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The act to strengthen company pensions is coming – with implications for all employers

Employment law - in brief ...

The Act to Strengthen Company Pensions (*Betriebsrentenstärkungsgesetz*) will come into force on 1 January 2018. In particular, introducing so-called "pure defined-contribution schemes" will lead to a change in the system regarding company pension schemes, which the legislator hopes will bring the German market closer to the defined-contribution systems particularly known in Anglo-Saxon countries. However, the "pure defined-contribution schemes" must still be put to the test in practice as soon as the necessary basis in terms of collective bargaining agreements has been established. It must not be overlooked, however, that as of 1 January 2018, numerous statutory changes will apply also to "traditional forms" of occupational pension schemes, which will have implications for the majority of employers.

In the following, we will inform you about the most important changes resulting from the Act to Strengthen Company Pensions and point out issues with regard to which action should already be taken today.

1. Introduction of mandatory employer contribution to deferred compensation

A crucial change will be the introduction of a mandatory employer contribution within the context of deferred compensation. Section 1a (1a) German Company Pensions Act [recast] (*BetrAVG n.F.*) newly included only shortly before the conclusion of the legislative procedure reads as follows: *"The employer must pay 15 percent of the deferred compensation amount as an additional employer contribution to the pension fund (Pensionsfonds), retirement fund (Pensionskase) or direct insurance (Direktversicherung) if the employer saves security contributions due to the conversion into deferred compensation."* This introduces a mandatory employer contribution, which concerns not only the newly introduced pure defined-contribution schemes (§ 23 (2) German Company Pensions Act [recast]) but all employers whose employees exercise their statutory entitlement to deferred compensation and with regard to whom compensation is deferred by way of pension funds, retirement fund or direct insurances. According to the legislator's express will, this employer contribution must not be paid, however, if compensation is deferred by way of a benevolent fund (*Unterstützungskasse*) or even a direct pension commitment (*Direktzusage*).

The employer contribution must be paid if the employer saves social security contributions due to deferred compensation. If, however, the employer does not save social security contributions, because, for example, compensation is deferred only with regard to income exceeding the contribution calculation limits, the employer does not have to pay the employer contribution. In practice, however, it may be difficult to determine the exact amount of social security contributions that are saved resulting in the fact that calculating the employer contribution may involve considerable effort. Moreover, it is still unclear whether contributions to the statutory accident insurance scheme are to be taken into account when determining possible savings in social security contributions. This is one of the reasons why the German Association for Company Pensions (*Arbeitsgemeinschaft für betriebliche Altersversorgung e.V.*) has quite rightly requested the legislator to revise the act.

The employer contribution is an integral part of the employee's contribution financed by way of deferred compensation. It shares the fate of deferred compensation and vests immediately. However, there are still some questions regarding the employer contribution that are still unanswered and unclear. For instance, it has not yet been determined whether or not and to what extent already promised employer contributions to deferred compensation can be deducted from the statutory contribution that will be mandatory in the future. This remains to be clarified.

The employer contribution generally applies to all employers. In this respect, the obligation to pay the employer contribution will apply with immediate effect to deferred compensation agreements concluded after 1 January 2019. A three-year transition period will apply to deferred compensation agreements concluded before 1 January 2019. In this respect, the employer contribution will not become a statutory requirement before 1 January 2022. It is, however, likely that employee representatives will request the payment of the employer contribution as of 1 January 2019 also with regard to this group of persons on the grounds of the principle of equal treatment.

2. Introduction of pure defined-contribution schemes – priority of collective bargaining agreements

The Act to Strengthen Company Pensions introduces a pure defined-contribution scheme for the first time. This means that employers do not promise specific or calculable retirement benefits but merely undertake towards the employees to pay specific contributions to an external pension provider. No specific (minimum) amount is guaranteed with regard to the retirement benefit paid out in the future ("guarantee prohibition"). Pension providers are thus able to reduce or increase the retirement benefits also during the pay-out phase depending on the performance of the capital market. The employer's obligation is limited to the proper payment of contributions ("pay and forget").

Pure defined-contribution schemes may be implemented only by way of direct insurances, pension funds and retirement funds; it is not possible to implement such a scheme as a direct pension commitment or a benevolent fund. Moreover, rights to future pension benefits resulting from a pure defined-contribution scheme will always vest immediately irrespective of whether they are based on contributions paid by the employer or the employee. In the event a pure defined-contribution scheme is financed by way of deferred compensation, the employer will in the future also be obligated to pay an additional employer contribution in the amount of 15 percent of the converted income to the pension provider, provided that the employer saves social security contributions due to deferred compensation.

The legislator has left the decision as to how to structure the pure defined-contribution scheme to the parties to the collective bargaining agreement (so-called social partner model). The pure defined-contribution scheme may be introduced only by way of a collective bargaining agreement or a works agreement based on a collective bargaining agreement, or by reference to a relevant collective bargaining agreement included in a works agreement or employment contract. Pure defined-contribution schemes must always be based on a collective bargaining agreement. Consequently, it will still take some time before pure defined-contribution schemes will be tested in practice. The reason for this is that the parties to the collective bargaining agreement (unions and employers' associations) must first negotiate and conclude the relevant collective bargaining agreements.

3. Introduction of "opt-out" model for deferred compensation

It is intended to further spread company pension schemes by offering an "opt-out" option with regard to deferred compensation. In the future, it will be possible to set out in a collective bargaining agreement or a works agreement based on a collective bargaining agreement that the employer will introduce mandatory deferred compensation for employees. So as not to participate in such a deferred compensation scheme, the employee would have to object to this within a specific period ("opt out"). By introducing such a system, the legislator hopes that numerous employees will not object to deferred compensation, which will thus help to spread company pension schemes.

4. Tax law changes resulting from the Act to Strengthen Company Pensions

So far, employees have been able to pay contributions of up to 4 percent of the contribution calculation limits of general pension insurance to a company pension scheme without having to pay tax and social security contributions (so-called "support framework"). When the Act to Strengthen Company Pensions comes into force, the support framework will be expanded from 4 percent to 8 percent of the contribution calculation limits (§ 3 no. 63 German Income Tax Act [recast] (*EStG*)). The additional tax allowance of EUR 1,800 per year will, however, be omitted. The contributions' exemption from payment of social security contributions will still be limited to 4 percent of the contribution calculation limits.

In addition, company pension schemes will be state subsidised with regard to low-income employees (maximum gross income of EUR 2,200 per month). If employers pay such employees a contribution to their company pension scheme in an amount ranging between EUR 240 and EUR 480 per year, the wage tax to be withheld will be reduced by 30 percent of the additional employer contribution, but not by more than EUR 144.

The changes mentioned above are already significantly flawed, which, in particular, could hamper the successful start of the pure defined-contribution scheme. According to the wording of § 3 no. 63, § 100 German Income Tax Act [recast], taxation incentives should apply only if the pension benefits are paid out in compliance with the requirements set out in § 1 (1) sentence 1 no. 4 German Law on the Certification of Private Pension Provision Schemes (*Altersvorsorge-Zertifizierungsgesetz, AltZertG*). This provision, however, provides that the benefits that are paid out during the pay-out phase are to increase or at least stagnate. The pure defined-contribution scheme cannot fulfil this requirement by definition, because in this respect the benefits must be reduced if capital coverage does not reach 100 percent. According to the current wording of the act, the contributions to a pure defined-contribution scheme would thus neither be tax free pursuant to § 3 no. 63 German Income Tax Act nor eligible for subsidy pursuant to § 100 German Income Tax Act [recast]. This was surely not intended by the legislator and thus remains to be clarified.

5. Social security law changes resulting from the Act to Strengthen Company Pensions

In terms of social security law, the subsidy for low-income employees will be accompanied by an advantage with regard to old-age social benefits. Voluntary additional pension benefits of up to EUR 202 per month will not be deducted from the old-age social benefits (any more). This serves to reward the effort to build up additional company retirement benefits even if the statutory pension received after having reached the statutory retirement age is not enough and must thus be topped up by the state by way of basic social benefits.

With regard to employees, there will also be changes to the so called "*Riester* subsidies" granted in the context of occupational pension schemes. As of 1 January 2018, no social security contributions will have to be paid on benefits received during retirement with regard to "*Riester* agreements" concluded in the context of occupational pension schemes. In addition, the "*Riester* allowance" paid by the state will be increased from EUR 154 to EUR 175 per year.

6. Outlook

It remains to be seen whether the legislator has indeed managed to strengthen and further spread company pension schemes as intended based on the Act to Strengthen Company Pensions. Employers should, however, familiarise themselves with the changes implemented by the Act to Strengthen Company Pensions in due time. Owing to the mandatory employer contribution with regard to deferred compensation, the legislator has further increased the complexity of company pension schemes and burdened employers. Internal processes, for example, must be adjusted to the mandatory employer contribution to deferred compensation, which has to be paid as of 1 January 2019.

We are happy to assist should you have any questions regarding the Act to Strengthen Company Pensions or company pension schemes in general.

Yours sincerely

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