TAXATION OF CROSS BORDER PENSION PROVISION
Danish National Report

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1. Danish Schemes for Pension Provision
The Danish system for pension provision may be described as a four-pillar system: 1) state pension, 2) Labour Market Supplementary Pension, 3) occupational pension, and 4) individual private pension. Generally, all income from these four pillars is treated as taxable income, i.e. subject to a progressive tax rate of up to 59%.

1.1 The State Pension Scheme
Any person who has attained the age of 65 is entitled to state retirement pension, which is financed on a pay-as-you-go basis through taxes. The retirement pension is made up of a basic benefit and a pension supplement.

In 2001 the basic benefit is DKR 51,144. The basic benefit is a fixed-sum benefit granted to everyone. The basic benefit is reduced by 30% of the amount with which the annual income from work exceeds a basic amount of DKR 217,300 for single pensioners and DKR 142,800 for married pensioners. However, the basic benefit is not reduced if income from other pension schemes is received.

In 2001 the pension supplement is DKR 50,712 for single pensioners and DKR 23,256 for married pensioners. The pension supplement is scaled down if the total annual income exceeds DKR 47,900 for single pensioners and DKR 96,200 for married pensioners. Income from other pension schemes may therefore cause the pension supplement to be reduced or even disallowed.

Both the basic benefit and the pension supplement are treated as ordinary income for tax purposes.

1.2 The Labour Market Supplementary Pension Scheme and the “Special Pension Savings” Scheme
The Danish Labour Market Supplementary Pension Scheme (ATP = Arbejdsmarkedets Tillægs Pension) is a compulsory, statutory pension scheme for all employees. The scheme is financed by contributions from employees and employers. An employer can treat the contributions as a deduction for the employer’s own tax purposes, and an employee is not liable to pay tax on the contributions (the contributions are disregarded in calculating the taxable income of the employee). The maximum annual benefit that can be received from this scheme is approximately DKR 18,000.

The “Special Pension Savings” Scheme was introduced as a permanent scheme in 1999. The contribution amounts to 1% of earnings. The employee pays the contribution, but in practice the employer withholds the amount. An employee is not liable to pay tax on the part of his earnings that is contributed to the “Special Pension Savings” Scheme.

The income from contributions is redistributed from high-income groups to low-income groups, so that the benefits will not be calculated by reference to the contributions. Benefits under the “Special Pension Savings” Scheme are paid over a 10-year period.
Both benefits received under the Labour Market Supplementary Pension Scheme and the “Special Pension Savings” Scheme are treated as ordinary income for tax purposes.

1.3 Occupational Pension Schemes
Most Danish employees are covered by an occupational pension scheme.

1.3.1 Civil Service Pension Schemes
Central and local government civil servants are entitled to benefits under the civil service pension scheme. The scheme is unfunded, as benefits are part of the expenditure of central and local governments. Consequently, no tax is imposed during the qualification period, but the pension benefits are taxed.

1.3.2 Other Occupational Pension Schemes
The majority of saving for pension purposes in Denmark is made with the large pension institutions, i.e. independent (private) funds, private insurance companies or banks. These pension schemes are either linked to employment under an agreement between the social partners or individual private pension schemes (see section 1.4 below).

Apart from the civil service, the characteristic feature of the Danish labour market is that the social partners regulate labour relations. In recent years, high priority has been given to introduce into collective agreements provisions providing for compulsory pension contributions to tax-privileged schemes. Today most employees in sectors regulated by collective agreements are generally members of a pension scheme. Under these schemes contributions are typically made to independent (private) pension funds. This also applies to the large number of public sector employees who are not civil servants, as such employees are employed under a collective agreement.

The fundamental principle of tax-privileged schemes is that the time of taxation is deferred from the time of contribution to the time benefits are received. Accordingly, the employee does not pay tax on the share of his earnings that is paid as a contribution to a pension scheme, but the employee is liable to pay tax on the benefits received. A modification to the principle of deferred taxation is the payment of an 8% labour market contribution, which is payable during the time contributions are paid to a pension scheme, whereas the labour market contribution is not payable at the time of receipt of pension benefits.

The employer can treat the contribution as a deduction for tax purposes, whereas the employee is not liable to pay tax on the share of the pension contribution paid by the employer nor his own share of the pension contribution (however, pension institutions are liable to pay an 8% labour market contribution on the contributions to the pension scheme). The annual capital gain on the pension assets is subject to a tax on the return on pension savings at a rate of typically 15%. On payment, the benefits are treated as ordinary income of the receivers for tax purposes.

As a general rule, Danish law provides that schemes have to be funded pension schemes operated by a pension institution. Consequently, unfunded schemes where employers have future pension liabilities are not widely used in Denmark.

1.4 Individual Private Pension Schemes
The private pension schemes will typically be used where a person is not covered by an occupational pension scheme, or where a person wants to supplement an occupational pension by additional pension saving. Individual private pension schemes and life assurance policies may be either tax-privileged or not tax-privileged.

In the individual private pension schemes that enjoy tax privilege, the contributor is entitled to tax relief on the contributions and liable to pay tax on the pension benefits. Accordingly, the time of taxation is deferred from the time of contribution to the time benefits are received in a manner similar to that described above in connection with occupational pension schemes. A modification to the principle of deferred taxation, however, is the payment of an 8% labour market contribution and a special pension contribution of 1%, payable during the time contributions are made to the pension scheme, whereas these two contributions are not payable at the time of receipt of pension benefits.

Benefits paid under a scheme where benefits are paid periodically or under a premium capital pension scheme (a scheme where benefits are paid by instalments over a period of not less than 10 years) are treated as taxable income. Benefits paid under a capital pension scheme, where the benefit is paid as a lump sum, are subject to a tax at the rate of 40%. The tax environment for capital pension schemes is not as favourable as previously, as the value of the tax relief granted on the contribution is lower for many high-income earners than the value of the tax relief granted on contributions to other tax-privileged individual pension schemes.

As for schemes that do not enjoy tax privilege, no tax relief is granted on contributions and benefits are not subject to tax. In such schemes taxation is not deferred to the time when benefits are received.

The essential difference between tax-privileged pension schemes and those schemes that enjoy no tax privilege is the taxation of the annual capital gain on the assets of the schemes. According to the Danish Act on Taxation of Yields on Pension Savings, the capital gain on the assets of tax-privileged pension schemes is generally subject to a tax of 15% payable by the pension institution. In contrast, the estimated return on the balance of a pension scheme that enjoys no tax privilege is treated as taxable income of the members of the schemes on an annual basis (see section 53A(3) of the Danish Pension Tax Act), and as the income is treated as investment income for the purpose of calculating the tax, the estimated return is subject to a tax of up to 59%. In this light, it is not surprising that pension schemes that enjoy no tax privilege are few and far between in Denmark (as for discrimination, see section 2.5 below).

2.1 Employee Contributing to a Foreign Pension Scheme
To obtain tax-privileged status (i.e. entitled to exemption of the income or tax relief on the contribution, taxation on payment of the benefits and a tax on the return on of pension savings of typically 15% on the capital gains), it is required that the pension scheme is a domestic Danish scheme. Foreign banks and insurance companies with no branches in Denmark are therefore precluded from providing tax-privileged pension schemes.

Contributions to a foreign pension scheme will therefore always have to be treated as contributions to a pension scheme that does not enjoy tax privilege. If an employer has made contributions to an employee’s foreign pension scheme, the employee is liable to pay tax on the contribution. No tax relief is granted on the employee’s own contributions to an individual pension scheme operated in
another state. Furthermore, the individual contributor is liable to pay tax at a rate of up to 59% on an estimated annual return on the balance (see section 53A of the Danish Pension Tax Act; and see section 2.4.2 below on the effect of section 53B of the Danish Pension Tax Act concerning persons moving to Denmark).

The double tax conventions between Denmark and Switzerland (Art. 28(4)) and Denmark and the United Kingdom (Art. 28(3)) contain a special provision granting tax relief on contributions to pension schemes whose members have moved to Denmark from Switzerland and the United Kingdom respectively provided certain conditions are met.

2.2 Employer Contributing to a Foreign Pension Scheme
If an employer pays a contribution to a foreign pension scheme for the benefit of the employee, the contribution will be treated as a pay supplement. Consequently, the employer can treat the contribution as a deduction in calculating profits for the employer’s own tax purposes, whereas the employee is liable to pay tax on the contribution. The employee is also liable to pay tax on an estimated return on the balance of the pension scheme (see section 2.1 above).

2.3 Cross-Border Elements in the Taxation of Capital Gains on Pension Assets
The liability to pay tax on the annual capital gain, i.e. the taxation of yields on pension savings, on a tax-privileged pension scheme is imposed on the pension institution. The rate of tax is generally 15%. Tax relief may be granted according to the credit method if income is earned that is subject to tax in another state, the Faroe Islands or Greenland (see section 19 of the Danish Act on Taxation of Yields on Pension Savings).

If savings have been made under a scheme that enjoys no tax privilege, the individual pension saver is liable to pay tax on an estimated return at a rate of up to 59%. Relief will probably be granted under a double tax convention or the general provision on tax relief contained in section 33 of the Danish Tax Assessment Act, provided tax has been paid in the other state.

2.4 Taxation of Cross-Border Pension Benefits
2.4.1 Benefit Payments from Denmark to Another State
If pension benefits are paid under a Danish tax-privileged pension scheme, the benefits are subject to limited taxation in Denmark (see section 2(1)(b) of the Danish Tax at Source Act). This applies to both occupational pension schemes and individual private pension schemes. Furthermore, retirement benefits and benefits paid under the Labour Market Supplementary Pension Scheme and the Special Pension Savings Scheme are subject to limited taxation.

Danish double tax conventions contain provisions similar to Article 19 of the OECD Model Tax Convention, which confers the right to tax civil service pension benefits on the state of source.

When concluding new double tax conventions or amending existing conventions, the Danish Government finds it important that the right to tax other pension benefits is conferred on the source state. This applies, in particular, to benefits under the retirement pension scheme, the Labour Market Supplementary Pension Scheme, and the Special Pension Savings Scheme, as well as benefits paid under tax-privileged pension schemes. Examples of conventions that contain provisions conferring the right to tax on the source state include the Nordic double tax convention (covering, inter alia, Norway, Sweden and Finland) and the conventions concluded with Belgium, Germany, Ireland, Italy and the United Kingdom. In contrast, it has so far not been possible to
negotiate a change in the allocation of the right to tax for pension purposes with France and Spain. In those cases in which an existing double tax convention has been changed so that the right to tax has been transferred from the state of residence to the state of source, this change has typically been complemented by special transitional provisions applying to persons who were resident in the other state at that time.

According to Danish administrative practice, the imposed tax of 40% on benefits paid under a capital pension (i.e. a pension scheme where the benefit is paid as a lump sum) is not treated as a tax falling within the scope of the double tax conventions. Similar treatment is accorded to the tax of 60% imposed when a tax-privileged scheme is terminated before the conditions laid down in the Danish Pension Tax Act have been met. In its judgment reported in Tidsskrift for Skatteret 1992, 291 ØLD, the Danish High Court, Eastern Division, accepted this practice.

A pension scheme that enjoys no tax privilege and which is not subject to tax at the time benefits are paid is not subject to limited tax liability.

2.4.2 Benefit Payments to Denmark from Another State
Payments of social security benefits made periodically to a person resident in Denmark from other states generally have to be included in the calculation of that person’s taxable income. If tax has been paid in the foreign country, relief may be granted according to the general provision on ordinary credit pursuant to section 33 of the Danish Tax Assessment Act.

As a general rule, no tax has to be paid on benefits paid under foreign pension schemes, according to section 53A(5) of the Danish Pension Tax Act (but as mentioned above, the individual scheme member is liable to pay a tax of up to 59% on the estimated annual return on the assets of the scheme).

An exception to this rule applies to certain pension schemes that were established in another state at a time when the person in question was a resident of that state. If, when he was resident in that other state, the person was granted tax relief on all contributions paid to the scheme in accordance with the tax law of that state, he will be liable to pay tax on benefits paid while he is resident in Denmark (see section 53B of the Danish Pension Tax Act). Relief may be granted under a double tax convention or the general provision in section 33 of the Danish Tax Assessment Act, provided tax was paid to the other state. This exception aims to place new arrivals on the same footing as Danes who have made savings for pension purposes under a tax-privileged scheme. On the other hand, it is an advantage to such taxpayers with a foreign pension scheme falling within the scope of section 53B of the Danish Taxation of Pensions Act that the annual capital gains are exempt from tax in Denmark (see section 53B(5) of the Danish Pension Tax Act).

2.5 Discrimination
The Danish rules on taxation of cross-border pension provisions do not distinguish between foreign and Danish pension schemes. Instead a distinction is made between tax-privileged and not tax-privileged pension schemes.

Ordinarily, however, only Danish pension institutions and Danish branches of foreign pension institutions can provide tax-privileged pension schemes, and it is therefore reasonable to argue that the Danish rules result in covert discrimination.
In the Bachmann case (C-204/90) from 1992, the European Court of Justice ruled that non-deductibility of contributions to foreign pension schemes may be justified by the need to preserve the cohesion of the tax system. Such a cohesion is *prima facie* present in Danish tax law, as (concerning tax-privileged schemes) deductibility of contributions is complemented by taxation of benefits, whereas (concerning schemes that do not enjoy tax privilege) non-deductibility of contributions is complemented by tax relief on benefits. It should be pointed out, however, that tax relief on benefits paid periodically under schemes that enjoy no tax privilege was not granted until 1998 (by Danish Act No. 429 of 6 June 1998). Whether the existing Danish rules are compatible with EU law depends on whether the European Court of Justice may be expected to reach the same conclusion as in its judgment in the Bachmann case.¹

Another type of covert discrimination is the taxation of the annual return on the assets of the pension schemes. When contributions are paid to a tax-privileged scheme, the pension institution is liable to pay a tax on the return on the assets, usually at a rate of 15%. When contributions are paid to a scheme that enjoys no tax privilege, the owner or the holder of entitlement etc. is liable to pay tax at a rate of up to 59%. Legal scholars have argued that this taxation is incompatible with Articles 39/43 of the EC Treaty (for protecting foreign pension schemes that enjoy no tax privilege and which are transferred to Denmark) or Article 49 of the EC Treaty (for protecting the freedom of foreign pension institutions to provide pension schemes in Denmark).²

In contrast, the above discrimination is not incompatible with provisions of non-discrimination at constitutional level.

The Danish double tax conventions contain a provision of non-discrimination that is, in essence, identical to the provision of non-discrimination in Article 24 of the OECD Model Tax Convention. The rules described above are unlikely to be incompatible with this provision of non-discrimination.

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