MALTA INSTITUTE OF TAXATION

NEW PENSION SCHEME ARRANGEMENTS

The Malta Institute of Taxation has considered very carefully the Report presented by the 2010 Pensions Working Group, and would now like to make the following further submissions, even though certain topics may not, strictly speaking, lie within our province, although of national importance. We desire, however, to immediately record our appreciation that most of our recommendations on the subject have been incorporated in the Group's Report.

May we, however, revert to two issues which we have already mentioned. The first concerns the blanket powers vested in the Commissioner of Inland Revenue by article 41 of the Special Funds Regulation Act. This is couched in the following terms:

> *"A retirement fund or scheme shall comply with any requirements as are established from time to time by the Commissioner".*

With due respect, this provision, at the very best, is poorly drafted, at the worst it can be little short of disastrous. Frankly, no such fund or scheme should be constituted with this sword of Damocles hanging over it. Effectively, the Commissioner is authorized, both on an individual basis, and generally, to lay down any conditions which he feels like imposing since the powers so granted are in no way defined or circumscribed. The Commissioner's powers regarding pension and other schemes are already wide under the Income Tax Act, and there is no need for article 41 as set out in the Special Funds Regulation Act. As a matter of fact we cannot agree with the suggestion made in the Report to the effect that the Inland Revenue Department be established as a clearing house to reduce administrative costs of pension fund regulation (Recommendation no 31). This is not a Revenue function and it would allow more unnecessary taxation-slanted intrusions into this delicate area.

The second issue concerns the exclusion of rental income from the possible benefit of tax exemptions granted to funds and schemes. This exclusion has never been explained, but it constitutes a serious disincentive to one of the most sought after investments by retirement funds, namely immovable property. Such property is particularly appreciated in this field because of its propensity for capital security linked with steady capital appreciation in the long term. Many well known funds have in fact invested in the premises in which the business of the related firm is carried out. Clearly the regulatory authorities would set limits and guidelines on the type of property available for such investment, but the said exclusion should now be reconsidered seriously.

May we also state that, as a constituted body, the Malta Institute of Taxation is in total agreement with the 2010 Pensions Working Group to the effect that any

gender discrimination in the existing, or proposed schemes, must be removed – irrespective of all considerations which, prima facie, might provide sound financial arguments to the contrary.

The 2010 Pensions Working Group has noted the tendency in Malta to sink one's savings in immovable property (one's house) rather than going for pension scheme arrangements. This seems to be inevitable both for cultural reasons and because of the impossibility of finding adequate rental premises within the range affordable by young people. The Institute, however, has no objection, in principle, to the eventual disposal of houses to obtain retirement benefits, including pension arrangements. This may actually be beneficial socially, as houses acquired to accommodate young families often become a burden later in life. The disposal of houses late in life is favoured in many countries, and the Malta Institute of Taxation would recommend that fiscal incentives be made available for this purpose. Furthermore, we do not see the argument made in the Report that the disposal of houses for this purpose would tend to concentrate immovable property in a few hands.

It appears that a decision has been taken to postpone, at least till next year, the introduction of mandatory Second Pillar pension schemes. The unions' arguments that workers cannot afford to make contributions to such schemes are understandable, however shortsighted they may be. Essentially, this is a 'let the future take care of itself' attitude which will only exacerbate the already serious current position. Of course, Government will be expected to pick up the pieces in due course.

The Institute believes that there are at least two possible ways in which a partial solution to the unions' position could be attempted. Probably no one overall solution is available: the vast volume of funds involved rules this out. The first partial solution is to initially fix the amount of contributions at a very low level, increasing them over a number of years. This is actually the way in which Malta's social security structure was introduced in the middle of the last century. Exact details are not readily available, but the contributions were only a few shillings a week, contrasting with the current rates which are a substantial percentage of earned income. Few complaints were heard, and the structure was slowly built up over the years. In a sense, this is only postponing the inevitable, but a steep flight of steps had best be negotiated slowly, not taken two or three steps at a time! The 2010 Pensions Working Group also appears to favour this line of approach.

The second partial solution is the re-introduction of a tax allowance in respect of social security contributions. This was removed some years ago when the exempt portions of taxable income were substantially increased but, at the same time, when all personal deductions were cancelled. Since then, however, several personal deductions have been introduced into the legislation, and it is therefore suggested that a tax allowance be re-introduced in respect of the portion of social

security contributions which are estimated to be devoted to retirement pensions. This would probably require to be arbitrarily fixed as the current financial and fiscal arrangements of the country are not so structured as to enable definite identification.

It is appreciated that this measure may mean a substantial reduction in the take from income tax. This can only be worked out by the Inland Revenue Department, but this exercise should not be too difficult.

It is understood that it is the intention to introduce the Third Pillar arrangements during the current year. This makes a lot of sense as they will fill a gap which in the past has been largely tackled by the self employed, for whom it is largely intended, fairly haphazardly. Too many self-employed could never really afford to retire, and while late retirement beyond the normal 60-65 range is not in itself economically or socially wrong, particularly when life expectancy has increased substantially, this should not be expected of them. In a sense, such a requirement would be discriminatory against the self-employed when the Second Pillar schemes are in place. Furthermore, many self employed require to pass on to the next generation the business or practice which they have built up over the years, and delay in so doing is socially deplorable. Of course, it can be argued that many self employed can afford to build up their own pension scheme arrangements without waiting for structured schemes to be introduced. No doubt, many can, and do so, but it must be admitted that not all the self employed have the financial and managerial know-how to carry such arrangements to fruition. Pressure to consume what has been earned very often leads to the collapse of 'do it yourself' schemes: something which can happen much less easily in structured schemes. We are glad that our thinking on this issue is in line with Recommendation 41 made by the 2010 Pension Working Group.

The mechanics of a Third Pillar system are obviously extremely complex, and one could write whole theses on the subject. This is fully recognized by the Working Group and, no doubt, adequate provisions are being contemplated in practice. The working Group Report mentions some of these difficulties, including the possibility of cross-migration between the Second and Third Pillar Schemes, as well as repetition thereof. Attending to many of these technical difficulties may perhaps be usefully deferred, in so far as it is possible to do so, until a structured Third Pillar Scheme has actually been given launched.