

TAX TREATMENT OF PENSIONS AND PENSIONERS

Key results

The personal tax system plays an important role in old-age support. Pensioners often do not pay social security contributions. Personal income taxes are progressive and pension entitlements are usually lower than earnings before retirement, so the average tax rate on pension income is typically less than the tax rate on earned income. In addition, most income tax systems give preferential treatment either to pension incomes or to pensioners, through additional allowances or credits to older people.

More than half (20 out of 35) OECD countries provide older people with additional basic relief under the personal income tax. Generally, this takes the form of an extra tax allowance or tax credit. In many cases – Canada and the United Kingdom, for example – this additional relief is phased out for older people with higher incomes.

A significant number of countries offer tax relief for particular sources of retirement income. Relief from income tax for public pensions, either full or partial, is available in 14 OECD countries. For example, between 15% and 50% of income from public pensions (social security) in the United States is not taxed, depending on the total income of the pensioner. In Australia, for example, benefits derived from pension contributions and investment returns that have been taxed are not taxable in payment for over 60s. This therefore applies to the mandatory defined contribution scheme and voluntary contributions to such plans.

In contrast some countries such as Denmark, Iceland, the Netherlands and Sweden tax earned income from work less than pensions.

Overall, 27 OECD countries have some concession for older people or pension income under their personal income taxes. In only eight is the tax treatment of pensions and pensioners at least the same as it is for people of working age.

Virtually all OECD countries levy employee social security contributions on workers: Australia and New Zealand are the only exceptions. In addition to these two countries, a further 18 do not levy social security contributions on pensioners. The rate of contributions in the 15 countries that do levy social security contributions on retirees is always lower than the rate charged on workers. Typically, older people do not pay contributions for pensions or unemployment (for obvious reasons). However, pensioners can be subject to levies to pay for health or long-term care and, in some cases, are liable for “solidarity” contributions to finance a broad range of benefits.

Empirical results

The charts show the percentage of income paid in taxes and contribution by workers and pensioners.

Starting with workers, countries have been ranked by the proportion of income paid in tax at an average earner level. This is then compared to the replacement rate that an average earner would see in retirement (as set out in the indicator of “Gross pension replacement rates” above). In eight OECD countries and six other major economies, such a pensioner would not pay any income tax in retirement. In some cases, such as the Slovak Republic and Turkey, this is because pensions are not taxable. In Ireland and the United Kingdom it is because the pension income would be less than the basic income-tax relief offered to older people. Pensioners with the gross replacement rate for an average earner would pay 12% of their income in taxes and contributions on average across the OECD.

The chart aims to show directly the impact of different tax and contribution treatment of earnings and pensions. The amount of taxes and contributions paid by an average earner worker – so not including any contributions from the employer – averages 27% in OECD countries and 12% in other major economies.

The last comparison shows how much a pensioner would pay with the same income: that is, a pension worth the same as average earnings. This averages 18% in OECD countries, some nine percentage points lower than workers’ pay with the same level of income.

The difference between this 18% rate for pensioners with an income equal to average earnings and the 12% paid in taxes and contributions paid on the income which is equal to the gross replacement rate for an average earner illustrates the impact of progressivity in income-tax systems for pensioners.


Further reading

Keenay, G. and E.R. Whitehouse (2003), “The Role of the Personal Tax System in Old-age Support: A Survey of 15 Countries”, *Fiscal Studies*, Vol. 24, No. 1, pp. 1-21.

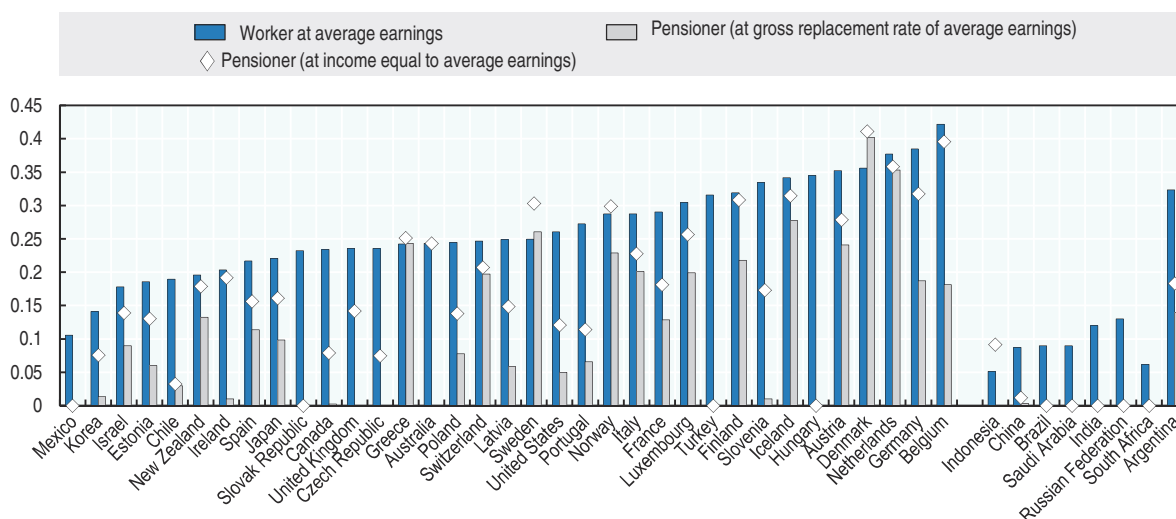
4.6. Treatment of pensions and pensioners under personal income tax and social security contributions

	Extra tax		Full or partial relief for pension income		Social security contributions		Extra tax		Full or partial relief for pension income		Social security contributions
	Allowance/credit	Public scheme	Private scheme	Pensions	Allowance/credit		Public scheme	Private scheme	Pensions		
OECD members						OECD members (cont.)					
Australia	✓	✓	✓	None	Low	Netherlands	✓				Low
Austria				Low	None	New Zealand					None
Belgium		✓		Low	None	Norway	✓	✓			Low
Canada	✓	✓	✓	None	Low	Poland					Low
Chile	✓			None	None	Portugal	✓				None
Czech Republic	✓	✓		None	None	Slovak Republic		✓			None
Denmark				None	None	Slovenia	✓				Low
Estonia	✓			None	None	Spain		✓			None
Finland		✓		Low	None	Sweden	✓				None
France				Low	None	Switzerland					Low
Germany		✓	✓	Low	None	Turkey		✓			None
Greece				Low	None	United Kingdom	✓				None
Hungary		✓	✓	None	None	United States	✓	✓			None
Iceland				None							
Ireland	✓			Low	None	Argentina		✓			Low
Israel	✓			Low	None	Brazil		✓			None
Italy	✓		✓	None	None	China					None
Japan	✓	✓	✓	Low	None	India	✓				None
Korea	✓	✓		None	None	Indonesia					None
Latvia	✓			None	None	Russian Federation					Low
Luxembourg	✓			Low	None	Saudi Arabia					Low
Mexico			✓	None	None	South Africa	✓				None

Source: See online "Country Profiles available at <http://oe.cd/pag>.

StatLink  <http://dx.doi.org/10.1787/888933633964>

4.7. Personal income taxes and social security contributions paid by pensioners and workers



Source: OECD pension models; OECD tax and benefit models.

StatLink  <http://dx.doi.org/10.1787/888933633983>



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