The Pan-European Pension Product (PEPP) is coming to Luxembourg

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PEPP: a pan-European pension scheme, from concept to market product

Before delving into PEPPs, we should look into how these products came about. Regulation (EU) 2019/1238 of the European Parliament and of the Council of 20 June 2019 on a pan-European Personal Pension Product (the PEPP Regulation) was essentially created to remedy a mobility problem of the European Union. For many years, the European Union has struggled against the United States on some metrics, one being sluggish cross-member state relocation. This is due to mobility barriers preventing corporates from hiring the best staff across the European Union.

One of the reasons for the PEPP's creation is to offer a solution to, for example, the fact that the EU's fragmented pension market has discouraged some individuals and their families from relocating to other member states, because they could not bring their personal pensions with them or they would lose some of the benefits of their pension contributions. The organization and constraints of these different pension plans also hampered firms from relocating their staff across borders. Therefore, the European authorities considered creating a so-called 28th regime—a pension plan that can cross borders—and the idea of the PEPP was born.

While the PEPP is a "classic" pension plan, allowing holders to invest in UCITS or other listed instruments, each member state will be required to recognize this product in their respective social security and personal tax regimes. This allows it to be "portable" from one member state to another without employees and employers losing any entitlements. Therefore, multinational employers (whether large or cross-border) will be able to manage one single pension scheme across EU borders in a more straightforward and uniform way, and with fewer costs through digitalization.

This product, which in spirit is a great-grandson of the SEPCAV, offers significant opportunities for the Luxembourg market—not only for the Grand Duchy to become the home of these plans but also, as UCITS are eligible instruments, to massively develop the assets under management for UCITS similar to 401K plans in the United States. For the product to be successful, it requires a few adaptations, such as ensuring two KIIDs will not be necessary and that information is available to investors and employers alike in a convenient way.

In terms of a timeline, the PEPP Regulation was published in the Official Journal in July 2019, with its regulatory technical standards (RTS) published in March 2021, and is set to apply from 22 March 2022. Member States will need to incorporate the necessary changes in their social and tax regulations and supervision organization, and Luxembourg is about to cross this Rubicon by finalizing the legislative process.

PEPP as a valuable tool to complement expatriates' state pension rights within the EU

For more than 50 years, Luxembourg has been a popular career destination for expatriates and their families, many of whom have acquired pensions in several EU member states. Despite coordinated EU rules that provide some protection to mobile workers to acquire a relevant first-pillar pension[1], it is still unclear how state pension rights will be calculated in the future. Moreover, given the disparity of the EU's state pension systems, the PEPP may provide not only a way to complement future state pension rights and payouts, but also a clear hope for the simplification and standardization of pension rights within the EU.

In this respect, the PEPP should be an ideal tool for mobile workers, offering the overall technicalities and support to provide EU pension rights across an entire career.

Regarding personal taxation, the European Commission has set out recommendations for tax provisions that would apply in one specific member state to third-pillar pensions and PEPPs, although PEPPs will not necessarily meet all these underlying conditions in all EU member states. The aim was to ensure the portability of this product across all EU member states. This was echoed by the Luxembourg lawmakers, who enacted a first set of personal tax provisions in the 2022 budget law.

On this basis, a new article 111ter was added to the Luxembourg Income Tax Law (hereafter "LITL") that allows the personal tax deductibility of eligible contributions made under a registered PEPP, and the personal tax treatment applicable to PEPP payout(s) and reimbursement(s).

As such, the personal-tax-deductible contributions cover incoming payments made to a Luxembourg sub-account of a PEPP account, which is listed in the centralized public register held by the European Insurance and Occupational Pensions Authority as per article 5 of the PEPP Regulation.

As at 1 January 2022, contributions made during the calendar year under a registered PEPP in line with article 111ter LITL, and those made under an individual pension scheme covered by article 111bis LITL, can benefit from a personal tax deduction subject to an annual aggregated cap of EUR3,200 per individual subscriber.

The PEPP provider must supply a document to the subscriber certifying compliance with the conditions set out in article 111ter LITL and reporting the amounts paid into a subscriber's Luxembourg sub-account for a concerned calendar year.

Ultimately, the taxation of PEPP payouts and reimbursements at level of Luxembourg resident beneficiaries and pensioners will be governed by article 111ter (that includes comparable provisions to article 111bis), while such payouts and reimbursement made to Luxembourg non-resident beneficiaries and pensioners[2] will be subject to relevant tax treaty provisions, and to the tax legislation of their own state of residence.

PEPP and VAT?

The VAT treatment of PEPP's management services is also an important element to consider. Adding VAT (from 17% in Luxembourg to 27% in Hungary, with an EU average of around 21%) to the price of the services used by PEPPs would negatively impact PEPPs' return. However, the EU VAT Directive foresees a VAT exemption for the management services of investment funds, and the Court of Justice of the European Union has confirmed that this exemption could apply to pension funds (except those working on the defined benefit principle).

The Luxembourg VAT law applies the exemption to all investment (such as UCITS), pension (such as SEPCAV), and some insurance funds which are supervised by the Commissariat aux Assurances (CAA) or the Commission de Surveillance du Secteur Financier (CSSF), along with similar funds established in other EU member states. Therefore, it would be crucial that this exemption is maintained for PEPPs.

If we could expect that Luxembourg continues its tradition of broadly and consistently applying the exemption to all vehicles that share enough similarities with investment and pension funds, we must mention that the European Commission is reviewing the VAT rules that apply to financial services, including the management services of funds[3]. The result of the public consultation held in the first semester of 2021 indicate strong support from most stakeholders, including pension and investment fund associations, for the principle of the VAT exemption that is considered a key element of these vehicles' success. The European Commission plans to issue a proposal in 2023 that member states will discuss and decide upon unanimously.

Conclusion

The fund industry welcomes the introduction of EU-registered PEPP products in Luxembourg, in the hope it will inspire more players to tackle the challenges of developing and commercializing these products through advanced regulatory and digitalized product offerings.

Luxembourg boasts a growing population of newcomers, pensioners and expatriates from around the world, especially from the European Union. These people will likely appreciate a more predictable and harmonized Luxembourg personal tax treatment of their PEPPs and other third-pillar pension savings upon retirement. Luxembourg non-residents will still rely on the applicable tax treaty and the personal tax provisions of their own state of residence as far as their PEPP saving's taxation is concerned.

To offer future pensioners suitable options to increase their future pension payout beyond their state pension expectations, Luxembourg lawmakers could certainly consider some interesting proposals made in the context of the 2022 budget bill, although not adopted. These include opting either i) into the annual deduction thresholds of individual contributions made to registered PEPP and/or other third-pillar pension products, or ii) into an increased annual threshold, similar to what currently applies to contributions made by Luxembourg self-employed workers into approved occupational pension schemes.

1) Regulation (EC) No 883/2004 of the European Parliament and of the Council of 29 April 2004 on the coordination of social security systems (Text with relevance for the EEA and for Switzerland) – weblink: EUR-Lex - 02004R0883-20140101 - EN - EUR-Lex (europa.eu)
2) Cross-border workers can be included here.
3) For further information we refer to the articles published by Raphaël Glohr and Michel Lambion in March 2021 (Revue européenne de la TVA dans le secteur financier : Pourquoi ?), April 2021 (Quelles solutions ?), September 2021 (Les réponses à la consultation publique) and October 2021 (Analyse sectorielle des réponses à la consultation publique).