source state only is entitled to tax. For instance, the Swedish Supreme Administrative court decided in 2003 that the French-Swedish tax treaty's article 18 (pensions from past private employment) and article 19 (pensions from past public employment) did not cover specifically the pillar 1 income and guarantee pensions paid in Sweden. In contrast, the payments under the former Swedish pension system (ATP) fell into article 21 of the tax treaty in question ("other income") taxable only in the residence state of its beneficiary, and Sweden was not allowed to levy the source tax SINK otherwise applicable to occupational pensions for instance.

Indeed, the problem of these tax treaties is that the qualification of pension income is not the same on the two sides of the border. For instance, the French tax authorities tend to treat the Swedish supplementary pension (tax deducted partly upon constitution) as "capital insurance" and not as employment income and hence do not tax this income in France. Therefore, it is possible to achieve double non-taxation in some situations.

Another diverging practice can be found in the double tax treaty signed with Spain, according to which Swedish pensioners who have moved out to Spain pay both the Swedish source tax (SINK 20%) on guarantee pension or any social security benefits and on individual retirement schemes ("pensionförsäkring") and the Spanish tax for residents (progressive). Instead of obliging Spain to give credit for the Swedish source tax (SINK), Spain negotiated to keep their right to tax residents, at the full income tax rate, and Sweden accepted to provide for a reverse credit of the source tax (SINK) in respect of the Spanish tax paid on Swedish pensions. This means that Swedish pensioners moving to Spain are double taxed on their pensions during the time in which Sweden makes them wait for the reverse credit.

Finally, a recent double tax treaty can also illustrate this diversity. The 2015 Swedish/UK double tax treaty provides a total taxation of pension in the state

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from which the pension is paid, and there is no question of imputation of the source tax on the residence tax any longer. This simplifies the situation for mobile pensioners, who do not have to fill in tax returns in their host state and wait a longer adjustment period for the Swedish SINK tax to be offset against the domestic income tax in the residence state.

From the Swedish mobile pensioner's perspective, most individuals probably moved to Finland, Germany, Norway, Spain, Greece, France and UK, the double tax treaties provide for quite different results. Under the Nordic tax treaty (applicable to pensioners moving to Finland and to Norway), Sweden is allowed to tax at source State pensions and occupational pensions, from public and private past employment, but the residence state may also tax the pensions after relieving the Swedish tax levied at source. In other double tax treaties concluded with Spain, France, Germany, Greece, and Austria, occupational pensions from private past employment are taxed in the residence state only. According to the statistics of the Pension authorities, such payments represent the majority of the pension rights paid to pensioners. This means that when the domestic tax rate on pension in these host states is lower than in Sweden, there is an incentive to move for tax purposes. In the double tax treaties where Sweden withholds its exclusive right to tax State pensions at source ("folkpension"), the pensioners may have an incentive to move out of Sweden for tax purposes when the host state effective tax rate on pensions is lower than 20%.

Conclusively, it can be stated that the impact of the provisions in double tax treaties can be decisive to the economic loss linked to an exit, for an aware taxpayer. Another decisive factor is the qualification of the income received in the host state for tax purposes. Receiving pensions in a lump sum or annuity may change the qualification of income and hence its tax treatment. As revealed in early EU studies, the lack of visibility and clarity in the tax systems makes it difficult to foresee the outcome of the pensioners' economic situation. The focus of these studies has always been on the occupational pensions and not on the total picture though.

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The study of Swedish practice of double tax treaties shows ultimately that bilateral tax treaties are decisive on the individuals' economic situation. However, even though tax rules may hinder mobility, the next question is to know whether EU law prohibits such hindrances.

4 Fundamental freedoms for mobile pensioners in the TFEU

4.1 Mobility problems relating to the constitution of pension rights

The Treaty on the Functioning of the European Union (TFEU) prohibits domestic law provisions that hinder the free movement of workers (art. 45 FEU), or the capital investment in other member States (art. 63 TFEU). The ECJ has repeatedly applied these prohibitions in situations where cross-border workers were taxed more heavily than non-mobile workers for the constitution of their occupational pension rights, or when the transfer of pension rights from one State to another was taxed heavier or even proved impossible.

Note worthily, the tax systems in question provided for some incentives to constitute additional pension rights, either directly on behalf of the individuals (third pillar pensions) or as individual retirement schemes in addition to the domestic occupational pension (second pillar pensions). In most case, the tax system was held in breach of EU law as it reserved the incentive to domestic schemes, and refused tax deduction of contributions in cross-border situations. While the ECJ found the restriction justified on the ground of public policy reason (keep the "temporal" cohesion of the tax system) in one early case, the latest decisions clearly depart from this line of reasoning and find heavier tax burden for mobile workers not justified by the need to ensure the cohesion of the tax system.

The European Commission also issued a Communication recognizing discriminatory treatment of contributions to foreign pension schemes and tax

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issues related to cross-border transfers of pension capital as the two main barriers preventing provision of second-pillar pensions across the EU. The Commission concluded such obstacles were contrary to the EC Treaty and, after having tried to reach political solutions to the problem together with the member States, opened nine infringement procedures against those still discriminating against payments to foreign pension funds: Belgium, France, Spain, Portugal, Ireland, Denmark, Sweden, the UK and Italy.

Since Denmark expressly disagreed on the principles and declared it was not going to change its law, it was referred to the Court of Justice, which ruled against Denmark. The ECJ found that the refusal to deduct from the tax liability payments to foreign pension schemes discourages mobility and taking up employment in other member States. Indeed, the temporal link between the tax deduction of pension contribution and the forthcoming right of a state to tax income arising from this deducted pension contribution is disrupted upon mobility, because double tax treaties allocate the right to tax the occupational in the residence state of the pensioner. Therefore Denmark loses the right to tax the forthcoming occupational pensions when the pensioner has moved out between the time of payment of contributions to a pension scheme and that of payment of the corresponding benefits. On the other hand, Denmark obtains the right to tax pensioners moving to Denmark, for the occupational pensions they receive and contributed during their employment period, irrespective of whether the deduction was granted in that other member state or not. This is not a proper justification ground to restrict the freedoms according to the ECJ, as in order to preserve the cohesion of the tax system, the link should work in both directions, upon emigration and immigration.

The same result was reached by the ECJ in the ruling Commission vs Belgium, The Belgian legislation at issue, which granted a tax reduction only for contributions paid to saving pensions managed by resident institutions, was held by the ECJ to be in breach of the freedom to provide services and the justification based on the need to preserve the coherence of the tax system presented by the Belgian Government was rejected on basis of the same reasoning followed in

Commission vs Denmark, again regardless of the fact that the Belgium Income Tax Code provided for exemptions of pension benefits when the payment to saving pension accounts were not granted a tax reduction.

In other words, the problem is that according to the OECD model treaty (art. 18) pensions linked to former private employment are taxable in the residence state of the employee only. The assumption is that tax treaties between States reflect a give-and-take in a bilateral situation, and that the tax base erosion linked to the deduction of contributions and lost upon exit of pensioners is balanced by the right to tax immigrant pensioners who deducted their pension contributions in another State. So if migration flows were balanced and of equal importance from two sides of the border, there would not be any loss of tax revenue for States, and no need to refuse the deduction of contributions to foreign pension schemes. The OECD therefore introduced in 2005 an optional clause in the commentary on article 18, whereby the deduction of contributions to foreign pension schemes is allowed under specific conditions. In the previous mentioned case Commission vs Denmark, this right was allowed for Danish taxpayers with pension funds in the UK, in the Netherlands and in Sweden. The bilateral agreements create, therefore, a difference of treatment between mobile workers depending on their place of work, but the ECJ does not support a horizontal equal treatment requirement and respects the different outcomes for tax purposes arising from bilateral tax treaties.

Some states find the balance element missing in their bilateral relationships, and have terminated their double tax treaties, which results in a double taxation of mobile pensioners other states, but also limits tax base erosion, when the balance of inbound/outbound pensioners is not kept. Other states, such as Sweden or Finland, have negotiated in their double tax treaties an exclusive right to tax at source, which also can cause problems as will be seen next.

4.2 Source taxation of pensioners on the move in EU tax law

Those who migrate out of their country of residence where they contributed to their pension, and received a tax benefit as a result, has the effect of eroding the tax base in their country of residence. One approach by EU member States to limit

this erosion is to tax at the source pensions paid from tax-subsidised schemes. Sweden has come to such an agreement in several double treaties. Although Finland has similarly come to such agreements, a case in 2006 led the ECJ to condemn the Finnish for withholding tax from mobile pensioners who left Finland, as it was much higher than the residence taxation of non-mobile pensioners staying in Finland. This law imposed a tax of 35% for non-resident pensioners, while resident pensioners were taxed on a progressive scale (for her 28.5%), and enjoyed tax allowances, tax deductions reflecting taxpayers' ability to pay. In this case, Mrs Turpeinen had moved to Spain where her only income came from her Finnish pension (public past employment). Therefore, she was in a comparable situation to that of a resident pensioner who did not leave Finland and did not have any other source of income than the pension. The ECJ found that this source taxations breached article 18 EC (21 TFEU) providing for the right to move and reside freely in the EU. None of Finland's justification grounds were upheld, as the need to simplify the tax collection for emigrants was not found relevant. Additionally, Finland had already amended the system in question to allow non-residents in a comparable situation as that of a resident taxpayer to take their personal situation into consideration.

In the 2015 Hirvoven case [2], the ECJ scrutinized the tax situation of a mobile pensioner who worked in Sweden and returned to Finland upon retirement. According to the Nordic tax treaty applicable at the time, Sweden had the exclusive right to tax this pension, while Mrs Hirvonen had no taxable income in Finland from which she could deduct the interest. Therefore, according to the law, she should have been taxed in Sweden as a non-resident at a rate of 25% (at the time) with no right to deduct the interest charged. However, Sweden allows non-residents to be treated like residents taxpayers if they are in a comparable situation to that of resident. As a result, Mrs Hirvonen should have been taxed on a progressive scale (30% up to 45.000€ and 50% on the net income above this threshold for 2015 taxable income) and allowed to deduct the interest charged. However, she contested this decision, and asked for the interest charged to be deducted from her non-resident tax bill. The Swedish tax authorities denied this possibility, and she countered that this was a breach of her freedom to move freely

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as EU citizen. The ECJ stated that, since her situation as a non-resident in Sweden (even without the right to deduct the interest there) was more favourable than it would be if she were a resident, her rights were not infringed upon. The court ruled that, in matters of taxation of income, the refusal to grant non-resident taxpayers who earned the majority of their income from one country, but move to a second country who have different tax codes , the same personal deductions as those granted to resident taxpayers under the ordinary taxation regime, does not constitute discrimination contrary to Article 21 TFEU where non-resident taxpayers are not subject to an overall tax burden greater than that placed on resident taxpayers and on persons in a similar situation whose circumstances are comparable to those of non-resident taxpayers.

This case law shows that mobile pensioners may contest a heavier taxation as a result of their change of residence, even if it arises from the application of the double tax treaties. However, EU law does not provide any guarantee that mobile taxpayers will be more favourably than non-mobile workers, as Mrs. Hirvonen would have been.

These cases show that taxing the source of the income, rather than where it is withdrawn, is problematic in the EU. Even if a solution is agreed upon for the issue of tax base erosion for States who subsidised the pension rights (through deduction from taxes at the moment of constitution of pensions), the issue of mobile pensioners needs to be addressed by each member state to comply with EU law.

A final comment on a pending case at the ECJ, which was also referred by a Finnish court.[3] According to Finnish tax law, resident pensioners are liable for an additional tax of 6% on pension incomes in excess of €45.000, after pension income deductions. In other words, the tax on pension incomes may end up higher

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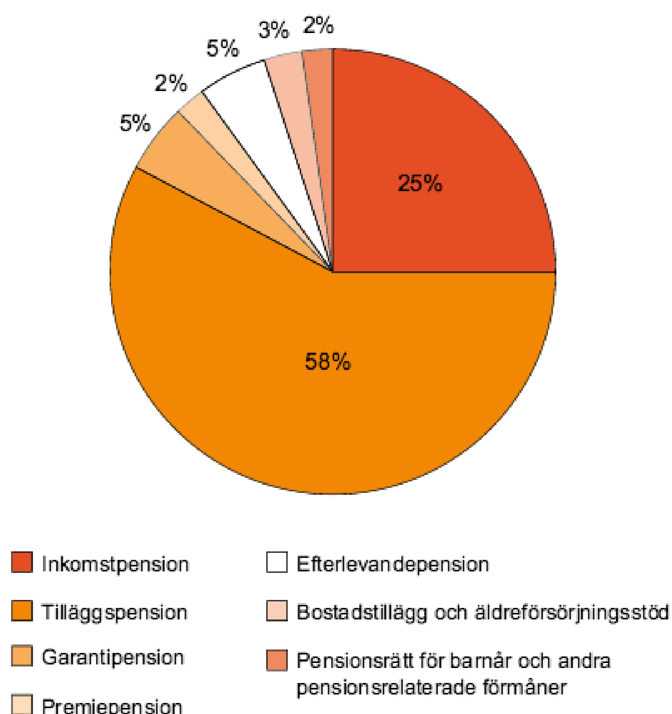
than the tax on a similar amount of employment income. This supplementary tax was meant to encourage workers, particularly those with high incomes, to postpone retirement. Indeed, the impetus for this tax is that a lower effective tax rate on pension than on employment income creates an incentive to retire earlier. An individual taxpayer challenged this tax in Finland, claiming that it breaches the prohibition of age discrimination provided for by article 21 of the EU Charter on Fundamental Rights, article 19 TFEU and the Directive 2000/78/EC on Employment Equality. If the ECJ would find these texts applicable, the next question is whether pensioners and active taxpayers are in a comparable situation (for the assessment of the ability to pay individual income tax). An argument in favour of this position is that pension income can be considered postponed employment income, and that it should not, therefore, be taxed at a rate. However, even if this proves correct, the ECJ has to decide whether distinct tax rates on employment and pension income is justified for an objective reason of public interest, such as the incentive to work longer and postpone the decision to retire later.

As any incentive reserved to a category of individuals, this law could be challenged therefore, and the ultimate argument against this type of incentives to work longer would be the difficult reconciliation with the proportionality principle. It could be argued that less stringent measures could be adopted than a higher tax rate in order to postpone the decision to retire, such as those proposed in other policies (increase time spent working, enhance employment of the elder and provide for life-long education, etc..).

APPENDIX 1 Allocation of Swedish pensions Pillar 1& 2 and social security payments.



SOURCE: Swedish Pension authorities, The Orange Report for 2014, p. 21

APPENDIX 2 List of Double tax treaties signed by Sweden

EU MS	Date conventions	Law of implementation
Austria	1959-05-14	SFS 1992:858-Changed SFS 2011:1350 (26-01-2011). Prop
France	1990-11-27	SFS 1991:673 Prop. 1990/91:174 s. 52
Germany	1992-09-22	SFS 1992:1193 Prop. 1992/93:3
Greece	1961-10-06	SFS 1963:497
Nordic Multilateral treaty	1996-09-23	SFS 1996:1512 ; Prop 1986/87:94s.36Prop1996/97:44 s. 53; prop 1989/90:33 s.49
Spain	1976-06-16	Förordning (1976:75) prop. 1976/77:2
UK	2015-03-26	Prop. 2015/16:7

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APPENDIX 3 Typology of double tax treaties signed by Sweden with States where Swedish pensioners move out

Type of pension	*Austria*	*France*	*Germany*	*Greece*	*Nordic DTT*[1]	*Spain*	*UK*[2]
Private employment	R	R	R	R	R/S	R	R/S
Public employment	N	N	N	S	R/S	R/S	N
Guarantee pension/Folkpension	N	R	N	N/S	S	R/S	N
Complementary employment pension[3]	R	R	R	R	R	R/S	R
Method of alleviation	E	E	E	E	C	RC	E

R: taxation in Residence State, S: Taxation in Source State, N: either Source or Residence, depending on nationality-C: Credit, E: Exemption-RC: Reverse Credit

[1] The Nordic Multilateral tax treaty applies differently to certain cross border situations, for instance such as the one between Sweden and Denmark where a specific agreement of October 2003 applies.
[2] The new tax treaty with the United Kingdom encloses a subject to tax clause according to which when one of the States does not tax the pension income, the other one is entitled to tax it.
[3] Voluntary pension/insurance contributed during working lifetime (partly tax deducted) but taxed as additional pension income upon retirement. For Swedish tax purposes considered as a replacement of salary and not as a social security benefit. Lagen (1967:53) Tryggande av pensionsutfästelse; 10 kap. 5§ IL; 11 kap.1§ IL; SFS (1998:674) om inkomstgrundad ålderspension.

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APPENDIX 4: Source or Residence taxation of exiting Swedish pensioners

Host member State	DTT	1) Private pension (Inkomstpension+ tilläggspension)	2) Public Pension	3) State minimum pension (garantipension)[4]	4) Voluntary additional pension (pensionförsakring)
Austria	1959	Residence taxation only-art. 15 (Austrian tax)	Source state (SINK) ONLY for Swedish nationals-16§1 Austrians= R, 16§2 a and for military pensions (art 16§2 b)* . Prop 1991/92:154 page 27.	Art. 16§1 =same as 2)	Residence taxation only Art. 15 (Austrian tax)
France ***	1990	Only R-State (France) art. 18	SINK source state for Swedish citizen (19§1 a) But R tax in France for French citizen(19§2 b)**	Only Residence (France) art.18	Other income, art.21, Residence state only (Folkpension, ATP)* Right to deduct contributions
Germany***	1994	Only R-State art. 18.1	Art. 19 R-state (Germany) unless Swedish citizen=> Only in S- Subject to tax clause art. 19.5	Art. 18.2 R-state (Germany) unless Swedish citizen=> Only in S- Soc.sec. pensions benefit allowances if taxable in other state.	R-State only (Other income)-
Greece	1961	Only R-State- Art.14 (Except ATP)	Only R-State (except Swedish ATP) Art. 16.	Only S-State- Art. 14	R-State (other income)
Nordic *** MT# DK, Finland, Norway	1996	S state+ Residence (Sweden)18.1 Credit of tax+20.000 deduction (art.26.4)	S State+Residence	Only in S State -Finnish and Swedish Garantipension not in the subject to tax clause (art. 26.3) Finnish state pensions exempt in both States.	R-State only (other income)
Spain	1976	R-State only (18.1)	S-State only for Swedish citizen (19.2a). Other citizen= R-State only	S- State (art18.3) and R-State (only for Swedish citizen)*****	S- State (art18.3) and R-State (only for Swedish citizen) *****
UK	2015	Source and Residence (art. 17) Prop p. 56****	Source and Residence (art. 17) Prop p. 56	Source and Residence (art. 17) Prop p. 56	R-State only*

NOTES:

*: Exemption with progression for public pensions, article 20§2- Sweden gives up internally this right to exempt with progression pensions from State employment or other exempt income in Sweden.

**Sweden applies exemption with progression on French State pensions tax exempt in Sweden and taxable in France only. Prop. 1990/91:174 p. 52-53.

*** Subject to tax clause (FR: art. 11 Protocole): If Frances does not tax, Sweden can do it. Same with Nordic DTT (Art. 26.2) and Germany (Art. 19.2)

**** New tax treaty not in force yet, income 2015. 3 years for pensions (used to be taxed in R-State under 1983 Tax Treaty).

A special agreement between Denmark and Sweden allows deduction of pension contributions to a scheme in the other State. See Prop. 2003/04:149 p 15. Handlening SV p. 154. SFS 2004:639, art.2 appendix 4.

Double tax treaty between Spain and Sweden, of 16 June 1976, article XVIII.2 and XXI5.5

***** This Treay provides for a reverse credit in these situations- Artcile 24.3: When Sweden taxes at source (SINK) the pensions paid to its nationals exited to Spain, the amount of Spanish tax paid on these pensions is deducted from this SINK by way of refund (cash flow issue).

[4] The Swedish Tax Authorities have commented the Nordic and German DTT on the qualification of "social security pensions", and suggest that more information shall be obtained in order to assess the nature of the payment in question, such as on the Deutsche Rentenversicherungs webbplats for Germany. See Skatteverket, *Handledning för internationell skatterätt*, p. 610.

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