Pension taxation
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The Danish Pension System

- *Public minimum pension for everybody*. Indexed.
- *Small obligatory labour market pension* (ATP), depending only on years on labour market. (Defined contribution scheme).
- *Obligatory labour market pensions schemes*. Total contributions:10-17% of salary. (Defined contribution schemes). Lowest percentage for people with lowest education.
- *Voluntary pension savings*. Large and growing.

The Public Pension

- Minimum indexed pension for everybody, not depending on former employment
- Taxfinanced (public budget)
- Maximum:15,600 Euros for singles without any other pension
- Minimum: 7,800 Euros for singles with large income from other sources

The Danish Tax Rates for Personal Income (Including Pensions)

Taxable Income (euro)	Tax rate
<35,000	39%
35,000-42,500	45%
>42,500	60%

Effective marginal tax rate on pension income

Effective marginal tax rate on pension probably close to 60% for a large part of the population.

- In relevant intervals: public pension falls with 15-30 kr. for every 100 kr. more income from other sources.
- High income earners: marginal tax rate 60%

Labour market pensions

- Both pensions for life and pensions for 10-25 years.
- Tendency in the direction of giving people right to choose at least part of the pension as a pension for 10-25 years.
- Tendency to give people influence on how pension savings should be invested
- Forced to save, free to lose, free to use early in retirement

The Danish Tax System: An Overview

- Proportional labour market tax (8%)
- Progressive income tax on income after labour market tax, rates between 39-60%
- Positive net capital income (interest) taxed as income
- Negative net capital income: tax rebate of 33% of negative capital income.
- Income from shares (dividends and capital gains) either 28% or 43% tax, depending on level of income from shares.
- Pension asset returns are taxed with 15% on an accrual basis.

Pension: column 2 and 3

Almost no limitations. People can:

- save 100% of salary
- administrate the portfolio themselves
- choose not to have any insurance in connection with saving
- make withdrawals before time from voluntary pension savings with little ”punishment” (if high income earners)

Changes in taxation or returns on pension assets

- Before 1983: No tax
- 1983-1999: Bond returns were taxed with varying rates from 34-57%. Returns on shares were not taxed
- 2000: Bonds returns were taxed with 26%, stock returns with 5%
- 2001-: All returns are taxed with 15%

Tax arbitrage and pension

People borrow to save for pension

Borrow at 4.5% interest

Lend at 4% interest

Borrowing rate after 33% tax: 4.5%(1-0,33)= 3.02%

Lending rate: 4%(1-0.15)= 3.4%

Small but positive reward if effective tax rate now and at withdrawal are equal

Taxation now – or later?

- 40% of working population pays highest marginal tax rate of 60%.
- The tax rate as pensioneer is rather uncertain.
- Public pension is income dependent. The ”effective marginal tax rate” on pensions for many people with low incomes is about 60%.

Conclusions

- People with high income and positive net capital income: Large advantage from pension saving (15% versus 60% tax on capital income)
- People with high income and negative capital income. Small advantage from pension saving
- People with middle income and positive capital income. Doubtful whether pension saving is advantageous
- People with middle income and negative capital income. Debt repayment is better than pension saving.