Pension saving

Belgium introduced a tax incentive for pension saving in 1987. 18 years later, one and a half million tax payers are contributing to a pension savings account or insurance policy.

What you get with an insurance company is an individual life insurance. You save for a capital and the insurance company guarantees a return of between 2.5 and 3.25 percent. On top of that it normally pays a share of its profits as well if it has made a profit on its own investments.

When you invest in a pension savings fund, you invest in a diversified set of investments. Most funds invest about 70 percent in stock. If you invest for the long term and are not averse to some risk, a pension savings fund is certainly worthwhile. If not you should look at a pension savings insurance. Or you can look into one of the defensive savings funds (KBC or Dexia) that only invest a third in shares.

The system is quite flexible. You do not even have to contribute every year, as long as you do five times. The taxman subsidises pension saving with a tax credit of around 40 percent of the amount you have saved. The maximum contribution is € 780; and that amount is index linked. That means a tax saving of some €312 in income tax (not taking account the tax for the commune).

But if you accept this favour, you should keep in mind that you pay tax at the end of the ride. On your 60th birthday the bank or the insurance company withhold 10 percent of your theoretical pension.

The insurance company calculates the tax on the capital you have actually saved. That is the total of all contributions capitalised at the rate of the guaranteed return (e.g. 3.25 percent). The bank does not look at the capital you saved. It capitalizes the contributions at a rate of 4.75 percent. Because you invested in stock, you may pay tax on a higher amount than the value of your pension saving account. But if your investments were profitable, the difference remains tax exempt.

This tax is final. If you take up the capital after 60, there is no further tax. And that makes it more attractive to keep saving between the ages of 60 and 64. You still get the tax credit and do not pay tax on the savings. You should never take out your savings before the age of 60, because then the tax is 33 percent.

Even despite the tax at 60, pension saving is interesting. In the long term the pension savings funds tend to perform better than the minimum return insurance companies offers. To limit the risk, you need to go for a defensive pension savings plan, or for pension insurance. Transferring from one bank product to another is possible without any tax implications apart from the exit and entrance fees. And transferring from a bank to an insurance product costs 33 percent in tax.

What you should not do is start investing in a pension savings plan in December. If you invest in January, you have the return for a full year. Moreover, most people tend to buy at the end of the year, and demand pushes the prices up. If you chose a pension saving account, the best option is a standing order. If you pay the bank the same amount every month, you buy into the fund at a lower price. When the stock is low you receive more units for your investment. And when the stock goes up, the value of your portfolio follows.

While researching this article, I checked my own pension savings account. Over 18 years, I

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contributed some €11.000 €. Thanks to the tax benefit I only paid € 6,600 €. The account is valued at some € 22,000. The tax at 60 will be some € 2,000, so that that as of today the return is about € 13,400. That is quite a respectable return; but it will only be a small saving for a rainy day.

It reminds us that we have to save for our retirement, but pension saving will not finance the pension gap. Raising the cap on the contributions by a quarter as Finance Minister Reynders just did is only a drop in the ocean.

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