



"Statut unique"

After protracted negotiations, draft legislation has now been submitted to parliament for the creation of a single employment statute for the private sector. The objective of this legislation is to remove many of the differences in treatment between blue-collar workers ("ouvrier") and white-collar workers ("employé privé") in Luxembourg. Accordingly, the proposed changes focus on harmonisation of employment law, sick pay and overtime compensation for the two groups and are expected to be introduced with effect from 1 January 2009.

The proposed legislation sets out two changes to the law on occupational pensions, which appear to be merely technical, but which will make the management of pension schemes more flexible. These changes are as follows:

1. No automatic extension of membership of pension plans as a result of the proposed law, where pension plans only cover a part of the workforce.
2. Possibility to determine membership of pension plans by date of entry into service when existing pension plans are revised.

By way of background, the law on occupational pensions is and will continue to be based on the premise that occupational pension schemes must be collective plans: All employees who fulfil the membership conditions must be affiliated to the plan (no individual opting in or out) and all employees in the same category must have the same plan (different plans are permitted for different levels of staff, but individual arrangements are not acceptable).

1. No automatic extension of membership of pension plans as a result of the proposed law, where pension plans only cover a part of the workforce.

A number of plans define categories of staff by reference to their statute (blue-collar worker or white-collar worker) or hierarchical level, with different membership conditions and benefit levels for each category. The definition of categories and benefit levels has always been the prerogative of the employer. The draft law excludes any automatic acquisition of rights for staff not currently covered by existing plans, which may arise solely by virtue of the single employment statute and thus preserves the principle of freedom of choice for the employer.

However, we would suggest that membership rules should be reviewed for all plans in those companies, where both blue-collar workers and white-collar workers are employed and are currently subject to different rules. In addition, all other employers may wish to take this opportunity to review existing pension arrangements and implement any changes they consider appropriate in the light of the development of their business.

2. Possibility to determine membership of pension plans by date of entry into service when existing pension plans are revised.

The proposed change means that there will be significantly more flexibility in situations where pension plans are revised. If an existing pension plan is amended, the employer now has the choice to keep existing employees in the old plan or, subject to the protection of entitlements, to transfer these employees to the new plan.

This change will enable employers to close existing plans to new entrants and establish a new plan for new employees. We note that the IGSS as the regulator for occupational pensions has indicated that it may be prepared to accept the application of this principle before 2009. We also note that the rule prescribing a single pension plan covering all employees in the same category will continue to apply in cases where a pension plan is newly introduced in a company.

Treatment of internally funded plans

Since 2000 discussions have taken place in respect of certain aspects of the tax treatment of internally funded plans (see Pecoma News 1-2005), but we understand that the position of the authorities has now been clarified to the disadvantage of internally funded plans.

One objective of the law on occupational pensions was to put all occupational pension plans on same economic basis, irrespective of their funding characteristics. This meant the removal of tax advantages from internally funded plans by abolishing the tax deferral of benefits available up to 1999 and by introducing the upfront taxation for all employer-funded benefits.

From an economic perspective, there are two key differences between internally funded and externally funded pension plans:

- ❑ Internally funded plans are obligations of the employer, for which provisions are constituted on the balance sheet of the employer. These provisions are increased by additional rights being acquired by employees over time and by the interest added to existing provisions each year.
- ❑ Externally funded plans are obligations of the employer, for which contributions or premiums are paid to pension funds or insurance companies. These contributions or premiums cover the additional rights acquired by employees in each year and the interest or investment return accruing to members over time is generated within the fund or the insurance policy.

Thus the two key differences are:

- ❑ The risk of insolvency of the employer in internal plans, which is covered by membership of and payment of levies to the PSVaG.
- ❑ In external plans only the additional rights acquired by the members in the year are funded by the contributions or premiums, but in internal plans the interest earned by the members on the provisions also appears as an increase of these provisions (which implies that the employer has to earn sufficient taxable income to fund this interest).



The law on occupational pensions imposes as a pre-condition for the deductibility of pension expenses that the "premiums, contributions and allocations to pension provisions" in respect of rights acquired from 1 January 2000 be taxed at a flat rate at entry. The law does not make the distinction between allocations for new rights and for interest in respect of internally funded plans.

On the basis of the draft format of the revised annual tax certificate recently presented, we understand that the interest allocation in respect of pension rights falling under the tax regime of the occupational pension law will now be subject to the flat rate tax of 20% and the regulatory levy of 0,9%. Up to now, industry practice has been to exclude the interest allocation from the taxable basis of the flat rate tax, in accordance with informal instructions from the IGSS (see circular 2005/01). Interest on untaxed provisions relating to rights acquired before 1 January 2000 should not be affected by this change.

The effect of the change could be to double the tax cost of internally funded plans to the employer over a typical career, due to the significant impact of interest earned on provisions in the later years of membership. Put another way, the annual incremental cost of internal plans rises from +/- 0,5% of provisions (levy due to PSVaG) threefold to +/- 1,5% of provisions (tax on interest of 5% plus PSVaG).

Obviously these proposals raise a number of taxation policy issues, but in any case we would expect that their implementation will force employers with material levels of pension provisions to consider the option of transferring their plans to an external funding vehicle.

In our view the key considerations for such a decision would be

- the economic value of the cash flow advantage from internal funding
- the additional cost of internal funding: tax and regulatory levy on interest allocations for taxed provisions, insolvency cover on total provisions, additional reporting requirements (IAS, PSV), when compared to the
- availability of free assets to switch to external funding
- the characteristics of external funding vehicles (group assurance contracts or pension fund) in respect of initial funding, ongoing costs and commitments
- the requirement to introduce changes in the membership rules and in the type and scope of benefits arising from the change to a single employment statute and the overall development of the business.

Extension of reporting requirements for occupational pension plans

The IGSS as the regulatory authority is in the process of introducing comprehensive electronic reporting requirements for all occupational pension plans in Luxembourg. Plan administrators are working on the implementation of these requirements, which require substantial system development and will replace some of the current paper-based administration of affiliates and annual reporting in due course.

As a pre-cursor, three specific reports on the collection of the dependency contributions (on payment of benefits falling due from 1 January 2006) and the regulatory levy (applicable from 2006) as well as statistics on the profile of affiliates and beneficiaries are required to be prepared and submitted as soon as it is practicable.

We are currently in the process of creating the necessary data files and will be contacting our clients in due course gather the additional information that may be required.

PSV being sued by German members

From press comment we note that the PSV is being taken to court over the implementation of the method used in the change of funding rights of active affiliates of covered schemes in Germany. As a reminder, the PSV was required to fully fund the accrued rights of affiliates of covered schemes with effect from 2006, leading to a one-off funding requirement of several billion EUR.

The one-off funding was shared between all members on the basis of the provisions as at 31 December 2005. The principle of a one-off distribution of the sum required as well as the basis for sharing the sum between employers is being contested. The PSV is resisting the action and we will keep you informed as the eventual outcome of this matter.

Pension "Portability" Directive

On 9 October 2007 the European Commission published an amended proposal for the "pension portability" directive, based on feedback from the European Parliament and significant adverse industry comment.

The proposed rules on the transfer of pension rights have been completely removed and the renamed directive proposes

- the reduction of vesting periods to one year for all employees above 25 years of age
- the requirement to treat the value of dormant pension rights fairly and "in line" with the rights of active members
- the requirement to provide relevant and timely information to employees and beneficiaries.

The proposed reduction of vesting periods will affect most pension schemes in Luxembourg and we expect significant discussion about the impact of the "fair" treatment provisions.

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