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Tax Incentives in Polish Pension System

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Abstract: Polish pension system has been severely changed in last years. However, it is still hard to find a purpose, for what these changes have been done. At the beginning of 1990 Polish pension system based on current payment (pass as you go system). In the end of 1998 a capital component was introduced. In the initial period of the mix system (pass as you go and capital) it was visible, that insured persons were not interested in self-building a capital for future pension payments. Due to this fact, special incentives were introduced. They were strictly associated with tax system, because these instruments introduced the possibility to minimize the tax base for those, who decided to save for own pension. This article analyses statistics dates concern these incentives and verifies the hypothesis, whether tax system shall create incentives for long-term saving plans.

Keywords: pension system, tax system,

JEL codes: H24, H55

1. Introduction

To this day, changes in the social insurance system have concerned old-age pension insurance only. The reform of 1999 introduced a three-pillar system of old-age pension insurance, including both a pay-as-you-go (PAYG) and a capital component, while the changes of 2014 moved the funds collected by then in the capital component from the private sector (Open Pension Funds – OPF) to the Social Insurance Fund (SIF), which was regarded as a form of retreat from the capital scheme. After 1999's reform the legislator introduced reliefs into the tax system as an instrument to encourage future retirees to enlarge the individual, capital part of their old-age pension insurance. The approach taken in this paper is to analyse the structure of these solutions in the tax system and their use for the purpose of collecting future old-age pensions by the insured in the

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light of empirical research. The aim of this article is to verify the hypothesis that the tax system should not provide incentives for long-term saving for retirement; as, in fact, the outlook for each of these systems is different. While tax regulations are concentrated – in terms of their fiscal function – primarily on generating budgetary revenues annually, the old-age pension system functions in the long-term scale.

2. Changes in pension and tax system

The new form of the old-age pension system introduced in 1999 led to the emergence of the capital component, in which future retirees were to deposit funds directly for their future retirement. The capital component consisted of both a mandatory portion of every contribution paid to the Open Pension Funds (the so-called Pillar II) and an optional third pillar, the creation of which was left to the insured person's decision. The reasons indicated for resigning from having the PAYG system only and introducing such a mixed system included ensuring financial stability of this system, as well as its solvency, and boosting economic growth through transfer of funds from the capital component to the financial market (*Przegląd*, 2013). The premises of doing so included solely macroeconomic factors and completely ignored incentives in the old-age pension system to accumulate capital in the third pillar. In subsequent years, changes in the size of contributions payable to OPFs were the only modifications made in the old-age pension system, an example of which was an amendment of regulations that came into force on 1st May 2011.[1] This change reduced the contribution transferred to an OPF from 7.3% to 3.5%. In subsequent years, these values were to become even lower (2.3% in 2011 and 2012, 2.8% in 2013). However, starting from 2014 the size of the contribution began increasing – from 3.1% in 2014 by 0.2 p.p. in subsequent years.

In mid-January 2014[2] the old-age pension system was once again significantly modified. The most important changes introduced by this Act were: depletion of funds accumulated in Open Pension Funds by transferring a portion of assets accumulated in OPFs to the Social Insurance

[1] The Act of 25th March 2011 on amending certain laws related to the functioning of the social insurance system (Dz. U. [Journal of Laws] of 2011, No. 75, item 398, as amended).

[2] The Act of 6th December 2013 on amending certain laws in connection with specifying the rules of old-age pension payments from the funds accumulated in Open Pension Funds (Dz. U. [Journal of Laws] of 31st December 2013, item 1717).

Fund (SIF); amendment of the size of the old-age pension contributions payable to the funds; introduction of optionality as to the second pillar; and, modification of investment limits applicable in the activities of OPFs (Rutecka, 2014: 2). The indicated optionality consisted in having a choice between continuing to accumulate funds in an OPF or paying one's contributions to SIF. Therefore, this did not constitute a possibility to resign from accumulating savings within the capital component of the system, but only a choice as to the manner and the beneficiary of the contributions paid by insured persons. And so, the old-age pension system continued not to provide any incentives or changes that could lead to an increase in the capital component of the system as far as voluntary savings were concerned.

The legislature sought to fill this gap with reliefs in the tax system, and more specifically, in corporate income tax (CIT) and personal income tax (PIT) settlements. Initially, the general system was supplemented with only Employee Pension Schemes (EPSs), to which solely those of the insured whose employer offered such a form of voluntary savings plan had access. These regulations came into force together with the change of the old-age pension system in January 1999. Later on, starting from 2004, the so-called Individual Retirement Accounts (IRAs) began operating as part of Pillar III; and in 2012 Individual Retirement Security Accounts (IRSAs) were introduced (J. Adamska-Mieruszewska, M. Mosionek-Schweda, 2015: 4).

From the beginning of the old-age pension system's reform process to the present day personal income tax rates have been significantly reduced. It happened in 2009, when the legislature replaced the three tax thresholds existing at the time with respectively 19, 30 and 40% ones and introduced two new one of 18 and 32%. The new rate of 18% pertained to income of up to PLN 85,528 – an amount which was previously taxed at the rates of 19 and 30%. The rate on everything above this income value was reduced by 8 p.p.

Currently, only those instruments related to the functioning of the tax system offer preferences aimed at increasing interest in long-term retirement savings plans. By reducing PIT rates, the legislator reduced also the impact of such reliefs, as smaller amount of tax will lead to an accordingly low interest in such a solution (Żyżyński, 2009: 280). Additionally, in the cases of IRA and IRSA the use of a relief entails a reduction in budgetary revenues, which – in terms of cash flow – will lead to partial financing of the old-age pension system in the voluntary capital component from public funds; as not using a relief by an insured person would, in fact, lead to a corresponding increase in tax revenues in the part in which the relief was not used.

Surveys show that the insured (taxpayers) have little knowledge of the above-mentioned instruments supporting the old-age pension system. In 2013, CBOS (Centrum Badania Opinii Społecznej [Public Opinion Research Centre]) investigated Poles' knowledge of long-term savings products (CBOS, 2013). CBOS's report identified that as many as 61% of the respondents did not even know what EPS is, and, similarly, in the case of IRSA – it was unknown to 54% and IKE – to 36%. Only 11% of the respondents stated that they have an IRA; and in the case of IRSA and EPS – 3%. Also, as many as 81% of people without any long-term retirement savings product indicated that they are not interested in such a form of saving.

A survey conducted in March 2016 by TNS (TNS, 2016) determined that as many as 53% of its respondents did not know any product that could assist them in saving for retirement. Respectively 13% and 3% of the respondents claimed to have knowledge of IRA and IRSA. An important part of this study consisted in identifying the obstacles which – in the opinion of the respondents – prevent them from saving for retirement. These were: proportionately low income (62% of the respondents), more significant on-going expenses (36%) and shifting responsibility onto the state as the entity which is to provide retirement pension (26%).

To conclude this topic, it should be noted that the introduction of the capital component into the old-age pension system was not connected with the creation of incentives for long-term saving by insured individuals. The tax system offers two reliefs aimed at making long-term savings (IRA and IRSA), and it is expanding the list of employer's tax deductible expenses, the purpose of which is the creation of old-age pension capital (EPS). However, surveys conducted in recent years indicate future retirees' scarce knowledge of these products.

3. Employee Pension Scheme (EPS)

The Employee Pension Scheme is geared for employers, who can increase the payroll fund with additional employee benefits that are transferred to their future old-age pension fund. The currently binding Act of 2004,[3] which replaced the Act of 1997,[4] introduced two types of contributions: basic and voluntary. The first of these is paid by the employer, and it is a tax deductible expense of the

[3] The Act of 22nd August 1997 on Employee Pension Schemes (i.e. Dz. U. [Journal of Laws] of 2001, No. 60, item 623, as amended).

[4]The Act of 20th April 2004 on Employee Pension Schemes (Dz. U. [Journal of Laws] No. 116, item 1207, as amended).

employer. It is calculated as a percentage of the employee's remuneration, and it cannot exceed 7% of it. The latter, i.e. the voluntary contribution, is paid by the employee – the employer deducts it from the salary and transfers it to EPS. In contrast to the basic contribution, the voluntary contribution amount is unlimited.

EPS, to which contributions are transferred, can function in the form of Employee Pension Funds, an agreement with an Investment Fund, an insurance contract with an insurance company or in the form of so-called foreign management. Selection of one of these takes place at the initial stage of scheme design; and later the employer is bound by the choice. The equity investments or insurance instruments options can be used by any employee, regardless of their age and risk profile. As indicated in the literature, proper functioning of the system requires close cooperation between the employer and employee representatives (Wijkowska, 219). In view of the often divergent expectations of the two groups, this is not always possible.

As far as the quantitative analysis of EPS is concerned, as shown in Table 1, the number of these schemes has been steadily decreasing since the end of 2011. This is due to the fact that more schemes are removed from records maintained by the Polish Financial Supervision Authority (PFSA) than are added to them.

Table 1. Number of EPSs and accumulated assets

Years	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**
Number of EPSs	3	29	150	182	207	342	906	974
Number of EPS participants (in thousands)	0.03	5.39	55.27	81.22	96.48	129.09	260.25	281.5
Assets (in million PLN)	0.03	4.73	71.23	279.83	526.97	919.45	1,695.47	2,793.2
Years	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**
Number of EPSs	1,019	1,078	1,099	1,113	1,116	1,094	1,070	1,064
Number of EPS participants (in thousands)	312.1	325	333.5	342.5	344.6	358.1	375	381
Assets (in million PLN)	3,806.4	3,607.7	4,998.2	6,286.1	6,597.7	8,350.9	9,407.3	10,259.5
Years	**2015**							
Number of EPSs	1,054							
Number of EPS participants (in thousands)	392.6							
Assets (in million PLN)	10,623.4							

Source: PFSA.

The number of participants continued to increase throughout the analysed period, as did the value of assets accumulated under EPS. In relative terms, however, these increases were growing smaller.

This indicates stabilisation of this instrument in the capital market and depletion in the number of companies interested in such a method of saving for retirement for their employees. The decreasing tendency of the number of EPSs is so pronounced in the last four years that there is no basis to the claims of its reversal. The more so that no legislative changes are being planned, nothing that could in any way encourage employers to create EPSs. The extent to which the regulator's impact is important in the case of this instrument is visible in the years 2004-2005, when the introduction of the new law led to a threefold increase in the number of EPSs.

4. Individual Retirement Accounts (IRAs)

Individual Retirement Accounts were introduced in September 2004[5] as another instrument to encourage saving for retirement. Unlike EPSs, these Accounts were individualised, as it was only the insured person's decision to save money. IRAs can take the form of: purchase of investment fund units, brokerage accounts, life insurance products, bank deposits, and – from January 2012 – voluntary old-age pension funds. An individual can only have one Individual Retirement Account; and payment of funds accumulated there is in principle connected with becoming of the age of 60 and a specified period of saving.

The introduction of IRAs coincided with changes in the capital gains tax, colloquially referred to as Belka's tax (named after the author of this solution, Marek Belka, Minister of Finance in 2002). At the time of implementing this levy it pertained to interest on bank deposits only and its rate was 20%. In 2004 its scope was expanded with income from other financial instruments, and its rate was lowered to 19%. The design of Individual Retirement Accounts was based on exempting from tax the savings of those persons who planned to save for retirement in this form. Simultaneously, the legislator introduced an annual quota amount limiting the value of payments into such an account. At the beginning it was 1.5-times the average monthly remuneration in the national economy. Today, it is three times this value – as has been since 2009. Table 2 shows the number of established IRAs, the value of accumulated assets and the amount of the annual limit on payments into such an account.

[5] The Act of 20th April 2004 on Individual Retirement Accounts, Dz. U. [Journal of Laws] No. 116, item 1205.

Table 2. IRA statistics in the years 2004-2015

Year	Number of	Assets (in thousands PLN)	IRA limit
2015	855,220	5,644,982	PLN 11,877
2014	824,485	5,030,537	PLN 11,238
2013	817,651	4,271,150	PLN 11,139
2012	813,292	3,530,313	PLN 10,578
2011	814,449	2,763,980	PLN 10,077
2010	792,466	2,726,395	PLN 9,579
2009	809,219	2,199,421	PLN 9,579
2008	853,832	1,613,789	PLN 4,055
2007	915,492	1,864,570	PLN 3,697
2006	840,263	1,298,545	PLN 3,521
2005	427,865	689,635	PLN 3,635
2004	175,500	200,000	PLN 3,435

Source: Ministry of Family, Labour and Social Policy.

The data presented in Table 2 indicate that the number of accounts remains relatively constant at around 800 thousand. After the introduction of this instrument in 2004, a sharp increase in their number took place, but in 2008 their number dropped and in subsequent years stayed constant. At the end of 2015 total accumulated assets amounted to PLN 5 billion – with no increase in the number of accounts, this resulted from the increase in the limit solely, which made it possible for savers to save larger amounts.

Due to the amount of exemption, in practice, the introduced tax relief has no material impact on the increase of the amount saved. While most IRAs are established in insurance companies in the form of life insurance policies, there is no synthetic data on the rate of return on these investments. However, there are average interest rates on bank deposits available for the period 2005-2015, and they can be regarded as the rate of return on IRA investments in the form of bank deposits. The amount of unpaid tax resulting from relief use is presented in Table 3.

Table 3 presents the average interest rates on deposits of households. Due to the nature of IRA, saving periods of over two years were taken into account. The amount of unpaid tax is calculated as the product of the interest rate, the amount limit and the tax rate (19%). As data show, the value of tax is small, compared to the amount of savings in a given period. Only in the long term is tax exemption likely to have measurable benefits for the saver (Biernacki, 2009: 215). In the light of the data presented in Table 2, this perspective, however, has no impact on people's

interest in this form of saving. The constant number of IRAs results mainly from the continuation of the previously opened ones rather than from new accounts being opened. Consequently, it can be assumed that this form of accumulating funds for retirement reached its market share peak and ceased to grow.

Table 3. The annual value of unpaid taxes in the case of IRAs functioning in the form of bank accounts

Year	The average interest rate on deposits of over 2 years	The annual amount of tax within IRA
2015	2.30%	PLN 52
2014	2.20%	PLN 47
2013	2.20%	PLN 47
2012	2.60%	PLN 52
2011	2.50%	PLN 48
2010	3.40%	PLN 62
2009	2.50%	PLN 46
2008	2.80%	PLN 22
2007	3.30%	PLN 23
2006	3.10%	PLN 21
2005	3.70%	PLN 26

Source: National Bank of Poland.

5. Individual Retirement Security Accounts (IRSAs)

The next and last form of saving for future retirement was introduced in 2012 as part of IRA regulations. Its implementation was based on the premise that it would stimulate the development of the third pillar (J. Adamska-Mieruszewska, M. Mosionek-Schweda, 2015: 6). The above-presented data indicate that both EPSs and IRAs did not gain popularity due to limited financial benefits for future retirees, hence IRSAs were more closely tied to the tax system - the insured can deduct the contribution amounts from the tax base. This allows them to effectively reduce the tax payable for the current year. What is more, distribution from such an account was in the end subjected to a flat-rate, 10% tax, provided that it took place after reaching retirement age and the insured person had been saving for a period of no less than 5 years. IRSA is not a substitute solution for IRA; the insured can save for retirement in both these forms.

Similarly to IRA, in IRSA the insured can choose the form of accumulating savings:

insurance form, bank deposit, investment fund units or a brokerage account. In this case the legislator also introduced an annual limit on contributions to the account, in order to minimise the fiscal consequences of the solution.

Table 4 shows the number of opened IRSAs as well as the value of assets and the amount limit on contributions through a number of years. Since in the first two years the limit was variable, it was not included in the table.

Table 4. IRSA statistics in the years 2012-2015

Year	Number of	Assets (in thousands PLN)	IRSA limit
2015	597,259	PLN 619,592	PLN 4,750.80
2014	528,142	PLN 295,350	PLN 4,495.20
2013	496,426	PLN 119,206	X
2012	496,821	PLN 52,882	X

Source: PFSA.

The statistics show a significant increase in the number of opened IRSAs, which led to a very rapid growth of accumulated assets. This means that the insured fully exercise the limits on contribution size and most of the accounts are active, i.e. the insured transfer funds to the accounts every year.

In Poland, in the case of this form of saving, the so-called bracketed progression in Personal Income Tax leads to greatest fiscal benefits for those whose incomes are subject to the rate of 32%. With this solution, they can deduct the entire value of the contribution limit from the tax base, and thus reduce their tax by the amount of PLN 1,520 (in 2015). On the other hand, with this size of assets, assuming that every taxpayer saving funds in this form made a deduction at the rate of 32%, the total reduction of income tax would amount to about PLN 200 million. In actuality, this amount is much less, as not all the tax-paying savers exceed the annual income amount of PLN 85,528 - which means that they are subject to the rate of 18%. Furthermore, not every insured individual deducts the funds in their annual tax return, even despite transferring them into an IRSA.

When analysing the dynamics of growth in the number of accounts, it is clear that this solution is still very popular. This is supported by the value of assets, which is also increasing significantly. It is impossible to compare IRSA with EPS or IRA here, as this instrument has been present in the economy for too short a time.

6. Conclusion

This article analyses the instruments to enable saving funds for future retirement outside of the mandatory social insurance system. Currently, the insured have a choice of three options, the first of which is closely connected with their employer (who decides on the implementation of EPSs), while the other two are forms of independent saving. The presented statistical data indicate that each of these forms enjoyed some interest in the initial period of its operation but it dwindled over a few years, and the instrument entered into stagnation. This is clear in the case of both EPS and IRA, which have already been in use for a relatively long period of time. The recently introduced IRSA attracts a lot of interest now, but experience shows that, like in the case of the other two solutions in the retirement system, its popularity will soon stagnate.

The analysed solutions are closely related to the tax system, as they enable reducing the tax base by the funds collected for future retirement. However, as indicated by the figures, such an "incentive" is not sufficiently adequate to the expectations of the insured to make these solutions widely favoured. Now, only IRSA enables effective tax reductions in such amounts that could make the statistical taxpayer become interested in this solution. Nevertheless, the greatest value of the tax benefit applies to those having annual income of over PLN 85 thousand, the number of whom is not high enough to have a significant impact on the popularity of this form of saving.

In conclusion, the presently possible methods of saving for future retirement did not attract enough of the society to become a viable guarantee of a retirement pension in the future. Tying the instruments of saving to the tax system proved to be misguided, as the proposed fiscal benefits did not translate into widespread interest in them. This conclusion is also confirmed by the fact that every few years the legislature introduces more instruments, as practice has showed that the already existing ones would fail to achieve the set goals. It also demonstrates lack of a coherent vision as to the old-age pension system's ultimate form.

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Zachęty podatkowe w polskim systemie emerytalnym

Streszczenie

Zmiany w polskim systemie emerytalnym wciąż trwają i obecnie trudno dostrzec kierunek, w którym one zmierzają. Wprowadzenie z końcem lat 90-tych ubiegłego wieku elementu kapitałowego skutkowało małym zainteresowaniem do dobrowolnego oszczędzania wśród ubezpieczonych. W konsekwencji ustawodawca zaczął wprowadzać zachęty do długoterminowego oszczędzania, które opierały się wyłącznie na rozwiązaniach ściśle związanych z systemem podatkowym. Przedmiotowy artykuł analizuje dane statystyczne związane z funkcjonowaniem tych rozwiązań. Weryfikuje również hipotezę, czy system podatkowy powinien być wykorzystywany do tworzenia długoterminowych oszczędności na przyszłą emeryturę.

***Słowa kluczowe**:* system emerytalny, system podatkowy.