

Summary

The Individual Pension Contribution and Income Tax

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The Swedish pension system came into effect in 1999. It is based on actuarial principles. The amount of each individual's pension is determined by their total yearly income. Originally, the idea was that the pension credit would correspond to 18.5 per cent of the pensionable income, which for employees consists of earnings from paid work.

The pension system is funded outside the government budget by means of contributions. These contributions are paid direct through an individual pension contribution of 7 per cent, and indirectly through an employer-paid pension contribution of 10.21 per cent. The contribution paid to the pension system therefore amounts to 17.21 per cent and earns a pension credit of 17.205 per cent. This is not equal to 18.5 per cent of the total income, but corresponds to 18.5 per cent of the pensionable income. The reason is that for the latter the

individual pension contribution is deductible, i.e. $(100-7)=93$ per cent of total income.

The pension contributions also affect income tax since the taxpayer can deduct the individual pension contribution when drawing up their income-tax return. Thus, the taxes to be paid is reduced by the total contribution paid. Consequently, government revenue in the form of income tax is less than would otherwise be the case.

The construction of the income tax system means that the individuals with the lowest incomes will not be able to deduct any tax contribution, or at least not all of it. In practice, this means that these individuals will have to pay a higher proportion of their individual pension contribution. This is the case for those with a yearly income of less than about 60,000 kronor.

When the old-age pension is paid out to the individual, it is taxable. The same goes for private pensions. However, when it comes to cost deductions there is a divergence between the individual pension contribution and the premium for (some) private pension schemes. The individual pension contribution is not deductible from income, but the private insurance premium is. This means there is a lack of neutrality in the tax system.

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