



**OECD
Tax Policy Studies**

Encouraging Savings through Tax-Preferred Accounts

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No. 15



ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

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Foreword

This publication provides an analysis of tax-preferred savings accounts that exist in a number of OECD countries. Its focus is on those accounts that are designed to encourage general non-pension savings, saving for education, saving to build assets for children and life-insurance contracts. It reports on a cross-country comparison of these tax-preferred accounts to identify the effects of their design features, focusing on three issues: how the benefits of the tax-preference are distributed across income groups, the extent to which they generate additional savings and the size of the tax revenue losses. The study was prepared by Giorgia Maffini, who was the Alessandro Di Battista Fellow in the OECD's Centre for Tax Policy and Administration in 2004-05. This Fellowship was generously established by the Italian government in memory of Alessandro Di Battista, an economist who died tragically young while working at the OECD. The study has benefited from data and comments provided by delegates to the Working Party No. 2 on Tax Policy and Tax Statistics of the Committee on Fiscal Affairs. The analysis, opinions and conclusions presented in the study are those of the author.

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Executive Summary

Increasing the domestic saving rate has been a major policy concern for many OECD countries in the past decade because low saving rates can hinder investment, economic growth, the balance of payments and the financial stability of households.

Governments have therefore introduced various incentives, including savings accounts that offer tax advantages, called tax-preferred savings accounts. While much attention has been devoted to the study of tax-preferred pension accounts in the past 20 years, there has been relatively little research on whether tax incentives encourage other forms of saving. Consequently, this report focuses on tax-preferred savings accounts (not linked to pension or retirement savings) that enhance the financial well-being of households, such as education-savings accounts and life-insurance contracts.

The data for this report were derived from an extensive questionnaire answered by 11 OECD countries, and the aim of the report is to analyse the data received in light of the existing literature on tax incentives for savings. The report then presents a cross-country comparison useful to policymakers interested in designing or modifying tax-preferred savings accounts. This international comparison focuses on: account design features; the impact on the income distribution; the accounts' effect on saving; and government expenditure related to such accounts.

In particular, the analysis of the effects on the income distribution includes: the number of account participants by income class; the participation rate by each income class; and the average contribution by income class in total, and as a percentage of income. Distributional issues regarding tax-preferred savings accounts have received little attention in the literature. This is puzzling because it is generally believed that the effectiveness of tax-incentive programmes (*i.e.* an increase in saving at the lowest cost) depends crucially on whether the plans create new saving among low and middle-income households. The literature (Benjamin, 2003; Engen and Gale, 2000) agrees that the saving effect of tax-preferred incentive plans is greater on moderate-income households. Thus, the greater the share of low and middle-income households participating in tax-favoured accounts, the more likely it is that new saving is created. Additionally, since moderate-income individuals face a lower tax rate, the more they participate compared with high-income individuals, the lower the government's foregone tax revenues (Antolin, de Serres, de la Maisonneuve, 2004).

The report is organized as follows: Chapter 1 describes the various tax-preferred accounts analyzed for each country and presents a comparison of their design features, followed by an analysis of the effects on the income distribution, the savings effect, and government expenditures on tax-favoured savings plans. Chapter 2 then describes in more detail the design features of each tax-preferred plan. The Annex presents tables with data submitted by OECD countries.

Findings

This report shows that the tax-preferred plans analysed display some common distributional features. First, participation rates increase with income: the highest income classes display the highest participation rates.¹ For some accounts, higher participation rates for the richest classes are somewhat mitigated by the fact that a great number of participants come from moderate-income classes. This means that even if wealthier households profit from the savings plans to a greater extent, the participation of low and middle-income households is substantial. Regarding the level of contribution and/or investment in tax-preferred accounts, all the plans analyzed display contributions increasing with the holder's income. This result is partially mitigated by the fact that contributions as a percentage of income are highest for low-income earners.

Tax-preferred environments have been introduced with the aim of increasing personal and national saving. The relation between tax incentives and personal saving is one of the most investigated aspects of the academic work in this area. There is no general agreement in the literature, though. It is likely that the effect of tax-favoured accounts lies between the hypotheses of no new saving and the hypotheses that all the assets deposited in the plans represent new saving (Hubbard and Skinner, 1996). Most of the data sent by OECD countries support this view, indicating that tax-preferred accounts other than educational plans create new saving only when moderate-income households participate in them.

The last issue we investigate is the cost of tax-preferred savings accounts. As highlighted by Hubbard and Skinner (1996), it is not possible to understand whether tax-favoured plans are efficient (*i.e.* they increase saving at the minimum cost) without knowing something about the cost of the program in terms of foregone tax revenues.

This report shows that costs depend on whether incentives are granted through tax credits or through the exemption of accrued earnings. Expenditure features are also influenced by the capacity limits of the accounts and by the saving bonus granted to the investor. Unsurprisingly, the most expensive accounts are those granting a tax credit or paying a generous saving bonus in the account.

The overall conclusion is that it is important for the efficiency of tax-preferred accounts to involve moderate-income households: the latter are more likely to increase saving when given the opportunity to invest in tax-favoured accounts. Furthermore, since moderate-income individuals face a lower tax rate, the more they participate in comparison to high-income individuals, the lower the cost of foregone tax revenues. However, the evidence indicates that, in fact, wealthier individuals have the highest take up of tax-favoured accounts. This suggests that there is still room to improve the effectiveness of these plans by changing some of the design features in order to attract more moderate-income households.

NOTES

- ¹ It is worth noting that the German Employee Savings Bonus plans are an exception because they target only low-income households.

Chapter 1

Comparative Analysis of Tax-preferred Accounts

This chapter investigates tax-favoured savings plans in 11 OECD countries: Belgium, Canada, Denmark, Germany, Ireland, Italy, Mexico, the Netherlands, Norway, the United Kingdom and the United States. It first describes and compares key design features of tax-preferred accounts intended to foster saving in general terms, saving for education, saving for building assets for children and life-insurance contracts.

The chapter then carries on with a cross-country comparison aimed at exploring distributional features of the aforementioned plans. Finally, an analysis of the efficiency (i.e. increase in saving at the minimum cost) of tax-preferred accounts is provided: the effect of the plans on saving is considered in connection to their costs in terms of foregone tax revenues.

In this section, we describe tax-preferred accounts main design features and carry out a comparison among different countries.¹ When tax incentives to savings are in place, the taxation system moves away from the benchmark of a comprehensive income tax system (where contributions and earnings are taxed while withdrawals are not - TTE system). The results of such a deviation are very diverse as they depend on the various accounts' design characteristics. In the first part of the analysis, we will concentrate on the type of tax system concerning each account and we will then summarize results in Table 1.1.

1.1 Description of the questionnaire

On 31 January 2005, the questionnaire was issued to the delegates of the following countries: Belgium, Canada, Denmark, France, Germany, Ireland, Italy, Mexico, the Netherlands, Norway, United Kingdom and the United States. Eleven countries answered: Belgium, Canada, Denmark, Germany, Ireland, Italy, Mexico, the Netherlands, Norway, United Kingdom and the United States.

Part I of the questionnaire asked countries to illustrate the design features of some tax-favoured savings schemes implemented. All countries were able to answer all the questions in the first part; a fairly detailed description of how tax-preferred schemes are organized can be found in the Chapter 2.

Part II of the questionnaire asked for data on the total amount of savings located in tax-favoured accounts, on the number of participants/contributors by income class and marginal tax rate class, and on expenditure for foregone tax revenues. Further questions asked countries to cite studies classifying participants/contributors by household's characteristics (age, wealth, income, number of dependants, etc.) or studies estimating how much savings has been diverted from taxable to tax-preferred accounts. We finally asked whether a micro dataset was available.

Denmark (from 1991 to 2003), Canada (from 1997 to 2004), the Netherlands (in 2005 for the Payroll Savings Scheme), Norway (for both the Tax-favoured Savings in Shares from 1996 to 1999 and the Tax-favoured Home Savings Accounts for Young People from 1996 to 2003), and the United Kingdom (from 1997 to 2004 for Personal Equity Plans, from 1991 to 2003 for Tax-Exempt Special savings Accounts and from 1999 to 2004 for the Individual Savings Accounts) provided data on the amount of total assets located in tax-preferred accounts. Data on the number of participants/contributors stratified by income class were provided by Canada, Germany, Italy, the Netherlands, Norway² and the United Kingdom. Data on the number of participants (or contributors) classified by marginal tax rate class were supplied by the Netherlands and the United Kingdom. Data on foregone tax-revenues were provided by Canada, Denmark, Germany, Norway and the United Kingdom. Previous studies on tax-preferred accounts were suggested by Canada, Italy, the Netherlands and the United Kingdom. No micro dataset was made accessible but some countries indicated where data is recorded: Germany, Italy, the Netherlands, Norway, the United Kingdom and the United States.

1.2 Description of tax-preferred accounts

For Belgium, we analysed the *Tax-preferred Deposit Accounts* in which contributions are made out of taxed earnings (T) and accrued earnings are tax-free (E) until a certain amount. Funds can be withdrawn whenever the investor wishes without

being taxed (E). These accounts are subject to a *Taxed-Exempt-Exempt (TEE)* system, as shown in Table 1.1.

We also investigated *Tax-preferred Life-insurance Contracts*. The premia paid for such insurance contracts are entitled to a tax credit (t) which is limited to a certain amount. The insurance companies have to pay a tax on the theoretical surrender value but the policy holder does not have to pay any taxes on it. The policy holder has to pay a 10% personal income tax on the capital paid out at the end of the contract (t). If the policy is surrendered before the end of the contract, the insurance company has to pay a 33% tax on the surrender value. We can conclude that the tax-preferred life-insurance contracts are subject to a *tEt (taxed-exempt-taxed)* regime as contributions are made out of net income but they are entitled to a tax credit. Earnings are not taxed while the capital is subject to a 10% personal income tax at the end of the contract. Tax incentives for life-insurance contracts are granted to the entire population, regardless of the income.

For Canada, we analysed the *Registered Education Savings Plans (RESPs)*. The latter are plans established for financing higher education. Earnings accrue tax-free and a government savings bonus is paid in the account. When funds are withdrawn for paying higher education expenses, earnings and the saving bonus are taxed. The funds may not be withdrawn until the beneficiary starts a qualifying educational program. The accounts are characterized by contribution limits.

The Canadian system of fiscal incentive to savings for educational expenses is mainly a *Taxed-exempt-taxed (TEt)* regime, as shown in Table 1.1: contributions are made out of taxed income and interest payments and capital gains accrued tax-free. Earnings are taxed at the withdrawal of funds at the student's income tax rate. A government savings bonus is also provided. Fiscal incentives to savings are given to the entire population but the amount of the saving bonus depends on the household's income.

For Denmark, we analysed the *tax-preferred savings accounts for children/grandchildren*. These accounts are tax-free accounts targeted at individuals under the age of 21. Earnings accrued on funds deposited are tax-free. The accounts are characterized by annual contribution limits. Funds are locked away for at least seven years. As shown in Table 1.1, the aforementioned Danish accounts are subject to a *Taxed-exempt-exempt (TEE)* regime: contributions to tax-preferred accounts are made out of taxed income and interest payments, capital gains, and withdrawals are untaxed. Fiscal incentives to savings are given to the entire population without any limit on the individual's income.

For Germany, we analysed the *Employee saving bonus (Arbeitnehmer-sparzulage) and tax-preferred life-insurance contracts*. The former is a saving bonus given to low and middle-income employees who lock funds in a special account for 7 years. Contributions to the account are normally paid in annually by the employer. Accrued capital gains and interests are taxable but the savings bonus is not. Thus, the scheme is mainly subject to a *Taxed-taxed-exempt (TtE)* regime: contributions are made out of taxed income, interest payments and capital gains are taxable (but the savings bonus is not) while withdrawals are untaxed. Earnings accruing to tax-preferred life-insurance contracts signed before 1 January 2005 were not taxable and premia paid were deductible (*tEE* system). After 1 January 2005, premia are no longer deductible and earnings are taxable for 50% of their amount (*TEt* system).

Incentives to savings are given only to low and middle-class employees through the Employee Saving Scheme and to the entire population through the tax-preferred life-insurance contracts.

For Ireland, we analysed a set of different accounts.

- **Special Savings Incentive Accounts (SSIAs)** were accounts offering a 25% matching contribution. Earnings accrued on funds deposited were tax-free but total profit in the account was then taxed (at 23%) when the plan expired. SSIAs were characterized by monthly contribution limits. Funds could be withdrawn after five years.
- **Special Savings Accounts (SSAs)** were accounts in which accrued earnings were taxed at a preferential rate. SSAs were characterized by overall contribution limits. Funds could be withdrawn after three months.
- **Special Investment Accounts (SIAs)** were accounts in which accrued earnings were taxed at a preferential rate. SSAs were characterized by overall contribution limits. Funds could be freely withdrawn.
- **Special Term Accounts (STAs)** are accounts where interest is not taxed if it does not exceed a certain limit. STAs are characterized by monthly contribution limits. Withdrawals are possible only after either three or five years.

The present Irish system of fiscal incentives to savings is a *Taxed-exempt-exempt (TEE)* regime: contributions to tax-preferred accounts (Special Term Accounts) are made out of taxed income and interest payments, capital gains, and withdrawals are untaxed.

Before 2001, a wider system of incentives to saving was in place. It was mainly a *Taxed-exempt-taxed (Tet)* system: contributions to tax-preferred accounts were made out of taxed income. Interest payments and capital gains accrued tax-free. At withdrawal, they were taxed at a preferential rate.

Fiscal incentives to savings were given to the entire population without any limit on individual income. Even Special Savings Incentive Accounts where individual's deposits were matched by a 25% government contribution could be accessed by the entire population.

Four similar savings products were introduced in the early 1990s to encourage funds to stay in the country in the context of the liberalisation of capital markets. The products were SSAs (cash deposits with banks) and three products generally known as Special Investment Accounts being Special Investment Schemes (investment in unit trusts), Special Investment Policies (a life assurance policy) and Special Portfolio Investment Accounts (a portfolio share managed by a stockbroker).

When originally introduced, the profit earned were taxed at a favourable rate of 10% when the income tax rate otherwise attaching to these products was 27% and the capital gains tax rate was 40%. By 2000-2001 the favourable tax rate had been increased to 20% which was also then the income tax rate and the capital gains tax rate attaching to such products that did not have a favourable regime. These products, therefore, no longer served any purpose and were phased out.

For Italy, we analysed **Tax-preferred life-insurance contracts** regulated by law provisions until 31 December 2000 and Tax-preferred life-insurance contracts regulated by law provisions after 31 December 2000. In the former, earnings accrued on funds

deposited were taxed only when the contract expired. Premia were entitled to a tax credit up to a certain limit and, in the meantime, they were taxable at 2.5% rate. Funds could be withdrawn after ten years in order to enjoy fiscal privileges. After the reform, the system is dual. Traditional life-insurance contracts still enjoy a tax credit for the premia paid. Premia are not taxable anymore and earnings distributed before the death of the policy holder are taxed only when the contract expires. For life-insurance contracts providing for the build-up of assets, earnings accrued on funds deposited are taxed only when the contract expires but premia are not entitled to any allowance. Funds can be withdrawn freely when the investors wishes.

Before 2001, the taxation of life-insurance contracts could be described as a *taxed-exempt-taxed (tEt)* regime: contributions to tax-preferred life-insurance contracts were made out of taxed income and they received a tax allowance. Earnings (*i.e.* the difference between the final payment and the sum of premia paid) were taxed only at the end of the contract and the tax rate was reduced by 2% for each year after the 10th. After 2001, the system became dual. The treatment of traditional life-insurance contracts³ can be classified a *taxed-exempt-Taxed (tET)* regime: premia receive a tax credit and earnings are taxed only at the end of the contract. There is no more tax rate reduction. The treatment of life-insurance contracts providing for the build-up of assets can be classified as a *Taxed-exempt-Taxed (TET)* as premia paid are no longer deductible. Fiscal incentives for life-insurance contracts are granted to the entire population.

For the Netherlands, we analysed two savings:

- The **Premium Savings Scheme (Premiesparen)** was a saving scheme targeted at employees. Contributions to the account were paid in by the employer with funds taken from the employee's net pay. The employer did not pay any taxes and social contributions on these deposits (up to a limit). Accrued gains were not taxable and withdrawals were tax-exempt in the hand of the employee if funds were withdrawn after four years (*TEE* scheme). The Payroll Savings Scheme was abolished on 1 January 2003.
- The **Payroll Savings Schemes (Spaarloon)** is a saving scheme targeted at employees. Contributions to the account are paid in by the employer using a part of the employee's gross pay. Accrued gains are not taxable and withdrawals are tax-exempt in the hand of the employee if funds are withdrawn after four years (*EEE* scheme). The aforementioned schemes are accessible to all employees, regardless of their income.

For Norway, we analysed the **Tax-favoured Savings in Shares (Aksjesparing med skattefradrag, AMS)**. These were accounts targeted at equity investments. Earnings accrued on funds deposited were taxed but the taxpayer was entitled to a tax credit equal to 15% of the purchased value of shares in the fiscal year. The tax credit was limited to a certain amount and funds were locked away for at least four years. The Norwegian scheme was mainly a *taxed-Taxed-exempt (tTE)* regime: contributions to tax-preferred accounts were made out of taxed income and earnings were taxed but they received a tax credit. Fiscal incentives to savings through the AMS were given to the entire population without any limit on individual income. The scheme was abolished in 2000.

For the UK, we analysed different schemes.

- **Personal Equity Plans (PEPs)** were tax-free accounts targeted at equity based products. Earnings accrued on funds deposited were tax-free. PEPs were

characterized by annual contribution limits. Funds could be withdrawn whenever the investor liked and withdrawals were tax-free.

- ***Tax-Exempt Special Savings Accounts (TESSAs)*** were tax-free accounts targeted at cash products. Earnings accrued on funds deposited were tax-free. TESSAs were characterized by annual contribution limits. Funds could be withdrawn tax-free only after five years. Early withdrawals were taxable. PEPs and TESSAs were abolished in 1999.
- ***Individual Savings Accounts (ISAs)*** are tax-free accounts targeted both at cash and equity products. Earnings accrued on funds deposited are tax-free. ISAs are characterized by annual contribution limits. Funds can be withdrawn tax-free whenever the investor likes.
- ***The Saving Gateway*** is a pilot project targeted at low to middle-income households. The Government matches the savings of individuals at different rates. Earnings accrued on funds deposited are taxable. The government saving bonus is limited to a certain amount. Withdrawals of funds before 18 months entail the loss of entitlement to the saving bonus.
- ***The Child Trust Fund (CTF)*** is a universal program for children. The Government deposits an initial saving bonus in the account. Earnings accrued on funds deposited are tax-free. Withdrawals of funds before 18 years of age are not allowed. Withdrawals after 18 years of age are tax-free.
- Regarding tax-preferred life insurance policies, there are two schemes: ***Qualifying Policies (QPs)*** and ***Friendly Society Tax-Exempt Savings Policies (TESPs)***. For QPs, income and gains are treated as already taxed at a 20% rate and no further taxes on gains are levied. For TESPs, income and gains are exempt and there are annual limits for the premia which can be paid. Funds are locked away for at least 10 years for both QPs and TESPs.

The aforementioned fiscal incentives could be portrayed as mainly subject to a *Taxed-exempt-exempt (TEE)* regime: contributions to tax-preferred accounts are made out of taxed income and interest payments, capital gains, and withdrawals are untaxed.⁴ Fiscal incentives to savings are offered to the entire population without any limit on individual income. There is an exception: the Saving Gateway. The scheme can be accessed only by low to middle-income households and the Government provides a saving bonus in those accounts.

In the USA, different schemes are available. We analysed the following.

- ***Coverdell Education Savings Accounts (ESAs⁵)*** were introduced to help households to build financial assets for financing children's education. Contributions to the Coverdell ESAs are not tax-deductible. Earnings are exempt from federal and state income taxes if withdrawals are used to pay for qualified tuition expenses. ESAs display income restrictions on participation and annual contribution limits. Earnings on non-qualified withdrawals are subject to both state and federal income tax plus a 10% penalty.
- ***529 plans*** are qualified tuition programs designed to help families save for college expenses. Contributions are not deductible for federal income tax purposes. They are deductible (subject to an annual maximum) in some states for state income tax purposes. Earnings accrue tax-free and qualified withdrawals

(i.e. to cover college expenses) are exempt from both federal and state income tax. 529 plans do not have income restriction on participation. There is generally a lifetime limit per beneficiary on account balances (the sum of contributions and earnings less fees and expenses). Lifetime limits vary across states.

- ***Flexible Spending Arrangements (FSAs)*** are accounts introduced to cover medical expenses for the beneficiary, the spouse and the dependants. Both the employer and the employee can contribute to the FSA. The employee does not pay federal income tax or employment taxes on the salary contributed to the FSAs. Withdrawals within the scope of the account are not taxed. Reimbursements not within the scope of the arrangement are not allowed. There are neither income restrictions on participation nor contribution limits.
- ***Health Reimbursement Arrangements (HRAs)*** are notional amounts held by an employer to reimburse covered employees for qualified medical expenses. An HRA can be funded solely by the employer. Contributions made by the employer to an HRA can be excluded from the employee's gross income for federal income tax purposes and from wages for employment tax purposes. An HRA may be used to reimburse employees for qualified medical expense at any time tax free. There is neither income limitation on participation to an HRA nor contribution statutory limits. Limits may however be set by employers.
- ***Health Savings Accounts (HSAs)*** are accounts designed to help consumers pay for health expenses until insurance benefits kick in. Both the employer and the employee can contribute to the account. Contributions are 100% deductible for income tax purposes. Some states allow the deductions for state income tax purposes as well. Earning accumulates tax-free and withdrawals are tax-free if funds are used for qualified medical expenses. There are contribution limits but no income restrictions on the participation. If funds are withdrawn not within the scope of the account, earnings will be taxed at the personal income tax rate plus a 10% penalty.
- ***Archer Medical Savings Accounts (MSAs)*** are accounts very similar to the aforementioned HSAs but the beneficiary is either an employee of a small enterprise or self-employed. The tax treatment of the Archer MSAs is similar to the one of the HSAs. The penalty on non-qualified withdrawals is higher as the penalty is 15%.
- ***Tax-preferred life-insurance contracts*** are not characterized by deductibility of the premia paid. Amounts obtained from the surrender of the policy or from partial withdrawals of cash value are generally taxed "basis-first". Distributed amounts first reduce a taxpayer's investment in the contract. In general, premia paid are treated as taxable receipts only if investment in the contract is zero. Penalties in excess of normal taxes are not imposed on withdrawals of funds held under life insurance contracts.

The USA system of tax incentives to educational savings is mainly subject to a *Taxed-Exempt-Exempt (TEE)* system as contributions are not deductible but earnings accrue tax-free and withdrawals are also tax-free. The system of incentives to savings for facing medical expenses is an *Exempt-Exempt-Exempt (EEE)* system as normally the part of the salary contributed to the analysed accounts is exempt from income tax.

Table 1.1
Tax treatment of tax-preferred savings schemes analysed

Accounts	Contributions	Funds ¹	Withdrawals/Payments
Tax-preferred deposit accounts*	T	E	E
Tax-preferred life-insurance contracts*	t	E	t
BELGIAN SYSTEM	T/t	E	E/t
Registered Education Savings Plans (RESPs)*	T	E (B)	t
CANADIAN SYSTEM	T	E	t
Savings Accounts for children/grandchildren*	T	E	E
DANISH SYSTEM	T	E	E
Arbeitnehmersparzulage*	T	T (B)	E
Life-insurance (regulated according to rules before 1 January 2005)	t	E	E
Life-insurance (after 1 January 2005) *	T	E	t
GERMAN SYSTEM (in 2005)	T	T	E/t
Special Savings Incentive Accounts (SSiAs)	T	E (B)	t
Special Investment Accounts (SIAs)	T	E	t
Special Savings Accounts (SSAs)	T	E	t
Special Term Accounts (STAs) *	T	E	E
IRISH SYSTEM (in 2005)	T	E	E
Life-insurance contracts (traditional)*	t	E	T
Life-insurance contracts (build-up of assets) *	T	E	T
ITALIAN SYSTEM (in 2005)	T/t	E	T
Premium savings schemes	T	E	E
Payroll savings schemes*	E	E	E
THE DUTCH SYSTEM (in 2005)	E	E	E
Tax-favored savings in shares (Aksjesparing med skattefradrag, AMS)	t	T	E
THE NORWAGIAN SYSTEM	t	T	E
Tax-Exempt Special Savings (TESSAs)	T	E	E
Personal Equity Plans (PEPs)	T	E	E
Individual Savings Accounts (ISAs) *	T	E	E
Saving Gateway*	T	E (B)	E
Child Trust Fund*	T	E (B)	E
Life-insurance contracts*	T	E/t ²	E
UK SYSTEM (in 2005)	T	E	E
Coverdell Educational Savings Accounts (ESAs)*	T	E	E
529 plans *	T	E	E
Tax-preferred life insurance contracts*	T	E	E ³
Flexible Spending Arrangements (FSAs)*	E ⁴	E ⁵	E
Health Reimbursement Arrangements (HRAs)	E ⁶	E	E
Health Savings Accounts (HSAs)*	E	E	E
Archer Medical Savings Accounts (MSAs)*	E	E	E

Accounts	Contributions	Funds ¹	Withdrawals/Payments
USA SYSTEM (in 2005)	T/E	E	E

Note: T = taxed under personal income tax (or other tax affecting financial income); t = partially taxed (or taxed at a reduced rate); E = exempt;

B = receiving a saving bonus.

* The scheme is still in place in 2005.

1. The letter B indicates that the account offers a saving bonus.
2. Gains in Qualifying Policies are taxed in the hands of the insurer at a lower 20% tax rate.
3. Tax is imposed on contract earnings in excess of policy expenses, including mortality costs, but only on net earnings distributed in excess of accumulated premiums; distributions paid by reason of death of the insured are wholly exempt from tax.
4. The employer does not pay federal income tax or employment taxes on the salary contributed to the FSA.
5. Notice that there are normally no earnings in FSAs: FSAs provide a predetermined amount of funds to reimburse the employee's qualified expenses.
6. Contributions made by the employer to an HRA can be excluded from the employee's gross income for federal income tax purposes and from wages for employment tax purposes.

1.3 Comparative analysis of design features

As shown in Table 1.2, most of the accounts compensate the preferred fiscal treatment with the fact that funds invested in the tax-favoured schemes are blocked for a period of time (from three months to 12 years).

When funds are blocked, early withdrawals, if allowed, bear a penalty.⁶ The latter normally consists of the loss of the fiscal advantage, as earnings normally become taxable when funds are early withdrawn. It is the case of the Irish SSIs, SSAs and STAs; of the Premium Savings Scheme and the Payroll Savings Schemes in the Netherlands; of the TESSAs and tax-preferred life-insurance contracts in the UK and of the AMS in Norway. Another type of penalty consists in the loss of entitlement to the government savings bonus, when the latter is payable (*e.g.* for the Employee Saving Bonus in Germany and the Saving Gateway in the UK). Canada penalizes early withdrawals from the RESPs with 20% tax on top of the personal income tax rate to be paid on earnings. In the US, the earnings of non-qualified withdrawals from 529 plans, ESAs and HSAs are subject to federal and state income taxes at the distributee's rate in addition to a 10% penalty tax. Archer Medical Savings Accounts (MSAs) bear a 15% penalty.

Tax-preferred accounts differ also for the way contributions can be paid into the account. For most of the schemes analysed (see Table 1.3), the beneficiary deposits funds in the account. This is the case of all the Irish plans, of the life-insurance contracts (Germany, Italy and the UK) and of the UK tax-preferred accounts (except for the Child Trust Fund).

In the Netherlands, contributions to the Premium Savings Schemes and Payroll Savings Schemes are paid in by the employer. The latter withholds an agreed amount of the employee's net (for the Premium Savings Scheme) or gross pay (for the Payroll

Savings Schemes). The particular feature of Dutch tax-preferred accounts reflects the Government's plan to encourage wage restraint by employees together with savings.

Table 1.2
Accounts blocked for a period of time

Countries	Accounts blocked	Period of blocked funds	Penalty	Accounts not blocked
Belgium		Tax-preferred life-insurance contracts	Yes ¹	Tax-preferred deposit accounts
Canada	Registered Education Savings Plans (RESPs)	Until the beneficiary incurs higher education expenses	Yes ²	
Denmark	Savings Accounts for Children/grandchildren	7 years	No ³	
Germany	Employee Saving Bonus (Arbeitnehmer-sparzulage)	7 years	Yes ⁴	
	Life-insurance contracts	12 years	Yes ⁵	
Ireland	Special Savings Incentive Accounts (SSIAs)	5 years	Yes ⁶	Special Investment Accounts (SIAs)
	Special Savings Accounts (SSAs)	3 months	Yes ⁷	
	Special Term Accounts (STAs)	3/5 years	Yes ⁸	
Italy				Life-insurance contracts
The Netherlands	Premium Savings Schemes (Premiesparen)	4 years	Yes ⁹	
	Payroll Savings Schemes (Sparenloos)	4 years	Yes ⁹	
Norway	Tax-favoured Savings in Shares (AMS)	4 years	Yes ¹⁰	
USA	529 plans; ESAs	Until the beneficiary incurs higher education expenses.	Yes ¹¹	<ul style="list-style-type: none"> - Flexible Spending Accounts (FSAs)¹² - Health Reimbursement Arrangements (HRAs) - Tax-preferred life-insurance contracts
	Health Savings Accounts (HSAs) Archer Medical Savings Accounts (MSAs)	Until the beneficiary incurs qualified medical expenses.	Yes ¹³	
United Kingdom	Tax-Exempt Special Savings Accounts (TESSAs);	5 years	Yes	<ul style="list-style-type: none"> - Personal Equity Plans (PEPs) - Individual Savings Accounts (ISAs) - Saving Gateway¹⁴
	Child Trust Fund	Until 18 years of age	No	
	Life-insurance contracts	10 years	Yes ¹⁵	

1. Life-insurance companies are subject to the tax on long-term savings equal to 33% of the surrender value when the surrender is made before the contractual termination date.
2. Earnings are included in the subscriber's taxable income and are subject to an additional 20% tax.
3. Early withdrawals are not possible, unless the child is seriously ill.
4. The penalty consists in the loss of entitlement to the government saving bonus.
5. Early withdrawals of funds become taxable.
6. The amount withdrawn early is taxable at 23% tax rate.
7. Interest earned becomes taxable.

8. Interest earned is taxable at the ordinary rate.
9. If funds are withdrawn earlier, the accrued gains are liable to taxes and social security contributions.
10. In case of early withdrawal, the enjoyed tax credit has to be repaid back.
11. The earnings of non-qualified withdrawals from 529 plans and ESAs are subject to federal and state income taxes at the distributee's rate in addition to a 10% penalty tax.
12. The employee must be able to receive the maximum amount of medical reimbursement on the first day of the coverage period. Reimbursements outside the scope of the arrangement are not allowed.
13. Amounts distributed not used to pay qualified medical expenses will be taxable under the personal income tax, plus, if the distribution is before age 65, a 10% penalty. The penalty is 15% for the Archer MSAs.
14. Funds can be withdrawn from the Saving Gateway whenever the investor wishes. However, the entitlement to the government saving bonus is lost until funds are deposited again in the account.
15. If funds are withdrawn earlier, accrued gains are taxable.

Germany has a scheme supporting employees' savings as well: the Employee Saving Bonus. Contributions are paid by the employer using either his/her funds and/or the employee's ones. Usually, the amount of contributions is regulated in collective pay agreements, when the latter are in place.

In the USA, both the employers and the employees can contribute to Flexible Spending Accounts (FSAs) and Health Savings Accounts (HSAs).⁷

In some accounts, a third party can pay in contributions. It is the case of accounts aiming at building financial assets for children such as the Savings Accounts for Children and Grandchildren in Denmark and the Child Trust Fund in the UK. In the former, parents, grandparents, great-grandparents, great-great grand parents and the child are allowed to contribute to the account.⁸ In the UK Child Trust Fund, the child, the parents and any other individual are allowed to make contributions.

The Canadian Registered Education Savings Plans (RESPs), the US 529 plans and Coverdell ESAs are not only targeted at children but they are specifically designed for building savings for future higher education expenses. There are no requirements for the contributors of the aforementioned three accounts: a contributor does not have to be related to the designed beneficiary in order to pay in funds to the beneficiary's RESP⁹, 529 plan or ESA.

Table 1.3
Accounts by contributors

Country	Employer	Individual (self-contribution)	Others
Belgium		- Tax-preferred deposit accounts - Tax-preferred life-insurance contracts	
Canada			Registered Education Savings Plans (RESPs) ¹
Denmark			Savings Accounts for children/grandchildren ²
Germany	Employee saving bonus (Arbeitnehmersparzulage)	- Life-insurance contracts	
Ireland		- Special Savings Incentive Accounts (SSIAs) - Special Savings Accounts (SSAs) - Special Investment Accounts (SIAs) - Special Term Accounts (STAs)	
Italy		Life-insurance contracts	
The Netherlands	- Premium Savings Scheme (Premiesparen) - Payroll Savings Schemes (Spaarloon)		
Norway		Tax-favoured Savings in Shares (AMS)	
USA	- Flexible Spending Arrangements (FSAs) - Health Reimbursement Arrangements (HRAs) - Health Savings Accounts (HSAs) - Archer Medical Savings Accounts (MSAs)	- Flexible Spending Arrangements (FSAs) - Health Savings Accounts (HSAs) - Archer Medical Savings Accounts (MSAs) ³	- 529 plans; - Coverdell Education Savings Accounts (ESAs) - Tax-preferred life-insurance contracts
United Kingdom		- Personal equity Plans (PEPs) - Tax-Exempt Special Savings Accounts (TESSAs) - Individual Savings Accounts (ISAs) - Saving Gateway - Tax-preferred life-insurance contracts	Child Trust Fund

1. There are no requirements for the contributor. Only for a “family plan” the beneficiary must be connected by blood relationship to the contributors.
2. Parents, grandparents, great-grandparents, great-great grandparents and the child can contribute to the account.
3. For the Archer MSAs the employee’s contribution excludes the employer’s one and vice versa

Some of the schemes analysed are specifically targeted at low and middle-income households, as shown in Table 1.4. This is the case of the Employee Saving Bonus in Germany and of the Saving Gateway in the United Kingdom. Participation to these plans is restricted to individuals with an annual income lower than a threshold.¹⁰ In Germany, the income threshold is EUR 17 900 for an individual and EUR 35 800 for a couple participating in the Employee Saving Bonus scheme. In the UK, access to the Saving Gateway first pilot project was allowed to individuals with household annual

earnings lower than GBP 11 000 (or GBP 15 000 with children).¹¹ In the second pilot, the threshold was increased to GBP 25000 (EUR 36 980) of individual earnings with household income less than GBP 50 000 (EUR 73 960).

Table 1.4
Accounts targeted to certain income classes

Country	Eligibility restricted on income	Income limit	No restrictions on income for participants
Belgium			- Tax-preferred deposit accounts - Tax-preferred life-insurance contracts
Canada			Registered Education Savings Plans (RESPs) ¹
Denmark			Savings Accounts for children/grandchildren
Germany	Employee saving bonus (Arbeitnehmersparzulage)	EUR 17 900 (single) EUR 35 800 (couple)	Life-insurance contracts
Ireland			- Special Savings Incentive Accounts (SSIAs) - Special Savings Accounts (SSAs) - Special Investment Accounts (SIAs) - Special Term Accounts (STAs)
Italy			Life-insurance contracts
The Netherlands			- Payroll Savings Schemes (Spaarloon) - Premium Savings Schemes (Premiesparen)
Norway			Tax-favoured Savings in Shares (AMS)
USA	Coverdell ESAs	USD 95 000 - 110 000 (single) USD 190 000 - 220 000 (joint)	- 529 plans - Flexible Spending Arrangements (FSAs) - Health Reimbursement Arrangements (HRAs) - Health Savings Accounts (HSAs) - Tax-preferred life-insurance contacts
United Kingdom	Saving Gateway	GBP 11 000 (single - EUR 16 272) GBP 15 000 (couple – EUR 22 188) ²	- Personal equity Plans (PEPs) - Tax-Exempt Special Savings Accounts (TESSAs) - Individual Savings Accounts (ISAs) - Child Trust Fund

1 There are however different matching contribution rates for different households' income.

2 The figures here reported refer to the first Saving Gateway pilot project. In the second pilot, the threshold was increased to individual earnings less than GBP 25 000 (EUR 36 980) with total household earnings under GBP 50 000 (EUR 73 960). The figures in Euros have been calculated using an exchange rate of EUR 1.4792 for GBP 1.

Accounts targeted to low and-middle income households are characterized by a government savings bonus (see Table 1.5). German Employee Savings Bonus (*Arbeitnehmersparzulage*) offers a 9% matching contribution by the Government on savings aimed at financing housing expenses. An 18% matching contribution is provided for savings aimed at equity investment.

In the United Kingdom, the Saving Gateway provides different rates (ranging from 20% to 100%) of matching contributions in different areas.

In Canada, Ireland and in the United Kingdom, some accounts offer a saving bonus even if they are not specifically targeted at low and middle-income households. In the Canadian Registered Education Savings Plans the savings bonus decreases as household income increases. The Government matches savings at different rates, according to the household earnings. Rates are 20%, 30% and 40%. From 2004 an extra CAD 2 000 (EUR 1 234) lump-sum saving bonus (the Canada Learning Bond) is offered to households entitled to the National Child Benefit supplement. In the Child Trust Fund, the UK Government provides GBP 250 (EUR 370) for starting up the account. The saving bonus doubles for families eligible for the full Child Tax Credit (CTC) with household income at or lower than GBP 13 480 (EUR 19 940).

In Ireland, in Special Savings Incentive Accounts the Government offered a 25% matching rate contribution to all investors.

All the saving bonuses analysed are limited to a certain amount: the Government matches only a part of the savings deposited into tax-preferred accounts.

Table 1.5
Accounts with saving bonus/matching contributions

Country	Saving bonus	Amount of saving bonus	No saving bonus
Belgium			- Tax-preferred deposit accounts - Tax-preferred life-insurance contracts
Canada	Registered Education Savings Plans (RESPs)	20%-30%-40% ¹	
Denmark			Savings Accounts for children/grandchildren
Germany	Employee saving bonus (Arbeitnehmersparzulage)	9% (building saving) 18% (investment in equity)	Life-insurance contracts
Ireland	Special Savings Incentive Accounts (SSIAs)	25%	- Special Savings Accounts (SSAs) - Special Investment Accounts (SIAs) - Special Term Accounts (STAs)
Italy			Life-insurance contracts
The Netherlands			- Premium Savings Scheme (Premiesparen) ² - Payroll Savings Schemes (Spaarloon)
Norway			Tax-favoured Savings in Shares (AMS)
USA			- 529 plans - Coverdell Education; Savings Accounts (ESAs) - Flexible Spending; Arrangements (FSAs) - Health Reimbursement Arrangements (HRAs) - Health Savings Accounts (HSAs) - Tax-preferred life-insurance contracts
United Kingdom	Saving Gateway	Depending on the area	- Personal Equity Plans (PEPs) - Tax-Exempt Special Savings Accounts (TESSAs)
	Child Trust Fund	GBP 250 (EUR 370) ³	- Individual Savings Accounts (ISAs) - Life-insurance contracts

1. The matching contribution depends on the household's income. From 2004, the Canada Learning Bond (CLB) will provide up to CAD 2 000 for children born in families entitled to the national Child Benefit supplement.
2. The employer could provide up to a 100% matching contribution.
3. The savings bonus becomes GBP 500 (EUR 740) for families eligible for full Child Tax Credit (CTC) with household income at or below the CTC income threshold (GBP 13 480 – EUR 19 940 for the 2005-06 fiscal year).

1.4 Comparative data analysis of selected OECD countries

In this Section, we carry out a cross-country comparison of three characteristics of tax-preferred accounts: distributional features, savings effect and tax expenditure. The comparison is crucial to understand whether particular design features influence the effectiveness (*i.e.* an increase in personal and national saving at the lowest cost) of the aforementioned tax-favoured savings schemes.

1.4.1 Distributional features of tax-preferred accounts among countries

Distributional issues regarding tax-preferred savings accounts have received a little attention in the literature. This is puzzling because it is generally believed that the encouragement of saving is more needed for moderate-income households. The reason is twofold. Low and middle-income individuals' stock of saving is normally too low for preserving their financial stability. Moreover, the effectiveness of tax incentives programs (*i.e.* an increase in saving at the lowest cost) depends crucially on whether the schemes create new saving. The literature (Benjamin, 2003; Engen and Gale, 2000¹²) agrees that the saving effect of tax-preferred incentive schemes is greater on moderate-income households. Thus, the greater the share of low and middle-income households participating in tax-favoured accounts, the more likely it is that new saving is created. Additionally, since moderate-income individuals face a lower tax rate, the more they participate in comparison with high income individuals, the lower the tax expenditure for foregone tax revenues (Antolin, de Serres and de la Maisonneuve, 2004).

In Table 1.6, we investigated four main distributional features of tax-preferred accounts: the number of participants per income class (this reveals income characteristics of participants in tax-preferred accounts), the participation rate¹³ of each income class (this reveals which income groups participate more in tax-favoured schemes), the average contribution/investment by income class (this is an indication of the size of the benefit from participation, in levels) and the average contribution/investment as a percentage of income (this is an indication of the relative benefit from participating in tax-preferred plans).

For Belgium, as shown in Figure A.1 in the Annex, in 2002 the number of individuals paying a tax-preferred life-insurance premium cannot be summarized in a monotonic relationship with income. As shown in Table A.1, the participation rate increases with income. The average premium paid in 2002 increased with income: the lowest income class (*i.e.* people earning up to EUR 5 000) paid a premium 4.5 times smaller than the premium paid by the richest income class (*i.e.* individuals earning more than EUR 250 000). The average contribution as percentage of income decreased as income increased: on average individuals in the poorest income class displayed a premium equal to 4.57% of their income. The richest income class displayed a premium equal to 0.41% of their income.¹⁴

As shown in Table A.3 in the Annex, in 2002 in Canada the participation rate in Registered Education Savings Plans (RESPs) increased with income. The better-off classes participated more in the RESPs: 41.6% of households with income over CAD 40 000 had a Registered Education Savings Plan. This is almost three times the participation rate of the lowest income group (12.9% of households with under CAD 15 000 yearly income had a RESPs in 2002) and twice that of the group with income between CAD 15 000 and CAD 25 999 (21.7% in 2002). The amount of median investment and contribution also increased substantially with income. The median value

invested in RESPs by households with income between CAD 15 000 and CAD 25 999 is CAD 3 000. Households with adjusted income greater than CAD 40 000 have a median investment of CAD 5 000. Nonetheless, investment and contribution as a percentage of income increased as income decreased (*e.g.* the median contribution, as percentage of income is 20% for households with income under CAD 15 000. The figure decreases to 12.5% for households with income over CAD 40 000).

In Canada, distributional features of RESPs mirror the characteristics of general savings for postsecondary education. Lefebvre (2004) reports that in 2002, 69.7% of children in households with over CAD 40 000 adjusted income had savings for their postsecondary education while only 29% of children from households with less than CAD 15 000 of adjusted income had savings for education. Household wealth is another important characteristic: 67.5% of children with parents owning the house and without a mortgage had savings put aside for their postsecondary education in 2002. Only 32% of households renting the house had saved for their children's postsecondary education.¹⁵ Income and wealth also seem to influence the amount of savings: families with adjusted income of over CAD 40 000 on average saved CAD 7 700 while households with less than CAD 15 000 on average saved CAD 1 600 for postsecondary education. However, Lefebvre (2004) discovers when controlling other family characteristics (parents' education, family composition, labour force status, house ownership, and mortgage status), that the child's characteristics (age, academic performance, and sex), parental aspirations and program awareness reduced the difference between the two income groups to CAD 2 900.

Some recently introduced design features could change the distributional characteristics of Canadian RESPs. As shown in Table A.3 (second-last column), in 2001 the traditional CESG bonus effectively paid to households by the Government increased with income. The matching rate attached to the traditional CESG was the same for all income classes: 20% of contributions up to CAD 2 000. This means that individuals contributing more funds (*i.e.* normally wealthier households) would receive a greater saving bonus.

This could change with new law provisions. The Canada Learning Bond (CLB) and the new enhanced Canada Education Savings Grant (CESG) which started respectively in January 2004 and January 2005¹⁶ are targeted to low-income households. The former can be received only by moderate-income households. The matching rate of the latter is now indexed to the household income: the poorer the household, the higher the matching rate. This could foster the participation of moderate-income families by increasing the benefit for the poorest households and therefore change the distributional characteristics of RESPs. As shown in Table A.4, in 1998 the introduction of the CESG, even if not targeted to moderate-income households, fostered the participation in RESPs: the rate of increase in the number of contracts was 49% in 1998 and 35% the following year. The CLB and the enhanced CESG could have the same effect on moderate-income households. However, because of lack of data, we cannot assess whether the distributional characteristics of the RESPs have changed after 2004. The role of the CESG could be important in endorsing the decision to save: with an OLS model Lefebvre (2004) estimated that in 2002 households aware of the saving bonus were more likely to save, irrespective of income. However, this could be caused by different preferences towards savings: "good savers" could search for more information regarding savings incentives. In this case, the author would estimate the effect of preferences rather than the effect of the CESG bonus.

For Germany, we analysed the number of participants in the Employee Savings Bonus scheme (*Arbeitnehmersparzulage*) by income class.¹⁷ As Table A.5 in the Annex shows, in 2001, the most numerous classes of participants are those with an income above EUR 11 029.¹⁸ This could indicate that low middle-income households profit more from the scheme than very low-income households. However, it might be possible that income classes above EUR 11 029 are the most numerous. Without any more specific data on the total number of individuals in each income class, we cannot derive any conclusion about the participation rates of each earning group. Certainly, thanks to their design features, the German schemes benefit only low-income households.

For Italy, we examined all the four dimensions characterizing the distribution of tax-preferred life-insurance contracts. Moreover, with data from 2000 and 2002, we could describe the impact of the reform of taxation of life-insurance contracts on the distributional characteristics. For contracts providing for the build-up of assets starting after 1 January 2001, premia paid were no longer deductible. As shown in Table A.6, in 2000, most of the contracts (95%) were held by households with income lower than EUR 59 999. Among those households, classes with income between EUR 5 000 and EUR 39 999 held 86% of total contracts. The lowest income class held 17.66% of total contracts. It seems that in 2000, moderate and middle-income households participated substantially in life-insurance contracts. A similar pattern can be observed for 2002 (see Table A.7). Households with income lower than EUR 59 999 held 93% of contracts. Among them, income classes between EUR 5 000 and EUR 39 999 held 78% of total contracts. Table A.8 displays participation rates for 2001 and 2002: figures steadily increase as income increases.¹⁹ In 2002, only 6.64% of individuals in households with income below EUR 5 000 subscribed to a life-insurance contract. The participation rate of households with income above EUR 60 000 is about ten times higher.

Both in 2000 and 2002, the average premium does not seem to display a regular trend. However, on average the premium paid by individuals in households with income lower than EUR 59 999 is smaller than the premium paid by agents belonging to richer families. The average premium for all income classes decreased in 2002 with respect to 2000 from EUR 1 307 to EUR 1 150. The general participation rate decreased from 2001 to 2002 by 1.66%.²⁰ This probably reflects the fact that life-insurance contracts providing for the build-up of assets became less profitable after the reform.

The average premium as percentage of income decreases with income, though the pattern is not regular for the richest income households. To provide an explanation for the high values of the average premium observed for low-income households, we calculated the ratio between the number of contracts subscribed by households belonging to each income class, and the relative number of households in each class of the sample. We found that only a small percentage of low-income families (9%) pay a substantial contribution as a percentage of income.

We can conclude that the reform did not have a major effect on the distributional features of tax-preferred life-insurance contracts. Our findings are in line with those of Jappelli and Pistaferri (2003) who studied the effect of the 1992 and 1994 Italian reforms of taxation of life-insurance contract.²¹ Using repeated cross-sectional data from 1989 to 1998, they found that the Italian tax reforms had no effect either on the decision to invest in life insurance or on the amount invested. Their explanations for this phenomenon include Italian investors' lack of information and lack of commitment to long-term investment.

As shown in Table A.9, in Ireland 49% of SSIA holders have an income between EUR 20 000 and EUR 50 000, 27.7% belong to the lowest income class (with income below EUR 20 000) and 23.2% to the highest income class (income above EUR 50 000). The moderate and middle-income individuals seem to substantially participate in the SSIA. However, without information on the participation rates of each income class, we cannot assess who profits more from the Irish tax-preferred accounts.

For the Netherlands, we analysed all four dimensions of the distributional characteristics of the Payroll Saving Schemes. As shown in Table A.10, 45.1% of employees participate in the Payroll Savings Schemes in 2005.

Regarding the number of participants, there is an indication that the Payroll Savings Schemes are taken up more by middle to high-income households. In 2005, households with income between EUR 25 000 and EUR 75 000 represented 77% of participants. As for the other countries, participation rates increase with income. For example, income classes between EUR 5 000 and EUR 15 000 display a participation rate of around 5% whilst income classes with income between EUR 62 500 and EUR 100 000 exhibit a participation rate of around 68%.

The reason may reside in the fact that the scheme is accessible only if the employer offers it. This might potentially select the “best employers” with a well established business and a friendly attitude towards employees. Thus, participants are more likely to have a stable post and a higher salary.

The average investment is also increasing with income but the average amount of savings located in a Payroll Scheme as a percentage of the household income is greater for low-income households. The same pattern can be observed for the net benefit²²: the level of the latter is increasing with income while the benefit as a percentage of income is decreasing with household income.

In Norway the most numerous classes contributing to tax-favoured savings schemes for shares (AMS) are middle-income groups, as shown in Table A.11. This is not surprising, as the investment in shares is a risky one and poorest individuals are likely to be more risk-averse than middle to high income individuals. It is worth noting that the low to middle-income contributors as a percentage of total contributors decreased from 1996 to 1999. In the meantime, high-income class individuals as a percentage of total contributors increased. We do not have data on the participation rates of each income class. Thus, we cannot assess which income group is more likely to use the AMS. As for previous countries, the average contribution increases as income increases while the average contribution as percentage of income decreases when income increases (see Table A.12).

For the UK, we investigated the distributional features of the Tax-Exempt Special Savings Accounts (TESSAs), the Personal Equity Plans (PEPs) and the Individual Savings Accounts (ISAs).

As shown in Table A.13, for both 2000-01 and 2001-02, the income classes with more participants in ISAs are those with yearly income ranging from GBP 5 000 to GBP 9 999 and from GBP 10 000 to GBP 19 000.

The number of people participating in ISAs increases with income up to the class with income between GBP 20 000 and GBP 29 999. Afterwards, the number of individuals taking up ISAs declines to levels lower than those of the poorest income class (*i.e.* under GBP 5 000).

As shown in Table A.14, the number of people participating in TESSAs in 1998-99 increased with income up to the class with income between GBP 10 000 and 19 999. Afterwards, the number of individuals taking up TESSAs declines to levels lower than those of the lowest income class (*i.e.* under GBP 5 000) for classes of income higher than GBP 30 000.

Regarding the holding of PEPs in 2001-02, the class with the highest number of participants is the one with income between GBP 10 000 and GBP 19 999 per year: around 28% of participants belong to that income class. Individuals with income between GBP 20 000 and GBP 29 999 per year and between GBP 5 000 and GBP 9 999 represent the second numerous income classes. The least numerous classes are those with the highest incomes: only 10.65% of participants into PEPs have an annual income of GBP 50 000 or higher. We can conclude that the most numerous classes of participants in tax-deferred accounts are low and middle-income classes. These classes seem to take up substantially tax-preferred accounts.

As shown in Table A.15 and A.16²³, participation rates clearly increase with income. We can therefore conclude that the highest income classes display highest participation rates. However, from a historical point of view, the participation rates from 1997-98 to 2002-03 grew much faster for the lowest income deciles than for the highest. This might suggest that low-income individuals are catching up with high-income individuals over time.

In Table A.17, the Family Resources Survey (FRS) sample was split in two groups: individuals with higher education and individuals who ended education before 18 years of age.²⁴ We use education as a proxy for lifetime earnings. The biggest increase rates for both groups were registered in 1999-2000, the year when ISAs were introduced (and PEPs and TESSAs abolished) and in the following year, 2000-01. The biggest percentage increase was registered for the less educated individuals. This might suggest that the 1999 reform particularly affected the latter.

We tested whether the distributional features of tax-preferred accounts improved after the 1999 reform with a very preliminary regression analysis on the FRS sample. We ran probit and logit regressions on the entire sample (a repeated cross-section of six years) and the results are summarized in Table A.18 and A.19. In the regressions, the dependent variable is either a dummy with value one if the individual participates in tax-preferred accounts (probit regression) or the level of wealth deposited in tax-preferred accounts (logit regression). The independent variables, or regressors, are the following. A dummy with value one if the individual stopped education after the 18 years of age, the age of the individual, a dummy indicating whether the individual is a female and finally a dummy with value one if the individual pays taxes. As shown in Table A.18, individuals with a higher education degree are 17% more likely to participate in at least one tax-preferred account. This raises some distributional issues: agents with higher lifetime resources seem to participate more in ISAs, TESSAs and PEPs. However, the situation improves slightly after the 1999 reform: the coefficient associated with the higher education gets smaller after ISAs were introduced. This pattern becomes clearer when we use the amount of wealth deposited in tax-preferred savings accounts as a dependent variable. As shown in Table A.19, before the reform individuals with a higher education degree were 29% more likely to have a positive amount of wealth in TESSAs or PEPs. After the introduction of the ISAs, which bear no penalty on early withdrawals, the figure decreases to 26%. In general, the age does not seem to have an effect on the holding of tax-favoured accounts: the estimation of the coefficient associated with age is

always very close to zero. Women seem to invest and participate more in tax-preferred accounts. As for the lowest educated groups, this effect increases after the 1999 reform.

Taxpayers are also more likely to have a tax-favoured account: in general, they are 36% more likely to hold such an account and 63% more likely to have a positive amount of wealth in PEPs, TESSAs and/or ISAs.²⁵ However, after the reform the estimated probabilities got lower (*i.e.* 35% and 59% respectively). This again could suggest that the reform might have made tax-favoured accounts more profitable to the lowest income classes. Other useful characteristics for assessing the distributive impact of tax-preferred accounts are the amount of funds invested and contributed to TESSAs, PEPs and ISAs.

As shown in Table A.20, the average investment in ISAs increases with income for both 2000-01 and 2001-02 (except for the income class between GBP 5 000 and GBP 9 999). This means that higher income classes contribute more to ISAs and they consequently enjoy a higher benefit (in levels). However, lowest income classes have higher average investments as a percentage of their income than highest income classes. Table A.21 displays the same characteristics for investments in PEPs.²⁶

For the United States, the literature on distributional features of tax-preferred accounts is wide. Thus, we will rely on previous studies for carrying out our analysis. Dynarski (2004) analysed the 2001 Survey of Consumer Finances and discovered that investors in 529 plans and/or Coverdell Education Savings Accounts (ESA) were a relative elite group.²⁷ The proportion of households holding either ESAs or 529 plans was very small in 2001: only three percent of households with children aged 16 or under. Households using savings plans specifically tailored for education were well-educated (*i.e.* 90% of them had at least 16 years of education²⁸), their median income was USD 41 000 higher than the sample median income and their median net worth was USD 281 200 while the sample median net worth was USD 61 830.²⁹ The results are not surprising: it is well known in the literature that higher income and higher education strongly predict a higher incidence of saving and a higher level of it. But do education savers have different characteristics from individuals saving in other types of savings plans? Dynarski (2004) compares the characteristics of education savers to those of people investing in other (retirement) savings plans, such as the Roth IRA, the Traditional IRA and Keogh plans.³⁰ The latter are plans organized in a similar way as 529 accounts and ESAs plans and thus, they attract motivated and well-informed savers as much as education savings plans do. As shown in Table A.22, retirement savers had a lower median income (USD 75 000 vs. USD 91 000) and a lower median net worth (USD 228 000 vs. USD 281 000) than education savers. The latter also had higher education. From the analysis in Dynarski (2004), we derive that education savings accounts in 2001 were especially used by wealthier and better educated households. However, the author analyses only 2001 data. At that time, 529 plans were new³¹ and 20 states did not have them yet. The pattern of investment in education savings has changed a lot in the following years: in 2004 only the state of Washington did not implement any plan and at the end of 2002 the number of 529 savings plans was six times the number of 529 plans at the end of 2000. Thus, the characteristics of education savers might have changed today as the first households who invested in the accounts might have been systematically different from the other households.

The Investment Company Institute (ICI)³² conducted a survey in the spring 2003 among 918 American households with children aged 18 or under.³³ The investigation responses reported the college savings behaviour of US households with children under 18 or younger. The respondents to the survey have a higher income and better education

than all U.S households with children. The reason resides in the fact that 40% of the households were drawn from a random digit dial national probability sample and the remaining 60% were drawn from households predicted to have children under the age of 18 and incomes of USD 50 000 or more (target sample).³⁴

Sixty-four percent of interviewed households saved for college while 36% of the households said they were not saving for college expenses (see Table A.23). As expected, the percentage of households saving for college increased with income: only 40% of households with an income of USD 50 000 or less saved for education against 72% of households with USD 75 000 or more. Education is also an important feature for understanding savings in education behaviour: 51% of households with high school or less saved for college against 74% of households with 4 year college or postgraduate degree.

How do households saving for college invest? As shown in Table A.24, among the savers for education, 93% of households used taxable investments, 42% used US Savings Bonds and 20% used education targeted savings programs (*i.e.* 529 plans and Coverdell ESAs) together with other types of investment. 44% of education savers invested only in taxable investment and 39% only in US Savings Bonds for building up assets for college expenses. Only 3% of the savers used only education-targeted savings plans.

The awareness of 529 plans and ESA accounts is quite strong among parents saving for college: two-thirds of the participants saving for education and not investing in education-targeted savings plans said they were aware of at least one of the education-targeted plans. As in Dynarski (2004), the relative newness of the programs seems to underestimate the actual participation rates: more than one-quarter of responding parents who are saving for college but who do not own any education-targeted savings accounts specify they are likely to open one of those accounts in the following 12 months.

In ICI (2004), the overall participation rate in education-targeted savings plans differed from the participation rate calculated in Dynarski (2004). In the former study, the overall participation rate is 16.7% (*i.e.* 20% of 918 interviewed households) while in the latter study the participation rate is only 3%. The participation rate in the ICI (2004) is overestimated because of the methodology used to build the sample: households with a higher probability of having 529 plans or Coverdell ESA accounts were selected and they represent 60% of the sample. However, the study is interesting for analysing the features of households investing in education-targeted savings plans. As shown in Table A.23, the characteristics of households saving for college through education-targeted savings plans are very different from those of the households not using the programs but still saving for college. As expected, savers in education-targeted plans have a higher median income (USD 99 200 versus USD 74 500), greater household assets (USD 129 100 versus USD 70 000) and a greater stock of savings for college (USD 15 000 versus USD 10 000). Parents investing in either 529 plans or ESA plans are also better educated: 73% of them have a college or postgraduate degree while only 51% of households not using education-targeted schemes (but saving for college) attained the same level of education. Parents not using the program analysed are more likely to expect to rely on scholarships, student loans, or income or savings earned by their child to pay for college than are parents investing in 529 and ESA plans.

As shown in Table A.26, the most popular plans are the State-sponsored 529 Collage Savings Plans as 250 respondents said they had at least one of them in spring 2003. Then Coverdell ESAs were used by 119 respondents and State-sponsored 529 Prepaid

Tuition Plans by 113 of them. On average the latter plans have the greatest balance account: mean assets invested in State-Sponsored 529 pre-paid plans are USD 14 500. Mean assets invested in State-Sponsored 529 College Savings Plans and Coverdell ESAs are USD 11 200 and USD 7 400 respectively.

The two aforementioned studies depict investors in education-targeted savings programs as an elite group in comparison not only with all US households but also with all savers households (for both college and pension). Parents saving for college through education-targeted savings programs are better educated, have higher income and greater wealth. However, the savings plans analysed were relatively new when the studies were carried out and therefore, the characteristics of households using them could have changed in the following years.

In summary, the tax-preferred savings accounts analysed display some common distributional features. First, participation rates increase with income: the highest income classes display the highest participation rates.³⁵ Three main reasons explain such a pattern (Poterba, 2003). Tax-free accumulation is worth less to low-income households as they face a lower marginal tax rate. Additionally, low-income individuals may be liquidity constrained and they might not be able to reduce their consumption further to fund their contribution to tax-preferred accounts. Finally, some plans are provided by the employer (*e.g.* the Payroll Savings Scheme in the Netherlands) and low-income individuals are less likely to work for firms offering such plans, if they ever work permanently. Nonetheless, as described above, German employer-provided Employee Savings Bonus schemes fare well from the distributional point of view. German schemes have two main characteristics: they are accessible only by low-income workers and they provide a saving bonus. Poterba (2003) suggested that matching the savers' contributions has a positive effect on saving: it increases the value of current contributions. This is particularly important for liquidity constrained households who might value current contributions to tax-favoured accounts very little.

For some accounts, higher participation rates for the higher-income classes are somewhat mitigated by the fact that a great number of participants in tax-preferred accounts come from moderate-income classes. It is the case of Italian tax-preferred life-insurance contracts and British Individual Savings Accounts (ISAs). This means that even if wealthier households profit more from the schemes, the participation of low and middle-income households is substantial.

Regarding the level of contribution and/or investment in tax-preferred accounts all the schemes display contributions increasing with the holder's income. This result is partially mitigated by the fact that contributions as a percentage of income are highest for low-income earners.

Our findings are in line with the literature investigating US tax-preferred pension savings accounts. Joulfaian and Richardson (2001)'s analysis of the wage-earning profile of US tax-preferred accounts participants found that participation rates in 1996 were highest for individuals with wage-earnings between USD 50 000 and USD 90 000 (between 80 and 90%) and lowest for individuals with less than USD 10 000 (between 15% and 25%). The authors also analysed the pattern of the average contribution through stratification by wage-earnings class. For IRAs, contribution levels rose with earnings. On the contrary, contributions as a percentage of wages declined monotonically: from 61.4% for individuals earning less than USD 5 000 to 0.4% for individuals earning more than USD 200 000. Regarding the cumulated tax expenditures, the poorest 50% of the population receives only 10% of it whilst the richest 10% of the

population gets 55% of the tax expenditure. Joulfaian and Richardson (2001) also found that households with one earner and households with dependants have a smaller probability of holding tax-preferred accounts. The opposite is true for households with a high marginal income tax rate and higher income.

Gale and Scholz (1994) found that there were large differences in incomes, assets, and net worth between households with or without IRAs. In the period between 1983 and 1985, the median IRA holder had twice as much income and eight times the increase in the net worth as the median household without IRA, and in 1986 had over four times as much as net worth. These results should be carefully interpreted. The differences in accumulated wealth between tax-preferred accounts holders and non-holders could depend on the household's unobservable tastes towards saving. A "good saver" would have both a higher stock of wealth and participate in a tax-favoured savings account, *ceteris paribus*. In this case, we could not conclude that a particular scheme has design features attracting wealthier individuals more than others. Gokhale *et al.* (2001) carry out some simulations to calculate who benefits from participating in tax-preferred accounts. They compare two types of US accounts: the 401(k) plans and the Roth IRAs. The former offers tax-deductible contributions, tax-deferred accumulation of earnings and taxable distributions and are provided by the employer. They can be classified as *tET* plans. The latter do not permit the deduction of contributions but neither accrued earnings nor the principal are taxed at withdrawal. They can be classified as a *TEE* system. Roth IRAs are accessible to employees whose firm does not offer 401(k) plans. Gokhale *et al.* (2001) found that while participation in 401(k) plans could increase lifetime taxes³⁶ for low-income households, participation to Roth IRAs always provide a guaranteed and non-trivial lifetime tax saving for all tax-payers. The reason is that saving in Roth IRAs is on an after-tax basis and withdrawals are not taxed. Accumulation of capital is also tax-free. The accounts also remove the risk that future withdrawals from the plan will be taxed at a higher rate.

It is worth noting that most of the plans analysed in this work can be classified as a *TEE* system. As shown in Table 1.1, some examples of *TEE* accounts are the Belgian tax-preferred life-insurance contracts, the Danish Savings Accounts for Children/Grandchildren, the Irish Special Terms Accounts, the Dutch Premium Savings Schemes, the British Individual Savings Accounts and finally the American 529 plans and Coverdell Educational Savings Accounts.

Table 1.6
Distributional features of tax-preferred accounts

Country	Accounts	No. of participants	Participation rate	Av. Contribution/investment	Av. Contribution as % of income
Belgium	Tax-preferred life-insurance contracts	No trend	Increases with income	Increases with income	Decreases with income
Canada	RESPs	N/A	Increases with income	Increases with income	Decreases with income
Germany	Employee savings Bonus (Arbeitnehmersparzulag)	Decreases when income increases	N/A	N/A	N/A
Italy	Tax-preferred life-insurance contracts	Decreases when income increases	Increases with income	Increases with income	Decreases with income
The Netherlands	Payroll Savings Scheme (Spaarloon)	Middle to high-income classes are the most numerous	Increases with income	Increases with income	Decreases with income
Norway	Tax-favoured savings schemes for shares (AMS)	Middle-income classes are the most numerous	N/A	Increases with income	Decreases with income
United States	- 529 plans - Coverdell Education Savings Accounts (ESAs)	N/A	Increases with income	The benefit increases with income	
	TESSAs	Decreases when income increases	Increases with income	N/A	N/A
United Kingdom	PEPs	Decreases when income increases	Increases with income	Increases with income	Decreases with income
	ISAs	Decreases when income increases	Increases with income	Increases with income	Decreases with income

1.4.2 Effects of tax-preferred accounts on savings in selected OECD countries

For the last 20 years, many theoretical and empirical contributions tried to assess the effect of tax-favoured accounts on saving. There is no agreement in the literature about that, though. Theoretically, individuals for whom tax-preferred saving is inframarginal (*e.g.* their desired level of saving exceeds tax-favoured plans contribution limits) will face no change in the rate of return on saving at the margin. For them the advantageous tax provisions generate an income effect but no offsetting substitution effect. Thus, they will reduce their current saving: if the tax rate on interest decreases, the net interest rate increases. This process brings about an increase in wealth and thus a rise in current consumption and consequently a decrease in saving.³⁷

On the other hand, individuals who prefer to save less than what is permitted in tax-preferred accounts will receive an increased return at the margin (*i.e.* for an incremental

unit of saving). Here, the effect of tax rebates on saving will depend on the magnitude of income and substitution effects. The standard argument goes as follows. When taxes on interest earned decrease, the after-tax return of saving increases. This means that the price of future consumption has diminished. Therefore, for the substitution effect, the individual will reduce present consumption, since the latter has become relatively more expensive. In other words, current saving will increase. The income effect goes in the opposite direction: when the after-tax rate of interest is higher, the individual is better off. The agent can therefore buy more of the two goods, *i.e.* present and future consumption. As present consumption increases, private saving will decrease. The overall result will depend on the magnitude of the two offsetting effects: if the substitution effect is greater than the income effect, saving will increase when taxes are cut. This is the case of consumers with a high elasticity of substitution: they are more willing to replace current with future consumption.³⁸

When there are liquidity constraints and/or precautionary saving motivations, individuals might not want to locate all their assets in tax-preferred accounts. Thus, the tax incentives in such accounts might increase the return on marginal saving (Bernheim, 2002) and therefore increase the level of saving. When there are imperfect markets for lending, households face limits on borrowing against future resources to finance current spending. Precautionary saving arises when markets for insurance are imperfect and when households have an uncertain earnings profile, an uncertain length of life and an uncertain expenditure profile (*e.g.* because of medical expenses). They decide whether to invest in liquid (conventional accounts) or in illiquid accounts.³⁹ Bernheim (2002) suggests young households have a higher preference for liquidity and a lower degree of substitutability of liquid accounts for illiquid environments. When illiquid accounts bear a tax advantage, some young households might decide to save more in order to exploit that advantage. This is then “new saving”. However, the greatest part of tax-favoured saving is undertaken by older households who divert “old saving” in tax-preferred accounts: they have a lower preference for liquidity and easily shift wealth from conventional to illiquid tax-preferred accounts (Bernheim, 2002).

By granting tax-breaks, the government loses revenues and, if fiscal incentives are financed with debt, public saving might shrink. *Ceteris paribus*, one dollar of foregone revenue for the government lessens public saving by one dollar. Thus, in order for the national saving to increase, private saving has to raise more than one dollar.

Thus, whether saving deposited in tax-preferred accounts is new saving is an empirical issue. The literature⁴⁰ has tried to answer this question for the last twenty years, in particular investigating US IRAs and 401(k) plans, with conflicting results. The lack of an undisputed common view depends on the fact that results can be over- or underestimated as saving behaviour is likely to be driven by unobservable preferences. Individuals with a high propensity to save are likely to have a great amount of assets in both tax-preferred and taxable accounts. In other words, unobserved preferences affect both the explanatory variable (*i.e.* the amount of saving deposited in tax-favoured account or the holding of tax-preferred plans) and the dependent variable (*i.e.* total saving or taxable saving). This causes a problem of endogeneity.

Venti and Wise (1986, 1990, 1991, and 1992) analyzed the US Individual Retirement Accounts (IRAs). They typically found a non-negative conditional correlation between IRA saving and non-IRA saving. Therefore, the authors infer that the introduction of IRAs in the US has helped increase the saving rate. Nonetheless, the correlation is driven by individual unobserved preferences. Venti and Wise’s studies

suffer from the biases described above: individuals participating in tax-favoured plans are likely to have a strong preference for saving. Thus, they will have a great amount of resources invested in both IRA and non-IRA saving (Bernheim, 2002).

Gale and Scholz (1994) found a result opposite to that of Venti and Wise (1990). They analyzed the 1983-1986 Survey of Consumer Finances (SCF) and found that the increase in contribution limit in IRAs from 1983 to 1986 did not help to create new saving. They estimated an econometric model whose parameters can vary according to the fact that the individual is an IRA contributor or not. They eliminated the bias in Venti and Wise (1990) as they took into account that people participating in IRAs are likely to have different tastes towards saving than non-participants. However, their analysis is again biased because of an assumption of homogeneity: contributors to IRAs, conditional on a list of covariates, have the same preferences. Gale and Scholz (1994) found that contributors who have reached the capacity limit of the IRA, have a higher propensity to save in accounts other than IRAs and they interpret this as a proof that tax-preferred savings accounts just diverted saving from taxable to tax-favored accounts. However, this behaviour might be caused by heterogeneity in preferences among participants to IRAs. Those preferring to save more are also very likely to have a higher propensity to save in both types of accounts and to use the entire capacity limit of tax-preferred accounts.

Attanasio and De Leire (1994) divided their dataset (*i.e.* the Consumer Expenditure Surveys) in a treatment group, new contributors to IRAs, and a control group, old contributors to Individual Retirement Accounts. The choice of such a control group implies that preferences towards savings are the same for old and new participants in IRAs. The authors find that control and treatment groups have the same rate of consumption growth whilst new contributors have a slower rate of growth in non-IRA savings. They interpreted this as an evidence of asset reshuffling. In fact, a slower growth of conventional savings could be caused by preferences differences between the control and the treatment group. Bernheim (2002) explains that old contributors might have started locating funds in tax-preferred accounts before as they have a higher preference for saving than new contributors. In other words, new contributors are likely to be less willing to save and thus have a slower rate of growth in conventional savings. Attanasio and De Leire (1994) rejected this critique by using a well-known result of the life-cycle hypothesis: if differences in saving are simply the result of differences in preferences (*i.e.* rate of time preference) and if the inter-temporal elasticity of substitution is positive, those who prefer to save more would experience more rapid consumption growth (Bernheim, 2002).

Many contributions in the literature focus on 401(k) plans. Eligibility for these plans depends on the employer. This might prove to be useful for finding exogenous variations to eligibility not related with the individual determinants of savings. Poterba *et al.* (1994) and Poterba *et al.* (1995) exploited this feature of 401(k) plans and proved that eligibility is significantly correlated with median financial wealth. By contrast, eligibility has very little effect on non-401(k) financial wealth. They conclude that virtually all contributions to 401(k) plans are new saving. In fact, it is dubious whether eligibility is exogenous. Employees with a higher predisposition to save are more likely to choose a job providing good pension coverage. Moreover, employers usually set up 401(k) schemes because they are asked by the employees (Bernheim, 2002). Some contributions tried to circumvent the problem of endogeneity of eligibility and exploited the fact that the legislative authorization for 401(k) is relatively recent (Bernheim, 2002).

Poterba *et al.* (1995) use repeated cross-sections for estimating accumulated financial assets in each year for those who are eligible and for those who are not. Their estimation shows that there has been an upward shift in the relative financial assets held by the group of eligible workers. At the same time, there has not been any downward shift in the relative level of non-401(k) financial assets held by this group.

Engen *et al.* (1994) also use repeated-cross sections and try to circumvent the biases in Poterba *et al.* (1995) by restricting the analysis to selected subsets of the eligible and ineligible population. The group of eligible workers is made up of 401(k) contributors. The group of ineligible workers contains individuals who are not eligible but who have IRAs. The choice of this latter set of individuals allows homogenizing the two groups: they should both contain highly motivated savers. The result of the analysis is that, between 1987 and 1991, the age-financial wealth profile of eligible workers shifts downwards whilst the profile of the ineligible workers shifts upwards. Engen *et al.* (1994) conclude that 401(k) plans do not represent new saving. However, this work contains a bias against the finding that 401(k) can increase saving. After 1986, IRA eligibility was restricted. Therefore, those remained in the group of ineligible workers (with IRAs) should be the most serious savers. This would explain the upward shift of the age-financial wealth profile found in Engen *et al.* (1994).

There is little literature on the evidence of the effect of tax-preferred savings accounts in countries other than the US. Some studies attempt to draw conclusion from cross-country comparisons. Bernheim (2002) points out that it is not possible to reliably infer the saving effects of these programs from simple cross-country correlations or regressions. In a country where voters care more about saving, it is likely that tax-preferred accounts are introduced. In that country, the saving rate will be higher and this will not be driven (at least not only) by the availability of tax-deferred schemes, but by tastes towards savings. Carroll and Summers (1987) exploit the fact that the US and Canada introduced tax-preferred plans at a different point in time. This approach allows the examining of whether the saving rates of different countries converged or diverged. The authors compare the historical savings rates of Canada and the US and discover that during the mid-1970s, when Canada expanded its program of tax-deferred savings accounts, the savings rates of the two countries diverged. Carroll and Summers (1987) interpret this as an evidence that tax-preferred accounts in Canada increased the level of saving. In fact, as highlighted by Bernheim (2002), an inference of causality from the observed pattern requires a leap of faith. Many other economic and/or psychological factors may have caused the savings rates of Canada and the US to diverge.

Attanasio *et al.* (2004) study the effectiveness of Tax-Exempt Special Savings Accounts (TESSAs) and Individual Savings Accounts (ISAs) in the UK. Regarding TESSAs, the summary evidence from aggregate statistics is consistent with a reshuffling behaviour: British savers seem to have shifted their wealth from taxable to tax-preferred accounts. The idea is based on two major findings. First, the average balances in TESSAs display discrete jumps at the beginning of each fiscal year and they get close to the maximum contribution limit. When the contribution limits are widened (*i.e.* when a new fiscal year begins), investors deposit as much funds as they can in TESSAs. Second, TESSAs average balances continued to increase until the first five years accounts began to mature. Afterwards and until TESSAs were abolished in 1999, average balances remained quite stable. If households hold only a limited amount of assets, and if agents just shift funds from taxable to tax-preferred accounts, then the average balances in TESSAs will start to become stable at a certain point in time. The analysis of the effect of ISAs is carried out using descriptive evidence from micro-data

of the Family Resource Survey (FRS). The authors discovered that the holding of tax-preferred accounts increased from 1998-99 to 2002-03 for all age and education groups. In particular, when the increase in the percentage of households holding those accounts is considered, it seems that youngest and lowest educated investors increased their holdings of tax-preferred wraps more. However, at the same time, the holdings of assets in conventional taxable accounts seem to have decreased for all education and age groups, especially for the youngest and less educated savers. Even if the decline in taxable assets could have been sharper in the absence of tax-preferred products, Attanasio *et al.* (2004) concluded that it is hard to reconcile this evidence with the idea that new savings has been created by the introduction of ISAs.

Hubbard and Skinner (1996) reckoned that the effect of tax-preferred accounts on saving should lie between the hypotheses that no new saving is created and the hypotheses that all the assets deposited in tax-favoured plans is new saving. Some recent literature added evidence to this idea. Benjamin (2003) found that in aggregate only about one quarter of 401(k) balances represents new national saving and only one half of 401(k) balances represent new private saving. Interestingly, the study discovers that tax-preferred accounts have a different effect on different groups of population: all of renters' 401(k) balances are new saving while none of the homeowners' are. Engen and Gale (2000) divide the population in different income and wealth groups and they found, in accordance with Benjamin (2003), that tax-favoured accounts have a bigger effect on moderate-income households. In particular, they found that 401(k) plans are more effective for renters and households without IRAs than for homeowners and IRA holders. They explain their findings as follows. Low earners and low savers are likely not to save much in stocks as they lack the suitable information and also because transaction costs might be too high for them. Tax-preferred savings plans could raise incentives to savings because they provide a cheap access to the stock market. For households saving for precautionary reasons, illiquid accounts such as some of the tax-preferred accounts are not perfect substitutes for other types of savings. Thus, when low earning households contribute to such plans, the contributions should be all new saving. Furthermore, high earners and/or high savers should be more economically sophisticated and they should be already able to shelter earnings, without necessarily using tax-preferred plans.

Our data do not allow for an econometric study of whether tax-preferred accounts created new saving. Nonetheless, for some countries we could derive some indications about the effect of tax-favoured accounts on savings.

As shown in Table A.4 in the Annex, the number of Canadian RESP contracts increased steadily after 1997. The increase rate is greater in the first years (it is 49.15% in 1997) and it decreased as time went by. The same pattern can be observed for the amount located in the aforementioned plans: assets increased from 1997 to 2003 but the pace of increase slowed down as time went by. Data displayed in Table A.4 might indicate that investors had first located the already existing stock of assets in tax-preferred accounts. After some time, they exhausted the aforementioned stock of wealth. The amount of assets located in RESPs increased over time because new contracts were signed, as shown in column two and three. This might be an indication that when RESPs became available, at least a partial reshuffling of assets might have taken place. However, as explained in Section 1.2.1, the introduction of the CESG in 1998 could also explain the sharp increase in the number of contracts in the first years.

As shown in Table A.3 (last column), only 41% of contributing higher-income households put in CAD 2 000 or more in RESPs. In other words, most of the higher-income families did not contribute enough to attract the maximum CESG, although they would apparently gain from shifting money from taxable accounts to RESPs. This might suggest that there is something special with accounts having policy objectives broader than conventional saving, such as the RESPs.

Before discussing the effect of Danish tax-preferred accounts on the national level of saving, it is worth highlighting that funds located in those accounts form just a very small part of total private financial assets. As shown in Table A.27, tax-deferred wealth as a percentage of total financial assets lingers around 0.5 %. Thus, it is likely that these accounts did not have a substantial effect on saving.

According to the data provided by the Danish Ministry of Taxation, the amount of savings located in accounts for children/grandchildren diminished from 1991 to 1997: in 1991 DKK 10 921 million (EUR 1 466 million) were invested in the accounts. In 1997 the figure sank to DKK 8 475 million (EUR 1 138 million).

In 1998 and 1999, the amount of funds located in the aforementioned accounts increased. According to the Danish Ministry of Taxation, the 1998 increase may be due to the legislation changes. In 1998, more than one depositor was allowed and more importantly, it became possible to place the funds in pool schemes or in separate safe custodies hoping for better returns. In 2000 and 2001, the amount of funds in the accounts lingered around DKK 9 200 million (EUR 1 235 million). Funds increased up to DKK 9 877 million (EUR 1 326 million) in 2003 but they never reached the 1991 level.

As shown in Figure A.4 and A.5, investment in tax-preferred accounts for children/grandchildren declined from 1991 to 1997. In the meantime, total private financial assets increased until 2000 when the crash of the stock market reduced the investment in financial assets. It is therefore hard to reconcile this evidence with the idea that tax-preferred accounts had a sizable effect on national saving.

In the Netherlands, the great majority of employees invest the maximum amount of savings in Payroll Savings Schemes. Table A.28 shows that in 1995, 91% of savers invested the maximum amount. The figure increased up to 96% in 2003. For most of the investors, the tax incentive does not change the marginal return on saving. According to the literature, this means most investors will not increase their savings. This is also in accordance with the evidence on distributional features of Payroll Savings Accounts: as described in the previous Section, these plans are mainly taken up by middle to high-income individuals who are less likely to create new saving.

In Norway, the pattern of the funds deposited in AMS is different from the pattern of funds invested in general financial wealth, as shown in Table A.29 and in Figure A.6. In the beginning, the former increased, and then it decreased from 1997 to 1998. From 1998 to 1999, the amount of funds deposited in the AMS increased again. In the meantime, total financial wealth increased steadily from 1996 to 1999. The AMS seemed not to have influenced total financial wealth much as the latter increased irrespective of whether the amount of funds deposited in the AMS increased or decreased. As shown in Table A.30, the greatest part of contributors to AMS contributed enough to have the highest deduction possible (*i.e.* NOK 750). According to the theory, for individuals contributing to tax-preferred accounts up to the limit, the return on the marginal unit of saving is not affected. Only the infra-marginal return on saving

augmentations and it brings about an income effect raising current consumption and decreasing saving. However, it is worth noting that individuals eligible to NOK 1 500 of maximum deduction are married couples with joint assessment, single parents with dependent children and taxpayers entitled to a deduction in income due to age, disability or reduced occupation ability. In other words, a part of this group consists of people likely to have a lower income. With respect to all other taxpayers, a smaller percentage of this group contributed to AMS enough to get the maximum deduction. In 1999, only 60.8% of them got the maximum deduction while 80.3% of all other taxpayers did. This might suggest that, for a part of the population, the AMS could have had an effect: for about 40% of taxpayers in tax class 2, the marginal return to saving has changed and this could have led to an increase in saving. Theoretically, granting a greater deduction to more disadvantaged individuals could contribute to increase saving. According to our calculations⁴¹, in 1999 individuals entitled to a NOK 1 500 reduction numbered 128 163. Of these, 93% received a tax deduction greater or equal to NOK 750. This means that there would have been much less room for the formation of new savings had the contribution limit been the same for all taxpayers.

For the United Kingdom, both risky and risk-less wealth invested in UK taxable accounts decreased from 1997-98 to 2002-03.⁴² In the meantime, wealth invested in tax-free accounts has increased steadily, except for the last fiscal year. In 2002-03, wealth in taxable assets started to increase again whilst wealth invested in tax-free accounts declined by a small amount. It is hard to reconcile this evidence with the idea that a significant amount of new savings has been created by the introduction of tax-preferred accounts. Nonetheless, the decline in taxable assets could have been sharper in the absence of tax-preferred products. Let us take a closer look at the data. As shown in Table A.32, the amount of funds under management in Individual Savings Accounts (ISAs) increased steadily since ISAs became available in 1999. The pace of increase slowed down rapidly: with respect to the first year, funds located in ISAs increased by almost 116% in the second year whilst the increase was only of 20.56% for the following year. In summary, we observe a positive but declining rate of growth of funds deposited in ISAs. Investment in TESSAs displays the same pattern. As shown in Table A.33, the amount of funds under management in Tax-Exempt Special Savings Accounts (TESSAs) increased steadily after 1992. The pace of increase slowed rapidly: with respect to the first year, funds located in TESSAs increased by about 103% in the second year whilst the increase was only 54% the following year. In summary, we observe a positive but declining rate of growth of funds deposited in TESSAs, until the accounts were discontinued (March 1999). Only two years are exceptional: 1996 and 1999, when the rate of growth of savings located in TESSAs increased more than in the previous year. As Attanasio *et al.* (2004) observed, in 1999 there might have been a “pre-abolition” effect.

When tax-preferred accounts became available (*i.e.* in 1999 for the ISAs), people might have reshuffled their assets shifting previously accumulated funds from taxable savings accounts to tax-preferred accounts. After some years, individuals started to run out of assets and even if new agents took up ISAs and TESSAs, the amount of funds located there grew more slowly.

The average contribution to ISAs shrank from 2000-01 to 2001-02 and this decline was highest for the lowest income classes. This might suggest that the poorest investors of each class were taking up ISAs and since they could contribute fewer funds, the average contribution declined in each class. It might also suggest asset reshuffling: initially investors contributed all their funds to the ISAs and after some years started to

run out of assets and were forced to reduce contributions. It is not surprising that the phenomenon is greater for the lowest income classes: the latter are expected to have a smaller stock of assets to reshuffle (see Table A.34).

The behaviour of the lowest income classes deserves closer attention. Already in the first years of existence of ISAs, the lowest income households displayed a very high average amount of funds under management as a percentage of their income. This could be the result of the following behaviour: people had transferred their old stock of savings from taxable accounts to tax-preferred accounts when ISAs become available (asset shifting). In the later years, they then contributed to the ISAs with funds coming from a “present” decision about how to split resources between savings and consumption. In this latter phase there might have been an increase in personal savings (see Table A.20).

The aforementioned analysis seems to suggest a partial asset reshuffling behavior, leaving some room for the creation of new savings. These findings are in line with Attanasio *et al.* (2004) and Inland Revenue (2005). In the latter, the authors analysed data from two waves of the NOP Random Location Omnibus Survey carried out in September 2003. As shown in Table A.35, 15% of ISA holders say they would have not saved, had ISAs not existed. This is an interesting figure, which could be used to measure the extent of new saving creation through tax-preferred accounts. It is worth noting that ISAs seem to have fostered young and moderate-income individuals’ saving more than others. Thirty-nine percent of individuals aged 18-24 said they would have not saved had ISA not existed. Only 11% of individuals aged over 45 said the same thing. There are also differences across social classes: 25% of individuals belonging to the working class (DE class) said they would have not saved without ISAs. The figure for the upper middle and middle class (AB class) is 11%. Lower-income classes seem also to be the most affected by ISAs: 23% of individuals in the income class between GBP 9 500 and GBP 19 999 said they would have not saved the money they put in the ISAs. The figures for the two highest income classes are 11% and 12%.

The findings in Inland Revenue (2005) confirm the importance of targeting moderate-income classes for increasing private saving, as also suggested in Antolin, De Serres and de la Maisonneuve (2004).

We conclude that the introduction of ISAs might have caused a partial asset reshuffling of wealth from taxable to tax-preferred accounts, in particular for wealthier and older individuals. Nonetheless, there are some indications of creation of new savings, especially among moderate-income individuals.

In the US, the literature has widely studied the effect of tax-preferred accounts on personal saving. Contributions mainly analysed the effects of IRAs and 401(k) plans but the results are often inconclusive, especially regarding IRAs.⁴³ Ma (2003) studied the specific effect of education savings incentives on household savings. The study is particularly interesting as it tries to solve the savers heterogeneity problem which has flawed most of the pre-existing literature.⁴⁴ When using the IRA or SRA/GSRA ownership, median regression results suggest that saving in Coverdell ESAs or in 529 plans does not offset other household assets. The same findings are confirmed when the propensity score method is used. In particular, households with higher propensities to use education savings accounts display a positive relationship between education saving and other household assets.

For some countries such as the UK, the aforementioned data analysis seems to suggest a partial asset diversion from taxable to tax-preferred accounts, leaving some room for the formation of new saving. In the UK, Inland Revenue (2005) found that around 15% of ISA holders would have not saved had ISAs not existed. There is an additional indication reinforcing the idea that at least some new saving was created: even if high-income classes have the highest participation rates, moderate-income individuals substantially participated in Individual Savings Accounts. This is in accordance with the literature presented above (Hubbard and Skinner, 1996; Engen and Gale, 2000; Benjamin, 2003) linking the partial creation of new saving to the participation of moderate-income households in tax-favoured plans.

For Norway and the Netherlands, the evidence on both distributional and saving effects of the AMS points in a different direction. Moderate-income classes do not seem to have participated much in the Norwegian tax-favored plans. According to the literature, this would not be beneficial to the creation of new saving. Moreover, the greatest part of AMS participants were entitled to the maximum deduction and the greatest part of Payroll Savings Schemes participants contributed up to the capacity limit of the account. This means that most of the taxpayers are not concerned by a change in the marginal rate of return to saving: they will not increase their saving.⁴⁵ In Norway, a historical analysis of the amounts of wealth from 1996 to 1999 did not show evidence of formation of new saving. Actually, the AMS was abolished due to the lack of proven effects and because the scheme implied non neutral fiscal treatment of different savings.⁴⁶

Since only a part of tax-preferred saving seems to represent new saving and since most of this new saving seems to be created by moderate-income households, an important public policy question rises: are fiscal resources spent efficiently on tax-favoured incentives to saving? Are accounts designed efficiently? In other words, is the creation of new saving achieved in the most cost-efficient way?

Based on the conclusions drawn above, some resources may go wasted when tax breaks for saving are granted to high-income individuals. High income households are more likely to just reshuffle assets and moreover, since they are subject to a higher income tax rate, they are given a higher tax break with respect to moderate-income earners. On the other hand, individuals with high-income are not numerous and the resources saved by excluding them from tax-preferred programs could be small.

When we analyse accounts for educational saving for Canada and the US, the evidence is mixed. In the US, Ma (2003) found that 529 plans and ESAs did not crowd out other savings. In contrast, studies on distributional features show that only wealthy households invest in 529 plans and ESAs. The two findings do not seem to match the theory predicting that new saving is created if moderate-income households participate in the plans.

In Canada, the high participation of wealthier classes in RESPs could lead to conclude that no new saving has been created. However, there seems to be an empirical puzzle: the greatest part of wealthier households do not locate funds in RESPs up to the capacity limit. This means that for the majority of educational savers, the marginal return on saving could have changed. This could lead to an increase in saving.

Educational saving is likely to be different from general saving. The former attracts wealthier households more. These households have more resources and they are probably more sensitive to educational matters. However, educational tax-preferred

accounts rarely attract the maximum contribution. The reason could be that they are extremely narrowly targeted (*i.e.* their funds can be used only for educational expenses) and therefore agents do not want to lock too high a level of resources in them.

In summary, most of the data for non-educational accounts we analysed seem to indicate that tax-preferred accounts create new saving when moderate-income households participate in them. This is in accordance with the theoretical literature forecasting an increase in the marginal rate of return to saving for individuals with liquidity constraints and/or precautionary saving motivations (see Bernheim, 2002). A recent stream of empirical literature (see Benjamin, 2003; Engen, Gale, 2000 and Hubbard and Skinner, 1996) also found evidence that low-income households are less likely to divert funds from taxable to tax-preferred accounts. Thus, they should respond with more saving to tax incentives.

1.4.3 Tax expenditure for tax-preferred accounts in selected OECD countries

As highlighted by Hubbard and Skinner (1996), it is not possible to understand whether tax-preferred accounts are effective without knowing something about the cost of the program in terms of foregone tax revenues. In this Section, we describe the tax expenditure for tax-preferred accounts in Canada, Denmark, Germany, Italy, Norway, the United Kingdom and the USA and we try to compare figures across countries. The scope of this Section is to understand which design features make tax-preferred plans more expensive.⁴⁷ The analysis below is concerned only with one-period expenditures and we will then compare the expenditure effects of different design features at the same point in time. In fact, the assessment of the real cost of a tax-preferred plan (tax expenditures minus revenues from taxing earnings) would require a multi-period approach: we should take into account also the tax revenues arising from taxing earnings when funds are withdrawn. Nevertheless, this is beyond the scope of the note.

It is worth noting that the accounts analysed are different in scope and, consequently, in the number of participants and in the total amount of funds there located. The scope of the UK Individual Savings Accounts and of the Italian life-insurance contracts is wider as the accounts are aimed at increasing general savings for all households. In contrast, Canadian, Danish and US programs are tailored to enhance savings either for education or for children/grandchildren. The German scheme is limited to housing and equity savings and it is available only for low and middle-income households.

We compared tax expenditures for each account using figures of tax expenditures as a percentage of GDP.⁴⁸ In 2004, Belgium spent 0.15% of GDP on tax-preferred deposit accounts and 0.0009% on tax-preferred life-insurance contracts. The United Kingdom in 2003-04 spent 0.09% of GDP on ISAs⁴⁹, Canada⁵⁰ 0.043% on RESPs, Denmark⁵¹ 0.005% on Savings Accounts for children/grandchildren (2003) and Germany 0.009% on the Employee Savings Bonus (2004). In 2004, the US Federal Government spent 0.002% on the 529 plans and 0.001% on the ESAs.⁵²

In order to understand which design features are more expensive, it is worth considering tax expenditure per participant. The comparison is however difficult as we have data for different periods of time. We will compare figures for the last years available for each country. The most generous incentives are the Italian ones. Italy spent around EUR 170 per participant in 2002 for fostering saving. Canada spent EUR 154.8

per contract in 2004 and EUR 136.3 the previous year (CAD 221 and CAD 218 respectively). Norway spent EUR 110 per participant in 1999. The United Kingdom in 2002-03 spent EUR 75 per participant (GBP 33.65) for ISAs. Germany spent EUR 25 per participant.⁵³ The US spent EUR 24 per participant in 2004 for the 529 plans.

The Belgian tax-preferred life-insurance contracts seem to be the most generous plans, the reason being that the tax credit granted for contributions is quite high: the maximum amount receivable in 2003 was EUR 720 (40% of EUR 1 800). The Italian tax-preferred life-insurance contracts are the second most generous plans: the maximum amount of the tax credit is EUR 247 (*i.e.* 19% of EUR 1 300). In Norway, incentives to savings were also granted through tax credits. The expenditure per participant in Norwegian AMS is about EUR 110. This figure is lower than the Italian one as the maximum tax credit receivable is EUR 184 in Norway. The experience of Belgium, Norway and Italy suggests that incentives through tax credits are quite expensive.

Canadian RESPs seem to be the next-most generous scheme, the reason being that RESPs have generous saving bonuses available to the entire population. Moreover, since 2004 they have increased as the household's income decreases in order to advantage more moderate-income households.

For the Individual Savings Accounts, the UK spent EUR 75 in 2002-03. ISAs are less expensive than the aforementioned plans as they grant neither saving grants nor tax-credits. ISAs only allow tax-free accumulation of savings. Nevertheless, they are more expensive than German plans as ISAs have much higher capacity limits.

The German and the US schemes are the least expensive. In Germany, the government matching rate is quite low (either 9% or 18%), the scheme is accessible only to low-income households and the level of savings receiving the government bonus is small: EUR 470 for housing savings and EUR 400 for equity savings. Moreover, earnings accruing in the account are taxable every year.

In contrast, in the Canadian RESPs earnings accruing in the account are not subject to taxation until funds are withdrawn and the total capacity limit is CAD 42 000 (or CAD 4 000 per year).⁵⁴ Moreover, not only is the savings bonus more generous than in Germany (matching rates vary from 20% to 40%) but also the amount of savings which can be matched is higher (CAD 2 000 per year).⁵⁵

The US 529 plans are less expensive as they do not provide a savings bonus. Moreover, part of the cost for foregone tax revenues for 529 plans is borne by the states as earnings and qualified withdrawals are exempt from both the federal and the state income tax. The expenditure presented in Table 1.7 considers only federal budget expenditures.

In summary, incentives to saving through tax credits seem to be quite expensive, as suggested by the Italian and the Norwegian experience. Encouragement to saving is less expensive if granted through exemption of earnings. However, if the latter is coupled with a saving bonus, the plans could become quite expensive in case the government matching rate is generous (like in Canada).

Table 1.7
Tax expenditure per participant in the scheme

Country	Account	Expenditure per participant	Expenditure as % of GDP ¹
Belgium	Tax-preferred deposit accounts	–	0.13% (2001) 0.15% (2002) 0.16% (2003) 0.15% (2004)
	Life-insurance contracts	BEF 6 974 (EUR 172.9, 1999) EUR 192.6 (2002)	0.09% (2002)
Canada ²	Registered Education Savings Plans (RESPs)	CAD 255.3 (€ 157.5, 1999)	0.038% (1999)
		CAD 240.8 (€ 148.6, 2000)	0.039% (2000)
		CAD 236.1 (€ 145.7, 2001)	0.041% (2001)
		CAD 218.5 (€ 134.8, 2002)	0.042% (2002)
		CAD 220.9 (€ 136.3, 2003)	0.043% (2003)
		CAD 250.9 (€ 154.8, 2004)	0.010% (2004)
Denmark ³	Savings Accounts for children/grandchildren	–	0.005% (2003)
Germany	Employee Saving Bonus (Arbeitnehmersparzulag)	EUR 25.42 (estimate ⁴)	0.009% (2004)
Italy	Life-insurance contracts	EUR 176 (2001) EUR 171 (2002)	
Norway	N/A	NOK 916 (EUR 115, 1996)	0.033% (1996)
		NOK 899 (EUR 113, 1997)	0.040% (1997)
		NOK 879 (EUR 110, 1998)	0.034% (1998)
		NOK 881 (EUR 110, 1999)	0.033% (1999)
United States	529 plans ⁵	USD 77 (EUR 63, 2000)	0.001295% (1999)
		USD 73 (EUR 60, 2001)	0.001019% (2000)
		USD 61 (EUR 50, 2002)	0.001876% (2001)
		USD 8 (EUR 7, 2003)	0.002579% (2002)
		USD 29 (EUR 29, 2004)	0.000456% (2003)
	Coverdell ESAs ⁶		0.001790% (2004)
			0.00020% (2000)
			0.00030% (2001)
			0.00048% (2002)
			0.00064% (2003)
United Kingdom ⁷	Individual Savings Accounts (ISAs)	GBP 33.65 (EUR 49.78, 2001-02)	0.01% (1999-2000)
		GBP 50.91 (EUR 75.31, 2002-03)	0.04% (2000-01)
			0.07% (2001-02)
			0.08% (2002-03)
			0.09% (2003-04)
	Tax-exempt Special Savings Accounts (TESSAs)	GBP 70.92 (EUR 104.9, 1998-99)	0.049% (1997-98)
			0.047% (1998-99)
			0.042% (1999-2000 & 2000-01)
			0.015% (2001-02)
			0.01% (2002-03)
	Personal Equity Plans (PEPs)	GBP 152.17 (EUR 225, 2001-02)	0.005% (2003-04)
			0.01% (1997-98)
			0.12% (1998-99)
			0.11% (1999-2000)
			0.09% (2000-01)
			0.07% (2001-02)
			0.06% (2002-03 & 2003-04)

1. We used GDP figures at current market prices.

2. Expenditure figures for Canada are in Canadian dollars. Conversions to Euros are made at an exchange rate equal to EUR 0.617 for CAD 1. Figures in column three for Canada refer to expenditure per contract rather than expenditure per participant.
3. Figures in Euros have been converted at an exchange rate of EUR 0.1344 for DKK 1.
4. We calculated the cost per participant by dividing the 2004 tax expenditure by the 2003 number of participants, as we do not have figures on the number of participants in 2004 and, on the other hand, we do not have data on tax expenditure for 2003.
5. For the USA, we could only calculate the expenditure per contract. It is worth bearing in mind that the same individual could have more than one plan. The exchange rate here used is EUR 0.8206 for USD 1.
6. We could only calculate the expenditure per contract.
7. The values in Euros are converted at an exchange rate equal to EUR 1.4792 for GBP 1.

1.5 Summary and conclusions

This work first describes and compares design features of tax-preferred saving accounts across selected OECD countries.

We then attempt to evaluate the effectiveness of the accounts. A plan is efficient if it increases personal and national saving at the lowest possible cost. To this aim, three characteristics of the accounts are important: the effects of tax-favoured schemes on saving, the distributive characteristics of such plans and the tax expenditures related to the incentives.

Most of the data sent by member countries seem to indicate that tax-preferred accounts other than educational plans create new savings only when moderate-income households participate in them. This is in accordance with the theoretical literature forecasting an increase in the marginal rate of return to saving for individuals with liquidity constraints and/or precautionary saving motivations (see Bernheim, 2002). A recent stream of empirical literature (see Benjamin, 2003; Engen, Gale, 2000 and Hubbard and Skinner, 1996) also found evidence that low-income households are less likely to divert funds from taxable to tax-preferred accounts. Thus, they should respond with more saving to tax incentives.

However, most of the accounts are taken up mainly by high-income individuals who also deposit on average more funds than middle and low-income households. These results are partially mitigated by the fact that contributions as a percentage of income are highest for low-income earners and that for some plans (such as the Italian and the UK ones), a great number of low-income households participate.

Regarding the tax expenditure features, incentives to saving through tax credits seem to be quite expensive, as suggested by the Italian and the Norwegian experience. Encouragement to saving is less expensive if granted through exemption of earnings. However, if the latter is coupled with a savings bonus, the plans could become quite expensive in cases where the government matching rate is generous (as in Canada).

In summary, it seems important for the efficiency of tax-preferred accounts to involve moderate-income households: the latter are more likely to increase saving when given the opportunity of investing in tax-favoured accounts. Furthermore, since moderate-income individuals face a lower tax rate, the more they participate in comparison to high-income individuals, the lower the tax expenditure for foregone tax revenue. However, the evidence seems to suggest that wealthier individuals in fact

mainly take up tax-favoured accounts. This could indicate there is still room for improving the effectiveness of the plans analysed: changing some of the design features in order to attract more moderate-income households could make the accounts more cost-efficient.

NOTES

¹ Table 1.1 summarizes the saving schemes according to the system *TEE*, *tEE*, *TET*, etc. In Chapter 2, we describe in greater detail the schemes in each country.

² It is worth noting that Norway provided such data for the Tax-favoured Home Savings Accounts for Young People but we decided not to include them in this study as we intend to analyse only accounts aimed at enhancing general savings.

³ For traditional life-insurance products we mean contracts covering the risk of death, the risk of chronic illness and the risk of not being self-sufficient.

⁴ In the Saving Gateway accrued earnings are taxable. Nonetheless, those earnings are considered as capital gains and they can therefore be included the capital gains tax allowance. Another exception is the fiscal treatment of life-insurance qualifying policies: gains are taxed in the insurer's hand at a 20% rate. The policy holder does not have to pay any taxes on the gains from qualifying policies.

⁵ Education IRAs were renamed Coverdell Education Savings Accounts (ESAs) in 2001.

⁶ The same is true for funds not used within the scope of the account as in the case of the Canadian RESPs, and the US 529 plans, ESAs, HSAs and Archer Medical Savings Accounts (MSAs).

⁷ For the Archer MSAs the employee's contribution excludes the employer's one and vice versa.

⁸ This also includes adoptive parents, foster parents and step-parents.

⁹ There is an exception in Canada. Only in a so-called RESP "family plan", the beneficiary (*i.e.* the child) must be connected by blood relationship to the contributors.

¹⁰ In the USA, the Coverdell ESAs have income restrictions on participation. However, the income limit is higher than the one of the aforementioned accounts (from USD 95 000 to USD 110 000 for single filers and from USD 190 000 to USD 220 000 for joint filers) and, they cannot be considered as targeted to moderate and middle-income households. Coverdell ESAs do not bear any saving bonus.

¹¹ This is equal to EUR 16 271 (or EUR 22 188 with children). We used an exchange rate of EUR 1.4792 for GBP 1.

¹² Benjamin (2003) found that taken together, assets invested in US 401(k) plans by renters are all new saving. In contrast, assets invested in 401(k) plans by homeowners would have been saved anyway had 401(k) plans not existed. Benjamin (2003) concludes that some types of households that typically save most (homeowners, IRA holders, those with a better education) respond least to 401(k). Egen and Gale (2000) found similar behaviour.

¹³ The participation rate of a class is the number of participants divided by the total number of individuals in one class.

¹⁴ The same trends can be observed for 1999 as shown in Table A.2 and Figure A.2 and A.3 in the Annex.

¹⁵ Lefebvre (2004) states that also the age of the children is important as the average amount of resources saved increases with the age of the child. In addition, the children's academic ability is important: 55% of children with A averages had savings, compared with 42% of those with C averages, and only 28% of those with below C. However, it is unclear whether good performance at school is an exogenous characteristic or whether it is influenced by parents' good education and possibly by parents' income.

¹⁶ Further details on the CESG and the CLB can be found in the Chapter 2.

¹⁷ According to the data received from the German Ministry of Finance, employers invested capital-forming contributions for 17.9 million employees in 2003. Of these, 40.78% (7.3 million employees) received the government saving bonus called *Arbeitnehmersparzulage*.

¹⁸ As explained in Section 1, the Employee Savings Bonus can be accessed only by households with less than EUR 35 800 annual income.

¹⁹ Figures here are taken from statistical analysis on tax returns.

- Here we refer to Table A.8 which displays individual data. Data are taken from analysis on tax returns.
- In brief, the 1992 reform cancelled the tax incentive for the rich. In 1994, a greater incentive was given to the lower-income households. In other words, from 1986 to 1992, life insurance premia were fully tax-deductible up to EUR 1 300 (2.5 million lire), so that after-tax returns increased with the marginal tax rate. In 1992 the tax incentive for individuals with marginal tax rates of 27% or higher became a flat rate of 27 percent. The old rules still applied to taxpayers with a lower marginal tax rate. In 1994, any link with the marginal tax rates was eliminated, and the incentive became proportional to the premium paid (a flat rate of 22 percent, lowered to 19% in 1998).
- The net benefit is calculated as the amount of savings in Payroll Savings Schemes times the marginal income tariff.
- The descriptive statistics displayed in Table A.15. and A.16 are drawn from the Family Resources Survey carried out jointly by the UK Office for National Statistics and the National Centre for Social Research. The Family Resources Survey (FRS) is a continuous survey with an annual target sample size of 24 000 private households. We analyze only individuals reporting to have savings between GBP 1 500 and GBP 20 000. Only for this group, information on the type of assets located in tax-preferred accounts is reported in the FRS. The sample used in our analysis is a repeated cross-section over six years: from 1997/98 to 2002/03 with size of 64 988 individual observations.
- 83.15% of the sample (54 714 individuals) finished full-time education at 18 years of age or under. The rest (10 274 individuals) ended full-time education aged over 18.
- This is not surprising as taxpayers are those who can benefit more from tax-exempt earnings.
- We do not have data about the average investment in TESSAs by income class.
- In the same work, Dynarski (2004) reckoned that the benefits of 529 and Coverdell plans rose sharply with income. The reasons could be the following. First, those with the highest marginal tax rates benefit the most from sheltering income. Second, the tax penalties that are assessed on families whose children do not use their Coverdell accounts to pay for college hit some families harder than others. Those in the top two tax brackets benefit more from non-educational use of a Coverdell than those in the bottom bracket gain from its educational use. Finally, the college financial aid system reduces aid for those families that have any financial assets, including an ESA or a 529 plan. Since the highest-income families are unaffected by this aid tax, this further intensifies the positive correlation between income and the advantages of the tax-advantaged college savings accounts.
- This means they attended university, at least at an undergraduate level. Among the households not investing in 529 and/or ESA, only 37% of them had achieved a Bachelor degree or a higher degree.
- See Table A.22.
- An IRA is a retirement investing tool that can be either an Individual Retirement Account or an Individual Retirement Annuity. There are several types of IRAs: Traditional IRAs, Roth IRAs, SIMPLE IRAs, and SEP IRAs. Traditional and Roth IRAs are established by individual taxpayers, who are allowed to contribute 100% of compensation (Self-employment income for Sole proprietors and partners) up to a specified maximum dollar amount. Contributions to the Traditional IRA may be tax-deductible depending on the taxpayer's income, tax-filing status, and coverage by an employer-sponsored retirement plan. Roth IRA contributions are not tax-deductible and withdrawals are not taxable. SEPs and SIMPLEs are retirement plans established by employers. Individual participant's contributions are made to SEP IRAs and SIMPLE IRAs. Dividends, interest and capital gain growth within an IRA are not taxable and monies eventually removed are taxable. Withdrawals prior to age 59 1/2 may be subject to taxes and a 10% IRS penalty. Avoidance of 10% IRS penalty (but not taxes) on withdrawals prior to age 59 1/2 is available if owner takes substantially equal periodic payments over his/her life expectancy based on IRS life expectancy tables. Distributions-withdrawals are required starting April 15 the year after owner turns 70 1/2. Keogh plans are tax-deferred pension accounts available to the self-employed. These plans allow earnings to grow tax deferred until the capital is withdrawn.
- The 2001 tax reform eliminated the federal tax on withdrawals from 529 savings plans. Afterwards, states began to quickly adopt the plans.
- The Investment Company Institute is the US National Association of American Mutual Funds.
- Interviews were carried out with the households' primary or co-decision maker for savings and investment.
- The target sample was selected in the aforementioned manner because of the low ownership rates of state-sponsored 529 plans and Coverdell ESAs among US households.
- It is worth noting that the German Employee Savings Bonus schemes are an exception as they are targeted only at low-income households.
- This occurs when the present value of taxes paid in the future is higher than the present value of taxes saved today. This happens mainly for four reasons. First, large withdrawals from 401(k) plans and other tax-deferred accounts might place the taxpayer in higher tax brackets with respect to when she/he made the contributions. Second, the Government can raise taxes when one retires. Third, contributions to tax-deferred accounts can place one in lower tax-brackets when young. This will reduce the value of mortgage interest and other deductions. Fourth, shifting taxable income from youth to old age can increase the share of Social Security benefits that become subject to federal income taxation. Federal income taxation on Social Security benefits can alone turn the participation in 401(k) plans into a bad deal for moderate-income earners.

- ³⁷ The assumption here is that current consumption is a normal good (*i.e.* a good for which the demand increases as income increases).
- ³⁸ This is the case of indifference curves between present and future consumption with a small curvature.
- ³⁹ Tax-preferred accounts are considered illiquid because they normally entail a penalty on early withdrawals.
- ⁴⁰ For an excellent survey of the literature, see Bernheim (2002).
- ⁴¹ Our calculations are based on 1999 Tax Statistics by Statistics Norway.
- ⁴² See Table A.29.
- ⁴³ For a detailed survey on the saving effects of tax-preferred pension accounts see Bernheim (2002).
- ⁴⁴ Two strategies are used in the study to solve the problem of savers unobserved heterogeneity. The first one is to use the ownership status of IRA or Supplemental Retirement Annuities/Group Supplemental Retirement Annuities (SRA/GSRA) as a signal of a household's taste for saving. The second one uses propensity scores methods to control for savers' tastes heterogeneity.
- ⁴⁵ However, it is worth noting that in Norway, a part of the lowest income class (taxpayers in tax class 2) could have increased their savings: 40% of them did not contribute the maximum amount into the AMS.
- ⁴⁶ It is worth remembering that AMSs were introduced also for fostering the national stock market. In other words, the aim was to affect the composition of saving rather than its level. It is beyond the scope of this study to assess whether such an aim was achieved. However, the literature agrees on the effect of tax-preferred saving accounts on the composition of saving.
- ⁴⁷ Countries have different systems for fostering saving, different levels of private and national saving, different pension systems, as well as different policy aims. A comparison of countries expenditure for saving incentives should be carried out considering the entire country system. Information here provided is not enough for such a scope.
- ⁴⁸ See Table 1.7.
- ⁴⁹ To this figure, expenditure for PEPs (0.005% of GDP) and TESSAs (0.06%) must be added. For more details on the UK tax expenditure for tax-preferred accounts, see Tables A.42 to A.46.
- ⁵⁰ For more information on the Canadian tax expenditure for RESPs, see Tables A.48 and A.49.
- ⁵¹ The calculations are carried out under the assumption that the average yield on deposits in savings accounts for children/grandchildren is 2% and that this yield could be taxed at 33% rate.
- ⁵² For more details about the US federal tax expenditure on 529 plans and ESAs, see Tables A.48 and A.49.
- ⁵³ We calculated the cost per participant by dividing the 2004 tax expenditure by the 2003 number of participants as we have neither figures for the number of participants in 2004 nor data for tax expenditure in 2003.
- ⁵⁴ EUR 25 914 (EUR 2 468 per year). We used an exchange rate of EUR 0.617 for CAD 1.
- ⁵⁵ This corresponds to EUR 1.234 (conversions are made at an exchange rate of EUR 0.617 for CAD 1).

Chapter 2

The Legislation Regulating Tax-Preferred Accounts in Selected OECD Countries

Chapter 2 reports a comprehensive description of the design features governing the tax-preferred plans analysed in this study. Specifically, for each account, the structure of the taxation of contributions, accrued earnings and withdrawals from the plans is described in details. Information is acquired from the responses to the questionnaire about tax-preferred plans sent to OECD member countries. Via the same questionnaire, other non-fiscal characteristics are reported: the type of beneficiaries (some accounts are targeted to a certain part of the population), the potential contributors (sometimes funds can be deposited by the employer or by a third party), the funds minimum lock-in periods and the penalties incurred when resources are withdrawn earlier, the additional Government savings bonus.

2.1 Belgium: Tax-preferred deposits accounts and tax-preferred life-insurance contracts

2.1.1 Tax-preferred deposits accounts

Tax-preferred deposit accounts are accounts in which accrued earnings are tax-free until a certain amount. Funds can be freely withdrawn.

In 2004, in the Belgian tax-preferred deposits accounts the first EUR 1 520 (EUR 3 040 for joint filers) per year of interest earned is exempt from advance levy on income derived from securities. If the interest accrued each year is more than the aforementioned limit, the excess will be subject to the advance levy. If the interest earned is less than EUR 1 520 (EUR 3 040 for joint filers) in a given year, the unused room for tax-exempt interest earned cannot be carried forward to the next year. The aforementioned limits apply to the total interest earned on all accounts held per individual. In the past however, the monitoring of the limits was concentrated on individual accounts rather than on total interest earned per individual.

There is no government savings bonus for the amounts deposited.

Belgian Law does not provide any limit on the number of accounts held by individual investors. In theory, the investor can hold as many accounts as she/he likes.

Only cash is allowed in tax-preferred deposit accounts. The duration of a deposit account is unlimited.

Funds are readily available to the investor wishing to withdraw them, for whichever use she/he likes. Thus, there are no penalties on early withdrawals. Anyone can make contributions. In practice, many contributions to accounts held by children are made by parents and grandparents. However, for accounts held by children, withdrawals are restricted and the use of the withdrawn funds must be in the interest of the child.

2.1.2 Tax-preferred life-insurance contracts

In Tax-preferred Life-insurance Contracts, premia paid are entitled to a tax credit which is limited to a certain amount. The insurance companies have to pay a tax on the theoretical surrender value but the policy holder does not have to pay any taxes on it. The policy holder has to pay a 10% personal income tax on the capital paid out at the end of the contract. If the policy is surrendered before the end of the contract, the insurance company has to pay a 33% tax on the surrender value.

Legislation regulating tax-preferred life-insurance contracts was introduced in the sixties and it is still in force.¹ The main aim of tax-preferred life-insurance contracts was to encourage private savings. Moreover, Belgian insurance companies had to invest a large percentage of the collected premia in governmental bonds.

All Belgian residents are eligible to invest in tax-preferred life-insurance contracts.

The fiscal treatment of life-insurance contracts is the following: the taxpayer is entitled to a tax credit valued at the average tax rate (with a minimum of 30% and a maximum of 40%) of the premia paid in one year. The tax credit is limited to 15% of the first EUR 1 500 of income plus 6% of the remaining income. There is also an overall limit of EUR 1 800 for 2003 indexed to consumer prices.

Since 1993, individual insurance contracts have been liable to the tax on long-term savings.² Insurance companies are subject to this one-shot taxation on the theoretical surrender value of the life policy as soon as the assured reaches the age of 60, even in the case that the policy has not been surrendered.³

The advance taxation rates are equal to:

- 16.5% of the theoretical surrender value, pensions, annuities or capital of the insurance policy, built up with premia paid until 31 December 1992.
- 10% of the theoretical surrender value, pensions, annuities or capital of the insurance policy, built up with premia paid as from 1 January 1993.
- 33% of the surrender value, when the surrender is made before the contractual termination date.

The capital and the surrender values are taxed separately⁴, unless the individual taxpayer is over 60 years of age. In particular, the capital paid out at the end of the contract is subject to a 10% personal income tax rate.

The penalty on early withdrawals is therefore the 33% tax rate paid by insurance companies.

2.2 Canada: Registered Education Savings Plans (RESPs)

Registered Education Savings Plans (RESPs) are plans established for financing higher education. Earnings accrue tax-free and a government savings bonus is paid in the account. When the funds are withdrawn for paying higher education expenses, earnings and saving bonus are taxed. The funds may not be withdrawn until the beneficiary starts a qualifying educational program. The accounts are characterized by contribution limits.

Registered Education Savings Plans (RESPs) were specifically recognized under the *Income Tax Act* in 1974 and they are still available in 2005.

Registered Education Savings Plans (RESPs) are a tax-assisted savings vehicle designed to help families accumulate savings for the post-secondary education of their children. While contributions are not tax-deductible, the income generated by these contributions can grow tax-free until it is withdrawn for the child's full-time post-secondary education.

There are three types of RESPs:

- *Individual RESPs*: These plans can only have one beneficiary. There are no restrictions on who can be a beneficiary under these plans. The beneficiary does not have to be related to the subscriber, and can be over 21 when named. Contributions to this plan can be made up to 22 years after the plan is established.
- *Family RESPs*: Each beneficiary of a family plan must be related by blood or adoption to each living subscriber under the plan or have been related to a deceased original subscriber. Under the *Income Tax Act*, a blood relationship is that of a parent and child (or other descendant, such as a grandchild or a great grandchild) or that of a brother and sister. The subscriber's niece, nephew, aunt, uncle and cousin do not meet the definition of "blood relative" and therefore do not qualify as a beneficiary under a family plan.

- *Group RESPs*: Group plans are operated on a pooling principle where the beneficiary named under a contract by a subscriber will receive Educational Assistance Payments when enrolled in a qualifying program, but if the beneficiary fails to qualify for payment, the earnings are distributed among other beneficiaries of the same age who do qualify.

For the subscriber/contributor there are no age restriction or residency requirements. Administratively, a Social Insurance Number (SIN) must be provided.

The beneficiary has to have a SIN and be resident in Canada. In a family plan, each beneficiary must meet both of the following conditions: the beneficiary must be connected by blood relationship or adoption to each living subscriber, or have been similarly connected to a deceased original subscriber; and the beneficiary must not have reached 21 years of age when named and the contributions are made in the plan.

The RESP is attached to government savings bonuses called Canada Learning Bond and Canada Education Savings Grant (CESG).⁵ A 20% Canada Education Savings Grant will be paid on the first CAD 2 000 of annual contributions made to all eligible RESPs for a qualifying beneficiary. Beneficiaries qualify for a grant on the contributions made on their behalf before the end of the calendar year in which they turn 17 years of age. The maximum CESG amount that a beneficiary can receive is CAD 7 200.

To strengthen assistance to low- and middle-income Canadian families that wish to save for their children's post-secondary education, the CESG program has been enhanced to increase the CESG matching rates for these families. Starting in 2005:

- For a child of a family with income up to CAD 35 595 (for the second preceding year) the CESG matching rate is 40% on the first CAD 500 annual contributions to an RESP.
- For a child of a family with income between CAD 35 595 and CAD 71 190 the CESG matching rate is 30% on the first CAD 500 annual contributions to an RESP.
- All other eligible RESP contributions, up to CAD 2 000 annually, will continue to qualify for the 20% matching rate.

In addition, beginning in 2004, the new Canada Learning Bond will provide up to CAD 2 000 to kick-start education savings by age 16 for children born after 2003 in families entitled to the National Child Benefit supplement. To access a child's CLB entitlements, an RESP will have to be opened with an RESP provider. The CLB will be deposited into the RESP, with the consent of the person receiving the National Child Benefit supplement for the child, and it will earn income in accordance with the plan.

The *fiscal treatment* of the RESPs is the following. Investment earnings on RESP contributions⁶ and on the payments from the Canada Learning Bond and Canada Education Savings Grant (CESG) programs⁷ grow tax-free over the life of the RESP.

The CESG plus any investment earnings (on the RESP contributions or the CESG) are paid to the student by the RESP provider as an Educational Assistance Payment (EAP) when he or she registers on a full-time basis in a post-secondary education program at a recognized post-secondary institution. These EAP payments are taxable⁸ in the hands of the student in the year they are received. In most cases, the student's relatively low income, combined with generous education-related tax credits, results in a minimal amount of tax.

To receive an EAP, a student must be attending a post-secondary program in a recognized post-secondary institution. A qualifying educational program is an educational program which lasts at least three consecutive weeks, and which requires a student to spend no less than 10 hours per week on courses or work in the program.

The full-time attendance criteria are waived if the student cannot reasonably be expected to be enrolled as a full-time student because of a certified mental or physical impairment.

There is a limit of CAD 5 000 on the first EAP that a student can receive. After the student has completed 13 consecutive weeks in the qualifying educational program, there is no limit on the amount of EAPs that can be paid if the student continues to qualify to receive them. The Minister of Human Resources and Skills Development may, on a case-by-case basis, approve an EAP amount of more than the above limit if the cost of tuition plus related expenses for a particular program is substantially higher than the average.

If the beneficiary does not pursue post-secondary education, the CESG and CLB are returned to the Government of Canada, and the earnings on the RESP (including those on private contributions, the CESG and CLB) can be returned to the subscriber as an Accumulated Income Payment (AIP).⁹ Earnings are included in the subscriber's taxable income, and are subject to an additional 20% tax. The additional tax approximates the tax that would have been paid on the investment income had the savings taken place in a non tax-preferred vehicle.¹⁰

There are contribution limits. The maximum yearly contribution that can be made to all RESPs in a beneficiary's name is CAD 4 000. This does not include the Canada Education Savings Grant. While unused RESP contribution room cannot be carried-forward to future years, the relative size of the yearly limit and of the lifetime limit (CAD 42 000¹¹) can enable a parent to make 'catch-up' contributions in later years, and effectively 'max-out' an RESP in only 11 years by making the maximum annual contributions.¹² An over-contribution occurs at the end of a month when the total of all contributions made by all subscribers to all RESPs for a beneficiary is more than the annual or lifetime limit for that beneficiary. Payments made to an RESP under the CESG or CLB programs are not included in determining whether a beneficiary has an over contribution. All subscribers to RESPs for that beneficiary are liable to pay a 1%-per-month tax on their pro-rated share of over contributions that are not withdrawn at the end of the month. The tax is payable within 90 days of the end of the year in which there is an over contribution. An over contribution exists until it is withdrawn.

There is no limit on the number of plans a subscriber can establish for a beneficiary, or on the number of RESPs a beneficiary may have. However, the annual and lifetime contribution limits are per beneficiary, and cannot be circumvented by establishing multiple plans for the same beneficiary.

The RESP must be terminated by the end of the year that includes the 25th anniversary of the opening of the plan. However, Budget 2005 proposes that this limit be extended from 25 years to 30 years following the year in which the plan was entered into, for single beneficiary RESPs, if the RESP beneficiary qualifies for the Disability Tax Credit in the 21st year of existence of the plan.

Since October 28, 1998, all investments held by a trust governed by an RESP must be qualified investments. Any property acquired by the trust before that date will be considered a qualified investment as long as the RESP trust continues to hold the property. Qualified investments include the following:

- Money and deposits.
- Guaranteed investment certificates issued by a trust company.
- Bonds and other debt obligations of the Government of Canada, a province, a municipality, or a Crown corporation.
- Shares listed on prescribed stock exchanges in Canada or in a foreign country.
- Bonds and other debt obligations of a corporation whose shares are listed on a prescribed stock exchange in Canada or in a foreign country.
- Bonds or other debt obligations of an authorized foreign bank payable at a branch of the Bank in Canada.
- Segregated fund policies; and prescribed investments.

Certain mortgages, units or shares of a mutual fund, and certain shares of small business corporations could also be qualified investments. Of note, with the exception of certain annuity contracts, the types of investments that qualify for RESPs are similar to those investments that qualify for RRSPs. There are no restrictions on the foreign property of RESPs.

2.3 Denmark: Savings Accounts for Children/grandchildren

Savings Accounts for Children/Grandchildren are tax-free accounts targeted at children under the age of 21. Earnings accrued on funds deposited are tax-free. The accounts are characterized by annual contribution limits. Funds are locked in for at least seven years.

Savings Accounts for children/grandchildren were introduced in the tax year 1960-61.¹³

In connection with a regulation of the already existing limited tax deductibility of contributions to pension schemes, it was decided to extend the use of limited tax deductibility. Among others, savings accounts for children became a possibility. The aim was to promote savings.

The system does still exist, but rules have been changed. Among others, contributions to the account are today no longer deductible.

Parents, grandparents¹⁴, great-grandparents, great-great grandparents and the child are eligible to invest in the aforementioned account. Only one account per child can be opened and the account belongs legally to the child.

The *fiscal treatment* of the Savings Accounts for Children/grandchildren is the following: up to 1 January 1987 contributions below DKK 2 000 (approx. EUR 269) was tax deductible. Today, the only advantage of the savings accounts is that the interests (and capital gains) are tax-free as long as the account is tied up.

There are contribution limits: maximum contribution is DKK 3 000 (approx. EUR 403) per year per account.¹⁵ Maximum total contributions are DKK 36 000 (approx. EUR 4 836), to which interest must be added. Excess contributions may not be paid in and unused contribution room cannot be carried forward to the following year.

The contribution can only be made until the child reaches 21 years of age. There are no compulsory contributions. The account has to be opened before the child reaches

14 year of age as the account must be tied up for minimum 7 years. The funds may at earliest be released when the child is 14 and at the latest when the child reaches 21.¹⁶ The funds can be withdrawn before the seventh year only in the cases of the child's death or serious illness.

Assets allowed in the accounts are the following: since 1 July 1998 it has been allowed to place the funds in pool schemes (the bank invests the funds in quoted bonds or stocks) or in a separate safe custody (the depositor participates in deciding how to invest funds).

2.4 Germany: Employee Saving Bonus (*Arbeitnehmer-Sparzulage*) and tax-preferred life-insurance contracts

2.4.1 *Employee saving bonus (Arbeitnehmersparzulage)*

The Employee saving bonus (Arbeitnehmer-sparzulage) is a saving bonus given to low and middle-income employees who lock funds in a special account for seven years. Contributions to the account are normally paid annually by the employer. Accrued capital gains and interests are taxable but the savings bonus is not.

The Employee Saving Bonus (*Arbeitnehmer-sparzulage*) was introduced on 1 January 1999 through a revision of the *Fifth Capital Formation Law* (*Fünftes Vermögensbildungsgesetz*).¹⁷

The Law aims to encourage savings by employees.

The Employee Saving Bonus is targeted to low and middle-income households: employees with an annual taxable income lower than EUR 17 900 (for singles) or EUR 35 800 (joint filers) are eligible to receive the government saving bonus called *Arbeitsnehmer-sparzulage*. All employees are eligible irrespective of age, provided that their income does not exceed the maximum amounts.

The government matches the employees' saving, called capital formation payments, with a bonus. The latter is formed by two baskets.¹⁸ In the first basket (*i.e.* for housing saving), the savings bonus is equal to 9% of value deposited into the account. The maximum value of deposits to earn the state bonus is EUR 470 (9% of EUR 470 is EUR 42.30) per year. The second basket holds building savings¹⁹ as well as voluntary payments into "productive property", such as Stock Funds.²⁰ For this basket there is an extra state bonus of 18% per year.²¹ The maximum amount of deposits to earn the state bonus is EUR 400. If both spouses are eligible, each is separately eligible for the bonus up to the maximum amount of EUR 400 and/or EUR 470. The unused contribution room in one year cannot be carried forward to the following year.

The capital formation payments are remitted by the employers. They are paid from funds from the employer and/or in part from the employee's. In many areas regulated by collective pay agreements, the amount of payments made by the employer is set out in the agreement.

Assets should stay in the account for at least seven years in order to receive the government savings bonus. The maximum duration of the account is ten years: after that term, the government does not pay any savings bonus. The employee loses his/her claim to the savings bonus if funds are withdrawn before the 7th year. Early withdrawals are

allowed without losing the entitlement to the savings bonus in the event of marriage, unemployment, incapacity to work and becoming a self-employed.

The employee savings bonus is determined each year, but is disbursed to the saver in a lump sum only after the blocking period of seven years has elapsed.

The *fiscal treatment* of the funds deposited in the account is the following: capital gains and dividends accrued in the account are taxable but the government bonus is tax-free and social contribution-free.

2.4.2 *Life-insurance contracts*

The *fiscal treatment* of tax-preferred life-insurance contracts signed before 31 December 2004 was the following. Returns on a unit-linked policy are tax-free if the following requirements apply: *i*) premia are annually paid, *ii*) death benefit is at least 60% of the total premia paid over the duration of the policy, *iii*) the policy duration is of at least 12 years. Premia paid on the relevant insurance contracts were deductible²² if the contract started to run before 1 January 2005 and at least one premium was paid up to and including 31 December 2004.²³

For life-insurance contracts subscribed before 1 January 2005, there was no restriction on the number of policies which could be held.

Tax incentives are now provided to a limited extent for insurance contracts signed after 31 December 2004. The new legislation provides that the proceeds of all life insurance policies contracted after 31 December 2004 will be taxed at the beneficiary's applicable income tax rates. If the following conditions are fulfilled, however, only 50 % of the proceeds will be taxed: *i*) the contract must be for at least 12 years; *ii*) the policyholder must be over 60 years when the policy ends. Unit-linked premia cannot be deducted from taxable income.

Early withdrawals of funds are never allowed before the 12 year period expires.

Chapter 54 (2) of the German *Supervisory Law* (Versicherungsaufsichtsgesetz) stipulates that assets covering the technical provisions of life insurance contracts (be they tax preferred or not) may be invested only in

- Receivable loans, bonds and participation rights.
- Debt Register claims.
- Shares.
- Participating interests.
- Real property and similar rights.
- Shares in undertakings for collective investment in transferable securities and for other investments which are placed in accordance with the principle of the spreading of risks, if the undertakings are subject to efficient public supervision for the protection of the holders of the shares.
- Current credit balances and deposits at credit institutions.
- Any other assets if they are admissible under articles 23 or 24 of the Directive 2002/93/EC.

Quantitative and qualitative requirements regarding the assets are laid down by regulation (Ordinance on the investment of the restricted assets of insurance undertakings- AnIV of 20 December 2001).²⁴ The requirements mentioned above do not apply for unit linked contracts.

2.5 Ireland: Special Savings Incentives Accounts (SSIAs), Special Savings Accounts (SSAs), Special Investment Accounts (SIAs) and Special Term Accounts (STAs)

In Ireland, four similar savings products were introduced in the early 1990s to encourage funds to stay in the country in the context of liberalisation of capital markets. The products were SSAs (cash deposits with banks) and three products generally known as Special Investment Accounts being Special Investment Schemes (investment in unit trusts); Special Investment Policies (a life assurance policy) and Special Portfolio Investment Accounts (a share portfolio managed by a stockbroker).

The investment limits as between these products were interrelated. An individual could invest either up to GBP 75 000 in a SSA; GBP 50 000 in an SIA and GBP 25 000 in an SSA; or GBP 25 000 in an SIA and GBP 50 000 in an SSA.

When originally introduced, profit earned in the accounts was taxed at a favourable rate of 10% when the income tax rate otherwise attached to these products was 27% and the capital gains tax rate was 40%. By 2000-01, the favourable tax rate had been increased to 20% which was then also the income tax rate and the capital gains tax rate attached to products that did not have a favourable regime. These products, therefore, no longer served any purpose and were phased out.

2.5.1 Special Savings Incentive Accounts (SSIAs)

Special Savings Incentive accounts (SSIAs) are accounts bearing a 25% matching contribution by the government. Earnings accrued on funds deposited are tax-free but total profit in the account is taxed (at 23%) when the plan expires. PEPs are characterized by monthly contribution limits. Funds can be withdrawn after five years.

Special Savings Incentive Accounts were introduced on 31 May 2001 and could be commenced up to 30 April 2002.

The objective of the scheme was to increase savings and promote savings habits in Ireland.

Everybody aged at least 18 and resident in Ireland for tax purposes was eligible to open a SSIA. Only one account per person could be opened and joint accounts were not permitted.

The government provides a saving bonus in the SSIAs: each month it contributes 25% of the amount contributed by the individual the previous month. To counterbalance this, there are contribution limits: in the first year, participants have to save at least EUR 12.50 each month. The maximum a participant can save in any month during the five-year period is EUR 254 (EUR 3 048 per year). For the second and following years, there is no minimum requirement. The maximum amount which can be saved per month is still

EUR 254 (EUR 3 048 per year). Total contributions from the saver, therefore, over the five-year period cannot exceed EUR15 240.²⁵ Excess contributions are not permitted.

The *fiscal treatment* of the Special Savings Incentive Account is as follows: earnings from the amounts saved are taxed at 23%. This tax will be deducted by the participating financial institutions at the end of the five-year duration of the SSIA. Tax at 23% will apply only to the difference between the total value of the assets held in the SSIA at that point less the aggregate of amounts contributed by the saver and amounts contributed by the Exchequer.

Any amount withdrawn before the end of the fifth year will bear tax at 23%. This has the effect of reclaiming a proportionate part of the government contribution and the imposition of an additional penalty. If the tax rate were only 20% then the only effect would be the withdrawal of the proportionate part of the government contribution. For example, suppose after 3 months of starting an SSIA with contributions of EUR 254 per month the individual concerned seeks to withdraw EUR 200, the position will be as follows:

Individual contribution 3 x EUR 254 =	EUR 762.00	
Government contribution 3 x EUR 63.50 =	EUR <u>190.50</u>	
Total before withdrawal	EUR 952.50	
Withdrawal of EUR 200	EUR <u>200.00</u>	(tax of EUR 46 deducted – net EUR 154)
Balance left in SSIA	EUR <u>752.50</u>	

Investors who keep their SSIA for its full term will be able to withdraw their money at the end of the 61st month. This extra month gives the time necessary for the last government contribution to be made to the SSIA (*e.g.* in the case of an SSIA that commenced in June 2001, funds can be withdrawn on 30 June 2006). Only the profit made from the investment of all contributions will be taxed.

Early withdrawals will be penalised except on the death of the individual concerned.

Funds can be invested in cash deposits, equities, bonds and life-insurance contracts.

2.5.2 *Special Savings Accounts (SSAs)*

Special Savings Accounts (SSAs) are accounts in which accrued earnings are taxed at a preferential rate. SSAs are characterized by overall contribution limits. Funds can be withdrawn after the first three months.

Special Savings Accounts (SSAs) were introduced on 1 January 1993 and they could not be opened after 5 April 2001.

The SSAs were introduced to keep funds in Ireland in the context of EU driven capital market liberalisation.

Individuals resident in Ireland for tax purpose who were 18 years or over or married were eligible to invest in Special Savings Accounts.

The *fiscal treatment* of the SSAs was the following: accrued interest was taxable at a favourable tax rate: the tax rate was 10% in 1993 and then increased to 15% in the 1995 Budget. It was further increased to 20% in the 1998 Budget. With the reduction in 2001 of the general tax rate on interest earned on deposits to 20%, SSAs no longer served any useful purpose and were then abolished.

A person may hold either up to GBP 75 000 in a Special Savings Account; GBP 50 000 in a Special Investment Account²⁶ (SIA) and GBP 25 000 in an SSA; or GBP 25 000 in an SIA and GBP 50 000 in an SSA. Excess contributions are not allowed. Most financial institutions arranged to keep the SSA funds within the permitted limit by transferring excess funds to a non-SSA account of the customer concerned.

Only one SSA per person was allowed, except in the case of an account held jointly with another person in which case two accounts were allowed held jointly with the same person.

There are no limits on the duration of the account. However, under SSA conditions, no withdrawal can be made in the first three months. After that, withdrawals required 30-day minimum notice. Breach of any of these conditions resulted in the favourable tax rate not being available. Funds withdrawn could be put back again in the account before the end of the fiscal year under the condition of not breaching the maximum capacity limit.

SSAs are cash deposits only.

2.5.3 *Special Investment Accounts (SIAs)*

Special Investment Accounts (SIAs) are accounts in which accrued earnings were taxed at a preferential rate. SSAs were characterized by overall contribution limits. Funds could be freely withdrawn.

As mentioned above, Special Investment Accounts were introduced in the early 1990s to encourage funds to stay in the country in the context of liberalisation of capital markets. There were three types Special Investment Accounts: Special Investment Schemes (investment in unit trusts), Special Investment Policies (a life assurance policy) and Special Portfolio Investment Accounts (a share portfolio managed by a stockbroker).

The fiscal treatment of the Special Investment Accounts is as follows: when originally introduced profits earned were taxed at a favourable rate of 10%. At that time, the income tax rate otherwise attached to these products was 27% and the capital gains tax rate was 40%.

By 2000-01 the favourable tax rate had been increased to 20% which was also then the income tax rate and the capital gains tax rate attaching to such products that did not have a favourable regime. The SIAs, therefore, no longer served any purpose and were phased out in 2001.

The investment limits for SIAs and SSAs were interrelated in the same way as SSAs and SSIAs. An individual could invest either up to GBP 75 000 in a SSA; GBP 50 000 in an SIA and GBP 25 000 in an SSA; or GBP 25 000 in an SIA and GBP 50 000 in an SSA. Excess investment was not allowed.

There was no requirement to keep funds invested for a particular amount of time. Thus, there were no penalties for early withdrawals. Funds could be withdrawn and put back in the account in the same fiscal year.

Regarding the assets allowed in the SIA, there was a requirement that a certain percentage of investment made into each type of SIA (*i.e.* Special Investment Schemes, Special Investment Policies and Special Investment Portfolio Accounts) be invested in quoted Irish shares. The percentages were as follows:

- up to 31 January 1994 40%
- up to 31 January 1995 45%
- up to 31 January 1996 50%
- up to 31 December 2000 55%

The requirement was the abolished in 2001.

2.5.4 *Special Term Accounts (STAs)*

Special Term Accounts (STAs) are accounts in which interest is not taxed if it does not exceed a certain limit. STAs are characterized by monthly contribution limits. Withdrawals are possible only after either three or five years.

Special Term Accounts (STAs) were introduced on 1 January 2002 and are still available. There are two types of Special Term Accounts: medium and long-term accounts. The former lasts for three years and the latter for five years.

STAs were introduced in the context of the change in the taxation regime of Credit Union dividends to a tax at source regime from one requiring personal disclosure responsibility.

Individuals aged 16 years or over and resident in the Republic of Ireland are eligible to invest in Special term Accounts.

The *fiscal treatment* of the STA is the following: interest paid in each tax year will not be subject to tax except where the amount of interest exceeds: *i)* in the case of a medium term STA EUR 480; and *ii)* in the case of a long term STA EUR 635.

At the commencement, contributions are unlimited. Afterwards, the maximum monthly amount is EUR 635. However, there is an exception: the taxpayer is allowed a one-off deposit of up to EUR 7 620 during the term of the account.

In general, funds may not be withdrawn from an STA other than on the occasion of the death of the holder within the third year or as the case may be the fifth year. An exception to this is in the case of an individual who has attained 60 years of age and was under 60 when the account was commenced. Such an individual is entitled to make one withdrawal of funds during the term of the account. An account will cease to be an STA if any of the statutory conditions cease to be satisfied. Where that occurs, the Bank will deduct from the account an amount equivalent to the amount of tax that would have been deducted if the account had never been an STA and past interest was being paid on the date of that occurrence.

Except in the case of married couples, the investor may not simultaneously hold, whether solely or jointly, another STA. Married couples may hold two joint STAs in their names.

Only cash deposits are allowed in STAs.

2.6 Italy: tax-preferred life-insurance contracts

2.6.1 *Tax-preferred life-insurance contracts (Law provisions until 31 December 2000)*

In Tax-preferred life-insurance contracts (law provisions until 31 December 2000) earnings accrued on funds deposited are taxed only when the contract expires. Premia are entitled to a tax credit up to a certain limit and, in the meantime, they are taxable at a rate of 2.5%. Funds can be withdrawn after 10 years in order to enjoy fiscal privileges.

Tax-preferred life-insurance contracts were introduced in 1986. Taxation of life-insurance contracts changed after 31 December 2000. However, the provisions described below are still valid for contracts subscribed before 31 December 2000.

All investors aged less than the maximum retirement age were eligible for subscribing to a tax-preferred life-insurance contract.

The *fiscal treatment* of the tax-preferred life-insurance policies is the following. In cases where the contract terminates with a lump sum payment, a 12.5% tax is applied on the difference between the sum of *premia* paid and final payment. The tax rate is reduced by 2% for each year after the 10th year. In cases where the contract is ended in the form of an annuity, 60% of the annuity is added to personal income and is subject to the PIT. Contributions are taxed at 2.5%. At the same time, 19% yearly contributions receive a tax credit up to a limit of EUR 1 300.

If the life-insurance policy is redeemed before 5 years, the allowances on previous contributions have to be paid back. A tax of 12.5% is applied to the difference between capital and total contributions if the policy is redeemed before 10 years. The tax is reduced by 2% annually after the 10th year. Death benefits are not subject to the beneficiary's personal income tax. Only 60% of gross benefits received in the form of an annuity are subject to the beneficiary's personal income tax. If those benefits are distributed because of the holder's death, they are tax-free.

There are no restrictions on contribution limits and on the number of contracts which can be subscribed. However, the limit of EUR 1 300 for deductible *premia* applies.

2.6.2 *The 2000 reform: tax-preferred life-insurance contracts providing for the build-up of asset and traditional life-insurance products*

In Tax-preferred life-insurance contracts providing for the build-up of assets, earnings accrued on funds deposited are taxed only when the contract expires. Funds can be withdrawn freely when the investor wishes.

The new legislation regulating life-insurance products came into force on 1 January 2001.²⁷

The new legislation introduced new rules for both rationalising the treatment of retirement savings and harmonizing the fiscal treatment of financial products. Thus, tax-preferred life-insurance products targeted at the build-up of assets were regulated differently from life-insurance contracts targeted at retirement savings. For the former, the *fiscal treatment* is the following: a 12.5% tax is applied on the difference between the sum of *premia* paid and final payment (capital gain); even if the benefits are distributed in

the form of an annuity. No allowances are granted for contributions to contracts subscribed after January 2001.²⁸ Funds can be withdrawn whenever the investor likes as Italian law does not set any limit for the duration of the contract.

The Law does not limit the number of contracts which can be subscribed to by an individual. There are neither annual nor overall contribution limits.

Funds deposited under the life-insurance contract are not able to be invested (either directly or indirectly) in derivative financial products.

In traditional tax-preferred life-insurance contracts, premia paid are entitled to a tax allowance up to a certain limit. Death benefits are tax-free while earnings accrued on funds deposited are taxed if the policy holder is alive when the contract expires. Funds can be withdrawn freely when the investor wishes.

By traditional life-insurance contracts, we mean contracts covering the risk of death, chronic illness and the risk of not being self-sufficient.

The *fiscal treatment* of the traditional life-insurance policies is the following²⁹: 19% yearly contributions receive a tax credit up to a limit of EUR 1 291.14.

Death benefits are not subject to the beneficiary's personal income tax. In cases where the contract terminates before the holder's death, a 12.5% tax is applied on the difference between the sum of *premia* paid and final payment.

There are no restrictions on contribution limits and on the number of contracts which can be subscribed to.

2.7 Mexico: Bank Deposits and tax-preferred life-insurance contracts

2.7.1 Bank Deposits

Bank deposits are accounts in which accrued earnings are tax-free until a certain amount. Funds can be freely withdrawn.

The current legislation regulating bank deposits was introduced in 1985.

One of the main policy considerations in the 1985 *Income Tax Law* (ITL) was to foster personal savings of low and middle-income individuals.

Until 1978, the *Mexican Income Tax Law* (MITL) considered as taxable income the interest from any kind of bank deposits, bonds and other fixed income assets. However, since 1979, the MITL explicitly exempted the interest paid to individuals by banks if it was less than 5% of the amount of the original deposit ((1979), MITL, article 49).

In 1985, the exemption of the interest paid by banks from savings deposits was limited to an amount less than twice the annual minimum wage of the Federal District (*Distrito Federal*) ((1985) MITL, section XIX of article 77).

More specifically, tax exemption is accorded to interest, paid by credit institutions, if such interest derives from checking accounts for wages and salary payments, pensions or savings from an investment with an average daily balance not higher than five minimum yearly wages of the geographical area of the Federal District (almost MXN 80 000). The interest in the aforementioned accounts with an average daily balance higher than five minimum yearly wages³⁰ is taxable income. In this case, a provisional withholding tax

rate of 0.5% of the average balance of the account is charged and later credited in the annual tax return. The interest from investments with an average daily balance not higher than five minimum yearly wages is also exempt if paid by savings and loan associations and by the popular financial societies.

There are no limits on the capital deposited in a bank account. Mexican Law does not provide any limit on the number of accounts held by individual investors. In theory, the investor can hold as many accounts as she/he likes. The duration of the deposit is unlimited.

Only cash is allowed in deposit accounts.

Withdrawals of funds are always possible and thus, there are no penalties on early withdrawals.

2.7.2 *Tax-preferred life-insurance contracts*

On 31 August 1935, the General Law of Insurance Institutions and Mutual Societies (*Ley General de Instituciones y Sociedades Mutualistas de Seguros*) and the Law of the Insurance Contract (*Ley sobre el Contrato de Seguro*) came into force. Since 1935, corporations can deduct the payment of insurance premia (*primas*) on behalf of their workers.³¹ Starting from 1979, amounts paid by insurance companies to insured individuals when the sheltered risk occurs are exempt.³²

In 1935, the government introduced legislation for insurance companies and insurance contracts with the purpose of developing this sector. The deduction of the insurance premia paid by corporations was introduced to foster the investment and growth of corporations and to encourage corporations to give more fringe benefits to their workers.³³

All Mexican residents who are at least 12 years old can invest in a life-insurance contract.³⁴

The *fiscal treatment* of life-insurance contracts is the following. When the sheltered risk occurs, amounts paid by insurance companies to insured individuals are exempt if the insurance premia were paid by the insured individual or the employer of the insured individual.³⁵ Corporations can deduct the payment of life-insurance premia (*primas*) on behalf of their workers. In the case of non-union workers, deductibility of the insurance fees paid is limited to ten times the yearly minimum wage of the worker's geographical region (MXN 165 000).³⁶

Mexican law does not regulate the duration of the life-insurance contract. The limits depend on the type of insurance contracted.

Partial or total early withdrawals (*i.e.* before the sheltered risk occurs) of paid premia (and their corresponding financial yields) will be considered taxable interest under personal income tax. This applies when the receiver of the early withdrawals is the insured individual.

Other early payments³⁷ (not considered final payments or interest) of insurance companies to individuals who are not the insured individual or his/her direct beneficiaries will be liable to a 20% withholding tax. Payments to the insured individual and his/her direct beneficiaries are not subject to the 20% withholding tax.

Mexican law does not regulate how much can be invested in a life-insurance contract, nor does it regulate how many life-insurance contracts can be subscribed to.

Funds contributed in life-insurance contracts can be invested mainly in the following financial assets: government bonds, bank deposits³⁸, discount operations of securities (*reportos*), guaranteed loans, real estate, inflation indexed bond (*UDI bonds*), quoted shares, warrants and futures.³⁹

2.8 The Netherlands: Payroll Savings Schemes (*Spaarloon*) and Premium Savings Schemes (*Premiesparen*)

2.8.1 Premium Savings Schemes (*Premiesparen*)

The Premium Savings Scheme (Premiesparen) is a saving plan targeted at employees. Contributions to the account are paid in by the employer and the latter does not pay any taxes and social contributions on these deposits (up to a limit). Accrued gains are not taxable and withdrawals are tax-exempt in the hand of the employee if funds are withdrawn after four years.

The Premium Savings Scheme was introduced on 1 January 1994 and was abolished on 1 January 2003.

The aim of the scheme was to promote saving by employees. The Dutch government wanted also to encourage wage restraint by offering the possibility of a tax friendly saving plan.

The employer withheld an agreed amount from the employee's net pay and deposited this in a premium savings account. The employer could then award the employee a savings premium of up to 100% of the amount withheld to a maximum of EUR 525 per year. Annual contributions were limited to EUR 1 838.⁴⁰ Employers were exempt from paying tax and social security contributions on each employee's pay to a maximum of EUR 1 313. No social contributions or payroll taxes needed to be paid on these savings. After four years, the saved amount was freely available to the participant, without any deductions.

Early withdrawal, that is withdrawal before the end of the four year term, was possible, but the sum paid out was then liable to tax or social security contributions.⁴¹ However when special conditions apply, the sum withdrawn early was not liable to tax or social security contributions: early withdrawals were possible for among others the purchase of a house, shares, pay off of a mortgage on a house, premia for a life-insurance contract, the start up of a company, moving expenses and child care expenses.

2.8.2 Payroll Savings Schemes (*Spaarloon*)

The Payroll Savings Scheme (Sparloon) is a saving plan targeted at employees. Contributions to the account are paid in by the employer. Accrued gains are not taxable and withdrawals are tax-exempt in the hand of the employee if funds are withdrawn after four years.

Payroll Savings Schemes were introduced on 1 January 1994 and are still available.

As for Premium Savings Scheme, the Dutch government introduced the Payroll Savings Schemes to promote saving by employees and support wage restraint by offering the possibility of a tax friendly saving plan.

Any employee⁴² is eligible for this scheme provided that her/his employer has introduced a scheme for employees. The employer withholds an agreed amount not exceeding EUR 613⁴³ of the employee's gross pay and deposits it in a savings account blocked for four years. When the sum is paid out after four years it is not liable to tax or social security contributions.

Early withdrawal, that is withdrawal before the end of the four year term, is possible, but the sum that is paid out is then liable to tax and social security contributions.

Tax-exempt early withdrawal is possible, if special conditions apply, for example, for the purchase of a house or shares, for the payment of the premia for a life-insurance contract, for the costs for education and the start up of a company.

Funds deposited in the Payroll Savings Schemes can be invested in stock and life insurance contracts.

Once funds have been withdrawn before the closure of the Payroll Savings Schemes, they can be put back again in the account only if the funds withdrawn have been used for the purchase of stock. After the sale of the stocks, the initial amount of the payroll savings scheme can be put back in the account. As explained above, in other cases of early withdrawal the amounts withdrawn are liable for taxation and social security contributions.

Only one payroll scheme per person/employee can be held.

2.9 Norway: Tax-favoured Savings in Shares (AMS)

Tax-favoured Savings in Shares were accounts targeted at equity investments. Earnings accrued on funds deposited were taxed but the taxpayer was entitled to a tax credit equal to 15% of the purchase value of shares in the fiscal year. The tax credit was limited to a certain amount and funds were locked in for at least four years.

Tax favoured Savings in Shares (AMS) were introduced 1 January 1982 and abolished in 2000.

The scheme was introduced with the main purpose of increasing capital access for private companies. Actually, direct and indirect share holdings were allowed in the AMS. In addition, there was a macroeconomic need to reduce private sector spending. Through these incentives, it was hoped that the public would invest rather than spending money. Lacking any proven effects, the AMS legislation was abolished in 2000 due to lack of proven effects and because the scheme implied non neutral fiscal treatment of different savings.

All persons aged 17 years or over and subject to ordinary Norwegian income tax were eligible to contribute to the AMS.

The *fiscal treatment* of AMS displayed a tax credit for the investor equal to 15% of the purchase value of the shares bought during the fiscal year. In order to obtain a final tax credit each investment had to be held for at least four years. If the holdings were alienated within the four year period, the taxpayers were obliged to repay the deduction.

The base for calculating the annual tax credit could not exceed NOK 10 000 (EUR 1 228) for single providers in tax class 2, *i.e.* married couples with joint assessment, single parents with dependent children and taxpayers eligible for special income allowances due to age, disability or reduced occupation ability. For all other taxpayers the annual limit was NOK 5 000 (EUR 614).

Thus, the annual limits of tax credit due to AMS were NOK 1 500 (EUR 184) and NOK 750 (EUR 92) respectively. Excess contributions were not entitled to any deduction and at the same time unused contribution room could not be carried forward to the following year.

2.10 The United Kingdom: Personal Equity Plans (PEPs), Tax-Exempt Special savings Accounts (TESSAs), Individual savings Accounts (ISAs), the Saving Gateway, The Child Trust Fund, tax-preferred life-insurance contracts

2.10.1 Personal Equity Plans (PEPs)

Personal Equity Plans (PEPs) were tax-free accounts targeted at equity based products. Earnings accrued on funds deposited were tax-free. PEPs were characterized by annual contribution limits. Funds could be withdrawn whenever the investor liked and withdrawals were tax-free.

Personal Equity Plans were introduced in 1987 and the ability to make further subscriptions to PEP accounts ended on 5 April 1999. However, PEP investments in existence before 5 April 1999 continue to benefit from tax relief.

Individuals eligible to contribute to a PEP were UK residents who were at least 18 years old.

The government introduced tax-preferred Personal Equity Plans to encourage individuals to consider saving in equity based products. Thus, cash was allowed in PEPs but only for the purpose of buying equity. Investments allowed include:

- Direct holdings in shares or securities issued by companies listed on a recognised stock exchange anywhere in the world,
- Units or shares in unit trusts and open-ended investment companies which are Financial Services Authorities (FSA) authorised UCITS, warrants or securities schemes or overseas UCITS schemes that do not provide ‘cash-like’ returns,
- Shares in investment trust companies, provided they do not receive eligible rental income.

The *fiscal treatment* of PEPs was the following: contributions were made out of taxed earnings, earnings accrued tax-free and withdrawals were not taxed either. Capital growth on assets was not taxed. Contributions to PEPs were not deductible and capital losses made were not deductible against capital gains made elsewhere. The aforementioned preferred fiscal treatment was counterbalanced by

- *Annual limits on the amount of contributions to a single PEP:* from 1990 the annual limit on general PEPs rose to GBP 6 000 a year and from 1992 a further GBP 3 000 a year could be invested in a single company PEP⁴⁴ (combined

investment limit of GBP 9 000 each year). The maximum that could be subscribed in to any PEP over the 12 years was GBP 91 200.

- *Limits on the number of PEPs which can be opened per person:* from 1987 to 1991, an individual could subscribe to only one PEP in any given year. From 1992 to 1999 an individual could subscribe to a general and a single company PEP⁴⁵ with a combined investment limit of GBP 9 000 each year.

Regulation of Personal Equity Plans did not set any limit on the duration of the account: funds were never locked away. Consequently, there were no penalties on withdrawals: funds could be withdrawn whenever the investor wished.⁴⁶

2.10.2 Tax-Exempt Special Savings Accounts (TESSAs)

Tax-Exempt Special Savings Accounts (TESSAs) were tax-free accounts targeted at cash products. Earnings accrued on funds deposited were tax-free. TESSAs were characterized by annual contribution limits. Funds could be withdrawn tax-free only after five years. Early withdrawals were taxable.

Tax-Exempt Special Savings Accounts were introduced on 1 January 1991 and no new TESSA could be opened after 5 April 1999. However, existing TESSA accounts continued to receive subscriptions until maturity. By 5 April 2004, all TESSAs had matured and thus these tax-preferred savings accounts ceased to exist.

The government introduced TESSAs with the aim of encouraging saving, in particular saving over the medium-term.

Individuals eligible to contribute to a TESSA were UK residents who were at least 18 years old.

The *fiscal treatment* of the TESSAs was the following: contributions were made out of taxed earnings, earnings accrued tax-free and withdrawals were not taxed either. Contributions were not deductible. The tax-preferred treatment of Tax-Exempt Special Savings Accounts was counterbalanced by:

- *Annual and overall capacity limits:* TESSA allowed annual subscriptions of up to GBP 3 000 in the first year and then up to GBP 1 800 in each of the four following years, to a total maximum of GBP 9 000 in subscriptions over the 5 years. On maturity of a TESSA, the capital only (not any interest that had accrued) could be rolled over into a follow-up TESSA, no additional subscriptions could be made, even if the total capital rolled over was less than GBP 9 000.⁴⁷ If the investor deposited more than allowed, the account ceased to be a TESSA and all the interest earned was taxable in the year the TESSA ceased.
- *Funds deposited in the account were blocked for five years* (and a further five years for any follow-up TESSA). If any capital was withdrawn, the account ceased to be a TESSA and all the interest earned was taxable in the year it ceased (this is the penalty on early withdrawals). Interest withdrawals were allowed but only of ‘net interest’ paid in to the account (*i.e.* the amount of interest that would otherwise have been paid or have accrued after tax).⁴⁸
- *Restrictions on the number of accounts held:* an individual could only ever hold one TESSA or one ‘Follow-on’ TESSA.⁴⁹

Only cash deposits were allowed.

2.10.3 Individual Savings Accounts (ISAs)

Individual Savings Accounts (ISAs) are tax-free accounts targeted both at cash and equity products. Earnings accrued on funds deposited are tax-free. ISAs are characterized by annual contribution limits. Funds can be withdrawn tax-free whenever the investor wishes.

Individual Savings Accounts (ISAs) were introduced on 6 April 1999. In the 2005 budget, the government announced the extension of the current ISA guarantee to 2010 (originally given to 2009) as well as extending the current ISA limits of GBP 7 000 with a maximum of GBP 3 000 in cash until April 2010. In 2006, the government is committed to a review of how ISA is working with a view to making any changes in 2009 when the 10-year commitment ends.

In 1997, half the UK adult population hardly saved at all. To encourage personal savings, the government introduced Individual Savings Accounts (ISAs), extending the principle of TESSAs and PEPs, continuing to offer favourable tax relief for saving. Through ISAs, the government aimed to encourage the saving habit of those who had never saved before, especially those on low incomes. ISAs provided easier accessibility to funds and greater choice allowing savers to save in a wider range of products than their predecessors (*i.e.* TESSAs and PEPs). ISAs give savers instant access to their funds unlike TESSAs. The latter had a five year lock-in for funds. Those who felt that they were not prepared to lock away their funds, especially those with less to save, are now able to save in an ISA.

All UK residents over the 18 years of age are eligible to invest in the Individual Savings Accounts (ISAs).⁵⁰

The *fiscal treatment* of ISAs is the following: contributions are made out of taxed earnings, earnings accrue tax-free and withdrawals are not taxed either. Capital growth on assets is not taxed. Contributions to an ISA are not deductible for personal income tax purposes and capital losses made are not deductible against capital gains made elsewhere. The preferred tax treatment of the ISAs is counterbalanced by:

- *Annual contribution limits.* Investment can either be in a Maxi ISA⁵¹ or (until 5 April 2005) up to three Mini ISAs⁵² with different providers - investing up to GBP 3 000 in cash products, up to GBP 1 000 in insurance products and up to GBP 3 000 in stocks and share products.⁵³ Excess contributions are not allowed. Where subscriptions exceed the annual limits, the account may be voided and tax relief on savings in that year repayable. Unused contribution room cannot be carried forward to the following tax year.
- *Limits on the number of accounts which can be held.* In any year, an individual can subscribe to either One Maxi ISA; or One Mini cash ISA (GBP 3 000); and One Mini insurance ISA (GBP 1 000 up to 5 April 2005) and One Mini Stocks and Shares ISA (GBP 3 000 to 5 April 2005; GBP 4 000 from 6 April 2005). Individuals can also continue to hold ISA accounts bought in previous years; they are not required to continue subscribing to the same account year on year.

The legislation does not prescribe that funds are locked away for a certain period in ISAs. Thus, no *penalties* are imposed by the legislation on early withdrawals from ISAs. Funds can be withdrawn whenever the investor likes. Individual investment products may have rules to allow them to reduce interest rate returns for early withdrawal but these must be explicit in the contract entered into by the investor. However, there is still a small

penalty: once funds have been withdrawn before the end of the plan, and if the capacity limit of the account has previously been reached, funds cannot be put back again in the ISA.⁵⁴ Any payment into the account is treated as a new subscription, even if it is intended as a replacement of amounts withdrawn. Where an investor has not used up the maximum annual limit for new subscriptions in any year, she/he can then use the balance of that annual limit to 'replace' amounts withdrawn.

The variety of assets allowed in the Individual Savings Accounts is quite wide and varies according to the different component of the ISA.

The cash component allows savings in:

- Cash deposit accounts.
- Investments in units or shares in unit trusts and open-ended investment companies which are:
 - Authorised by the Financial Services Authority (FSA) under the CIS Sourcebook as 'money market' schemes.
 - FSA authorised Undertakings for Collective Investment in Transferable Securities (UCITS)⁵⁵, warrants or securities schemes or overseas UCITS schemes that provide returns that are 'cash-like' in nature.
 - 'Funds of funds schemes' authorised by the FSA under the CIS Sourcebook that invest in the schemes set out above.
- National Savings products designed for ISAs.
- Units or shares in unit trusts and open-ended investment companies which are FSA authorised UCITS, warrants or securities schemes or overseas UCITS schemes that provide 'cash-like' returns.

Stocks and shares component of the ISA allows investments in:

- Direct holdings in shares or securities issued by companies listed on a recognized stock exchange anywhere in the world.
- Units or shares in unit trusts and open-ended investment companies which are FSA authorised UCITS, warrants or securities schemes or overseas UCITS schemes that do not provide 'cash-like' returns.
- Investment trust companies, provided they do not receive eligible rental income.
- Government securities.
- Depositary interests.

The insurance component allows investment in life-insurance policies including "Unit linked" or "Investment linked" policies and "With profits" policies. This component will be merged with the Stocks and Shares component rules from 6 April 2005: insurance products will be subject to the same ISA rules as units or shares in unit trusts and open ended investment companies, including limit on cash like products.

The following assets are not allowed; regarding the Cash component: general National Savings Products (Investment Account, Savings Certificates, and Pensioners' Guaranteed Income Bonds); regarding the Stock & Shares component: shares dealt on secondary markets such as Alternative Investment Market (AIM) or shares traded on the

OFEX⁵⁶, shares in unquoted companies, and direct investment in warrants, futures and options.

The ISA legislation does not impose limits on charges made by ISA providers or on investments held within the ISA. However, with the aim of encouraging the saving habit especially of those who never saved before, the Treasury Charges Access Terms (CAT) standards were introduced in 1999 to complement the ISA regime. These were non-legislative guidelines for products that had limits on charges, provided easy access to funds and had simple terms and conditions. Providers could market their ISA products as CAT standard if they satisfied the guidelines set.

From April 2005 CAT standards will cease to exist and will be replaced by 'stakeholder products' which are simple, low-cost, risk controlled savings and investment products. These are set out in legislation and were brought into the ISA as qualifying savings or investment products on 6 April 2005.

The government will also extend the list of qualifying ISA investments to include from April 2006 all FSA-authorised (or recognized for non-UK schemes) retail investment schemes, provided schemes do not place limits on investors' ability to access their savings. This will allow new products in Individual Savings Accounts.

2.10.4 Saving Gateway

The Saving Gateway is a pilot project targeted at low to middle-income households. The government matches the savings of individuals at different rates. Earnings accrued on funds deposited are taxable. The government saving bonus is limited to a certain amount. Withdrawals of funds before 18 months entail the loss of entitlement to the saving bonus.

The Saving Gateway is a pilot scheme established in 2002. The first pilot project started in August 2002 and came to an end in November 2004 with an evaluation in March 2005. The Chancellor announced a larger, GBP 15 million Saving Gateway pilot in the 2004 Pre-Budget report, to run from 2005 until 2007. The aim of the second pilot project is to investigate alternative rates of matching and measure the impact of matching for a wider range of income groups in order to build on this evidence-base and to evaluate the future role matching could play in government support for savings.

Any decisions about the future of the Saving Gateway will be made in light of the evidence from this second pilot. In the second pilot, there are no charges on participants and all costs for managing the accounts are borne by the government or the Halifax Bank. The second Saving Gateway pilot will test alternative match rates, different monthly contribution limits, the effect of an initial endowment, and the support of a wider range of community financial education bodies. It will also be made available to a wider range of income groups than the first pilot. The pilot will inform the development of matching as a central pillar in the government's strategy for promoting saving and asset ownership.

The Saving Gateway is targeted at low to middle-income earners and it aims at delivering strong, transparent incentives to save regularly through government matching rather than through tax relief.

Investors could have a Saving Gateway account in the first pilot if they are of working age (between 16 and 65, or 60 for women), and satisfy one or more of the following conditions:

- The investor has children and household earnings of less than GBP 15 000 a year.
- The investor has a disability and household earnings of less than GBP 15 000 a year.
- The investor does not have children or a disability and has individual earnings are less than GBP 11 000 a year.
- The investor is out of work and receiving benefits.

In the second pilot, investors can have an account if they have been invited and are aged 16-65 and one of the following applies:

- They are out of work and receiving benefits.
- In work and earning less than GBP 25 000 a year with a household income of less than GBP 50 000 a year.

The saving incentive in this type of accounts is delivered through government spending via ‘matching’ rather than more traditional tax relief. For every pound an investor saves, the government matches the individual’s saving (from 20% to 100%), up to a limit. Limits are different across different areas of the pilot. The maximum amount the government contributes to people’s savings is GBP 400. Investors receive their government contributions when their accounts mature, after 18 months.

For the second Saving Gateway scheme, the limits differ across the six pilot areas. For example, in one area people can pay in the account GBP 25 per month, up to an overall limit of GBP 400. Generally, the monthly limits range from GBP 25 to GBP 125 but the maximum contribution is always GBP 400. The final government saving bonus is calculated according to the match rates: it could be GBP 1, GBP 2 or GBP 5 for every pound saved, according to the different areas.

The saving incentive is counterbalanced by the following measures:

- Fiscal treatment: government contributions are treated as capital gains or payments for tax purposes. Therefore, this could be covered by the GBP 8 200⁵⁷ capital gains exemption.
- Limits on the number of accounts which can be held: only one account per person can be held.
- *Penalties on early withdrawals*: even if the saver can always withdraw funds, he/she is not entitled to receive any more contributions from the government until the money withdrawn is saved back in the Saving Gateway account. Government contribution cannot be withdrawn from the Saving Gateway account until the account has matured.
- *Unused contribution room*: the unused contribution room in one month does not roll over to the following one. The account lasts for 18 months and investors can save the maximum amount if they save for 16 out of the 18 months. This allows them to miss a month but not miss out on maximising their contributions. After 18 months the account matures and this is the end of their Saving Gateway account.

Only cash is allowed in the Saving Gateway and if at least GBP 1 is left in the account, money can be withdrawn straight away.⁵⁸

2.10.5 Child Trust Fund (CTF)

The child trust fund is a universal scheme. The government deposits an initial saving bonus in the account. Earnings accrued on funds deposited are tax-free. Withdrawals of funds before 18 years of age are not allowed. Withdrawals after 18 years of age are tax-free.

The Chancellor of the Exchequer announced his intention to introduce the Child Trust Fund (CTF) in the April 2003 Budget. The Child Trust Funds Act 2004 received Royal Assent on 13 May 2004 and the main Child Trust Fund Regulations subsequently came into force on 27 May 2004. The Child Trust Fund was formally launched on 11 January 2005 and vouchers began to be issued that same month. Government payments will go into accounts from 6 April 2005 and parents – and others – will be able to make contributions to accounts from the same date.

The policy objectives of the Child Trust Fund are to:

- Help people understand the benefits of saving and investing.
- Encourage parents and children to develop the saving habit and engage with financial institutions.
- Ensure that in future all children have a financial asset at the start of adult life.
- Develop financial education to help people make better financial choices throughout their lives.

Children are eligible for a CTF account if:

- They were born on or after 1 September 2002.
- Child Benefit has been awarded for them.
- They are living in the UK.
- They are not subject to immigration control.

Children of Crown Servants working overseas are also eligible where Child Benefit has been awarded for them. Children looked after by local authorities (and who do not receive Child Benefit) also qualify for Child Trust Fund.

The *fiscal treatment* of the Child Trust Fund is the following: account holders (the children) will not pay income tax or capital gains tax on their CTF savings and investments. The UK income tax settlements legislation is not applied to parents' contributions to the Child Trust Fund.⁵⁹ There will not be any tax charge when the Child Trust Fund account matures at the child's 18th birthday. These tax advantages will cease when the Child Trust Fund account matures on the account holder's eighteenth birthday.

The CTF is a long-term savings and investment policy under which the government makes payments (GBP 250 for 2005) to eligible children and can only be used to open accounts. There is an additional payment for children in low-income families (*i.e.* an additional GBP 250 for 2005).⁶⁰ The government has announced that further top-up payments will be made directly into CTF accounts when children reach the age of seven.

The preferred fiscal treatment is counterbalanced by the following measures:

- *Maximum contribution limits:* a maximum of GBP 1 200 a year may be contributed to each individual Child Trust Fund account. The start date for each

year is the child's birthday, except in the first year. In the first year the start date is the day the account is opened and the end date is the day before a child's next birthday. Government contributions to Child Trust Fund accounts do not count towards this limit. The treatment of contributions in excess of those allowed is not covered by the Child Trust Fund legislation. The treatment will depend on the individual terms and conditions applied by providers to excess contributions. Unused contribution room cannot be carried forward to the following year.

- Limit on the number of accounts which can be held: only one account per child is allowed.
- *Funds locked away.* Money may not be withdrawn from a Child Trust Fund until the account holder is eighteen.⁶¹ When the account holder reaches eighteen (or in cases when funds are released before eighteen because the account holder is terminally ill), funds may be accessed and used without restriction.⁶²

Investment in cash is allowed in CTF savings accounts. Equity is allowed in CTF Accounts that invest in shares and in Stakeholder CTF accounts.⁶³ Bonds and other fixed-income assets are allowed in Stakeholder CTF accounts. The list of assets not allowed in a Child Trust Fund essentially mirrors the assets which are not allowed in an Individual Savings Accounts. Details are set out in The Child Trust Funds Regulation 2004 (SI 1450/2004). In brief, the assets allowed in a Child Trust Fund are:⁶⁴

- Company shares listed on a recognised stock exchange.
- Company securities listed on a recognised stock exchange.
- Shares and securities in certain listed investment trusts.
- Units and shares in certain types of unit trust and open-ended investment companies.
- Units and shares of Undertakings for the Collective Investment of Transferable Securities (UCITS).
- Cash held with a bank or building society.
- Certain types of life insurance policy.
- Gilts and gilt strips.

Regulations for the Child Trust Fund set a 1.5% per annum cap on charges for administering a Stakeholder Child Trust Fund account. There is no limit for charges on other Child Trust Fund accounts.

2.10.6 Life-insurance contracts

There are two types of Tax-preferred life-insurance policies: Qualifying Policies (QPs) and Friendly Society Tax-Exempt Savings Policies (TESPs). For QPs, income and gains are treated as already taxed at a 20% rate and no further taxes on gains are levied. For TESPs, income and gains are exempt and there are annual limits for the premia which can be paid. Funds are locked for at least ten years for both QPs and TESPs.

Qualifying Policies (QPs)

The qualifying policy regime was introduced in 1968 as part of the chargeable event gain rules. Previously, gains on life policies were not subject to personal tax at all and premia attracted relief. This led to widespread avoidance of personal income tax. The aim of the chargeable event rules was to restrict both life assurance premium relief (LAPR)⁶⁵ and exemption to higher-rate tax on gains for long term policies meeting certain conditions. Overall, the 1968 changes were anti-avoidance legislation.

There are no restrictions for eligibility to Qualifying Policies. The latter are sold by UK insurers (*i.e.* insurance companies and friendly societies) and anyone can invest in them.

The *fiscal treatment* of Qualifying Policies is the following. Income and gains on the underlying insurers' funds are taxed on the insurer at the lower (also known as the savings) rate, currently 20%. Because of the tax suffered by the insurer, gains in the policyholder's hands are treated as having had lower rate tax already paid at 20%. But if the policy is a QP then the policyholder has no income tax to pay on gains made on the policy.⁶⁶ There is no tax to pay by the QPs policyholder on any gains arising.

There are no investment limits for Qualifying Policies.

There are no restrictions explicitly imposed by the QP tax rules on the type of assets that funds can be invested in.⁶⁷

The QP rules provide that the duration of policies must be at least ten years or three-quarters of the term if earlier, to avoid taxable gains arising.

Friendly Society Tax-Exempt Savings Policies (TESPs)

There has been provision for tax-preferred life policies from friendly societies since as long ago as 1806, although the evolution of the current TESP rules really began in 1966. Originally, the rationale for allowing friendly societies to sell tax preferred policies was that members would be of low income and outside the scope of income tax. Also, such policies were to provide benefits in old age and protection in the event of sickness or death. Thus, they were regarded as a good thing to be encouraged. By 1966, most members were paying income tax but the tax exemption was kept as it was seen as being in line with the purpose the exemption was introduced for – to help the less well-off by providing “life assurance for small periodical contributions payable at short intervals”.

TESPs can only be sold by friendly societies and any member of a friendly society can invest in them. There are no membership restrictions by friendly societies to prospective investors so effectively anyone can invest in them.

The *fiscal treatment* of TESPs is the following. Income and gains on the underlying friendly society funds are exempt from tax – this is what is meant by the policies being ‘tax exempt’. TESPs are always written as qualifying policies to ensure that there is no income tax on the gains in the policyholders' hands. Funds must be held for at least 10 years, or three-quarters of the term if earlier, to avoid taxable gains arising.

Premia which investors may pay into TESPs in each year are restricted to a total of GBP 300 (*i.e.* GBP 25 per month) if premia are paid more frequently than annually, or GBP 270 if premia are paid annually.⁶⁸ If the TESP limit is exceeded then the policy ceases to be tax exempt and income and gains on the underlying funds become taxable on the insurer. In addition, the policy cannot be qualifying and any gains arising are taxed in

full to the policyholder without any lower rate tax being treated as paid. Unused contribution room cannot be carried forward to the following year.

An individual can open any number of TESP, but the total premia invested into all TESP in any one year must not exceed the overall TESP limit of GBP 270 (or GBP 300 for regular saving). In practice, it would be rare for a person to take out more than one TESP and split the allowance given the relatively low limits.

Regarding the assets in which funds can be invested, there are no restrictions explicitly imposed by the TESP tax rules. In the event that funds are invested in personal assets, the policies may fall within the scope of another set of anti-avoidance tax rules (the Personal Portfolio Bond Regulations). Otherwise, the only restriction will be those imposed generally on UK life insurers by the regulatory body, the Financial Services Authority (FSA).

2.11 The United States: Educational Savings Accounts (ESAs), 529 plans, Flexible Spending Accounts (FSAs), the Health Reimbursement Arrangements (HRAs), Health Savings Accounts (HSAs), Medical Savings Accounts (MSAs), Tax-preferred life-insurance contracts

2.11.1 Educational Savings Accounts (ESAs)

Educational Savings Accounts (ESAs) are plans established for financing education. Contributions to ESAs are not deductible. Earnings accrue tax-free in the account. Qualified withdrawals are tax-free if the distributions are of equal or lesser value than the total qualified education expenses incurred by the beneficiary in the same year as the withdrawal. In the case of non-qualified withdrawals, amounts in excess of basis are subject to the beneficiary's Personal Income Tax plus a 10% penalty. The accounts are characterized by contribution limits.

The Taxpayer Relief Act of 1997 created Education IRAs, which allow tax free earnings on savings that are used to finance qualified educational expenses. The Economic Growth and Tax Reform Reconciliation Act of 2001 increased Educational IRA contribution limits from USD 500 to USD 2 000 and allowed tax free withdrawals for elementary and secondary school expenses. Education IRAs were also renamed Coverdell Education Savings Accounts (ESAs) in 2001.

Education IRAs were introduced in 1997 to help families save for their children's education. The program was expanded in 2001 in order to provide greater flexibility to more families by increasing the contribution limit, increasing income eligibility limits, extending the definition of a qualified educational expense to include primary and secondary education, and adding additional flexibility for special needs beneficiaries.

Any individual under 18 may be the designated beneficiary of an ESA. Contributions to an ESA will not be accepted after the designated beneficiary reaches his/her 18th birthday (unless the beneficiary is a special needs beneficiary). Total annual contributions to a single beneficiary from all eligible contributors are capped at USD 2 000. Contributions can be made, without penalty, to both a Coverdell ESA and a qualified tuition plan in the same year for the same beneficiary. An individual may contribute up to USD 2 000 to each beneficiary's ESA. Individuals who make contributions are subject to an income limitation regarding their maximum contribution per beneficiary (along with any limitation imposed by the USD 2 000 cap on total

contributions per beneficiary). The maximum contribution of USD 2 000 phases out between USD 95 000 and USD 110 000 (between USD 190 000 and USD 220 000 for married taxpayers filing jointly). Taxpayers with modified adjusted gross income above USD 110 000 (USD 220 000 for married taxpayers filing jointly) may not make contributions to anyone's ESA. A taxpayer does not have to be related to the designated beneficiary in order to contribute to the designated beneficiary's ESA. Organizations may also contribute to ESAs. Organizations are not subject to income limits, but are subject to the USD 2 000 cap on total contributions.

The *fiscal treatment* of the Educational Savings Accounts (ESAs) is the following⁶⁹. Contributions to ESAs are not deductible. Earnings accrue tax-free in the account. Qualified withdrawals are tax-free if the distributions are of equal or lesser value than the total qualified education expenses incurred by the beneficiary in the same year as the withdrawal. Qualified expenses generally include only out-of pocket expenses, thus total qualified expenses are reduced by any amounts covered by scholarships and other educational assistance excluded from income. Beneficiaries must be less than 30 years old to receive tax-free treatment of distributions. In the case of non-qualified withdrawals, amounts in excess of basis are subject to the beneficiary's Personal Income Tax plus a 10% penalty. The penalty is waived in certain cases including death of the beneficiary, disability, scholarship and most other educational assistance. If the non-qualified withdrawal is less than the account balance, the allocation of proceeds to basis and earnings is done on a pro-rata basis. Account balances may be rolled over or transferred tax-free from one beneficiary to another within the same family. Account balances remaining in an account once the beneficiary turns thirty will be deemed an unqualified distribution (and subject to relevant taxes and penalties).

Once funds have been withdrawn, they can be returned to the account within 60 days. After that time the funds would be considered an unqualified withdrawal (and subject to income tax and possibly a 10% penalty on the share of the withdrawal attributable to earnings). Up to USD 2 000 of the funds could be returned to the account, but would count toward the USD 2 000 annual contribution limit.

A loss on the investment in an ESA may be taken on to the income tax return of the beneficiary. The beneficiary can take the loss only when all amounts from the account have been distributed and the total distributions are less than the total amount of contributions to that ESA. The loss may be claimed as a miscellaneous itemized deduction (subject to other eligibility requirements).

Contributions to ESAs are considered completed gifts and are treated as such for gift tax purposes. ESA contributions count toward the USD 11 000 annual limit on gift tax exclusions.

The annual contribution limit to a given beneficiary is USD 2 000 from all contributors, regardless of the number of ESAs the beneficiary may hold. The one exception to this limit occurs in the case of transfers of account balances from the original beneficiary to a new beneficiary within the same family. Contributions other than rollovers may not be made after the designated beneficiary reaches 18 years of age. The beneficiary must pay a 6% excise tax each year on excess contributions that are in an ESA at the end of the year. The excise tax does not apply if excess contributions (and any earnings on them) are distributed before the first day of the sixth month of the year following contribution. To avoid the excise tax in future years, one may take the excess amount as a distribution (subject to relevant taxes), or limit next year's total contributions

to USD 2 000 minus current excess contributions. The unused contribution room may not be rolled over to the following year.

There is no limit on the number of accounts that an investor can set up for different beneficiaries. There is no limit to the number of ESAs that can be established for one beneficiary. The contributions can only be made in cash and the total contributions made to all ESAs for any beneficiary in one tax year may not be greater than USD 2 000.

Contributions to Education IRAs⁷⁰ must be made in cash. Money in the account may not be invested in life insurance contracts, nor may it be combined with other property except in a common trust fund or common investment fund. Money may otherwise be invested in any manner allowed by the trustee of the account (*e.g.* investments in bonds or equity).

There is no defined duration of the plan. The plan has to be opened before the beneficiary is 18 years old and any balance in an ESA must be distributed within 30 days after the date the beneficiary reaches age 30. These age limits will not apply to beneficiaries with special needs.

The amount remaining in the account may be withdrawn for the designated beneficiary or has to be distributed when he/she reaches 30 years of age. The designated beneficiary will be subject to both income tax and the additional 10% tax on the portion of the amount withdrawn that represents earnings if the designated beneficiary does not have any qualified higher education expenses in the same taxable year he/she makes the withdrawal. Alternatively, if the amount in the designated beneficiary's ESA is withdrawn and rolled over to another ESA for the benefit of a member of the designated beneficiary's family, the amount rolled over will not be taxable.

2.11.2 529 plans

529 plans are plans established for financing education (also called Qualified Tuition Plans). Contributions to 529 plans are not deductible. Earnings accrue tax-free in the account. Qualified withdrawals are tax-free if the distributions are of equal or lesser value than the total qualified education expenses incurred by the beneficiary in the same year as the withdrawal. In the case of non-qualified withdrawals, amounts in excess of basis are subject to the beneficiary's Personal Income Tax plus a 10% penalty. The accounts are characterized by contribution limits set by the states. They do not have duration limits.

Prepaid tuition plans were established in the late 1980s and early 1990s by a handful of states. The goal of the plans is to help families at all income levels provide for their children's higher education.

A court ruling held that assets in a state run prepaid tuition plan were state assets, and thus the Federal government had no right to tax the earnings on the assets while in the plan. Thus, contributions to the plan were not deductible under the Federal income tax, but earnings on the accounts accrued tax-free and were only taxed when they were distributed. To qualify for such federal income tax treatment, however, the individual's control over the investment of the funds after contributing to the plan needed to be very restricted.

The Small Business Job Protection Act of 1996 created Section 529 which codified this earlier court ruling granting federal income tax deferral for the State-run plan's

investment earnings. Between 1996 and 2000, 12 states added a tuition plan and 30 states added a savings plan.

The 2001 Economic Growth and Tax Relief Reconciliation Act (EGTRRA) allowed the exclusion from income of distributions from state-run 529 plans for qualified educational expenses. EGTRRA also allowed private institutions to establish qualified programs, but earnings on the accounts were taxed upon distribution. In 2004, the preferential treatment of earnings in state-run plans was extended to the plans of private institutions.

Currently all 50 states and the District of Columbia administer savings plans and 19 states have prepaid tuition plans. The Tuition Plan Consortium has begun a prepaid tuition plan for private colleges and universities. All 50 states and the District of Columbia currently offer a college savings plan. In general, these plans are managed by the 50 states. States may restrict investment access to their plans to state residents.

The *fiscal treatment* of 529 plans is the following. Contributions to 529 plans are not deductible. Earnings accrue tax-free in the account. Qualified withdrawals are tax-free if the distributions are of equal or lesser value than the total qualified education expenses incurred by the beneficiary in the same year as the withdrawal. Qualified expenses generally include only out-of-pocket expenses, thus total qualified expenses are reduced by any amounts covered by scholarships and other educational assistance excluded from income. In the case of non-qualified withdrawals, amounts in excess of basis are subject to the beneficiary's personal income tax plus a 10% penalty. The penalty is waived in certain cases including death of the beneficiary, disability, scholarship and most other educational assistance. If the non-qualified withdrawal is less than the account balance, the allocation of proceeds to basis and earnings is done on a pro-rata basis. Account balances may be rolled over or transferred tax-free from one beneficiary to another within the same family.

A loss on the investment in a 529 plan may be taken on to the income tax return of the beneficiary. The beneficiary can take the loss only when all amounts from the account have been distributed and the total distributions are less than the total amount of contributions to that 529 plan. The loss may be claimed as a miscellaneous itemized deduction (subject to other eligibility requirements).

Contributions to 529s plans are considered completed gifts and are treated as such for gift tax purpose. In other words, count as gifts against the annual USD 11 000 gift-tax exclusion and, if greater, against the unified estate- and gift-tax credit. However, 529 plans enjoy the benefit of a federal 5 year-averaging provision, so that up to USD 55 000 may be contributed in a single year without counting against the unified credit.

The designated beneficiary is generally the student (or future student) for whom the 529 plan is intended to provide benefits. The designated beneficiary can be changed after participation in the 529 plan begins. A 529 plan may be established by anyone, including non-relatives, for a designated beneficiary. There are no income restrictions on the individual contributors. Certain tax-exempt organizations may purchase an interest in a 529 plan as part of a scholarship program; the designated beneficiary is the person who receives the interest as a scholarship.

The 529 plans run by the 50 states and the District of Columbia may restrict investment in their plans to state residents.

Contributions to a 529 plan on behalf of any beneficiary cannot be more than the amount necessary to provide for the qualified education expenses of the beneficiary (as set by each State). Maximum account overall balance limit per beneficiary may be as high as USD 300 000 for some state 529 plans. In general, prepaid tuition plans cover up to 5 years of college costs. A 529 plan may not accept contributions in excess of the amount necessary to provide for the qualified higher education expenses of the beneficiary; the individual states determine the precise limit for their local plans. A program that accepts excess contributions will be disqualified from treatment as a 529 plan.

There is no limit on the number of 529 plans that can be opened per beneficiary.

There is neither general limit nor age limit to the duration of the plans.

All distributions that are not used for qualified educational expenses are considered taxable distributions. The portion of the distribution that represents earnings will be taxed as ordinary income. The taxable portion of the distribution is also subject to a 10% additional tax unless certain exceptions apply. These exceptions include distributions due to: a) death or disability of the designated beneficiary, b) receipt of a tax-free scholarship or fellowship, c) receipt of other non-taxable educational assistance by the beneficiary, d) attendance of the beneficiary at a US military academy. The exceptions only apply to the extent that distribution is no larger than the value of the scholarship, allowance, or payment. Distributions for education expenses that count toward Hope and Lifetime learning credits are also exempt from the additional tax.

The amount remaining in the account upon completion of the beneficiary's education may be withdrawn by the designated beneficiary. The designated beneficiary will be subject to both income tax and the additional 10% tax on the portion of the amount withdrawn that represents earnings if the designated beneficiary does not have any qualified higher education expenses in the same taxable year he/she makes the withdrawal. Also, assets can be rolled over or transferred to the 529 plan of a family member of the designated beneficiary without incurring any tax liability.

Contributions or (purchases of shares in a pre-paid tuition plan) must be in cash. Because these are largely state run plans, there are no federal rules guiding the investment of funds. Contributors may not directly or indirectly direct the investment of their contributions (or of any resulting earnings). Investments may not be used as security for a loan.

Two major types of Qualified Tuition Plans (529 Plans) are available: the prepaid tuition program and the college savings plan.

Prepaid Tuition Program

Under a prepaid tuition program, eligible expenses for a fixed period of time or a fixed number of credits are prepaid at an eligible educational institution or set of institutions (most often within state). For example, an individual may make prepayments for two future semesters at the state university at today's price. The prepayment guarantees the beneficiary two semesters, regardless of the future price. This means that the program manager bears the risks of poor returns on the chosen investments. There is currently one private sector plan available to contributors. This plan, called the Independent 529 Plan, lets the contributor pay today's prices for future tuition at one of the more than 220 private colleges participating in the plan. Contributions to any Prepaid Tuition Program are limited to amounts necessary to pay the beneficiary's qualified

education expenses. Prepaid Tuition Programs are required to provide adequate safeguards to prevent contributions in excess of this amount.

Participants in 529 prepaid tuition plans may withdraw from their plans. The formula used to determine the current value of the original tuition purchase is generally determined by the plan or the state. Plans established by one or more educational institutions must obtain IRS approval.

College Savings Plan

Under a college savings plan, amounts are contributed up to the dollar limit of the plan. The plan or its agents invests the money. The account balance can later be used to pay qualified expenses at any qualified higher education institution. All 50 states and the District of Columbia currently offer a college savings plan. As with Prepaid Tuition Programs, contributions to College Savings Plans are limited to amounts necessary to pay the beneficiary's qualified education expenses. These plans are required to provide adequate safeguards to prevent contributions in excess of this amount.

2.11.3 Flexible Spending Arrangements (FSAs)

Flexible Spending Arrangements (FSAs) are plans established for financing medical expenses. Contributions to FSAs come from gross income. There are normally no earnings in the account. Withdrawals are possible only for qualified medical expenses. Payments outside the scope of the account are not allowed. Unused funds at the end of the year are forfeited.

Section 125 of the Internal Revenue Code was enacted in 1978. It allows employees a choice between cash and certain tax-preferred benefits. At that time, some employers were already providing Flexible Spending Accounts-type benefits. Proposed regulations were issued in 1984 to provide specific guidance about the requirements relating to Health FSAs. The regulations specifying the rules for health FSAs were issued to limit certain employer activities that had already taken place without explicit authority. Participation in a health FSA lowers the employee's out-of-pocket cost of medical care and helps the employee to pay for unexpected medical expenses. Flexible Spending Arrangements are an employee benefit offered as a reimbursement account or a similar arrangement through which employees are reimbursed for medical expenses or a dependant's care expenses.

The *fiscal treatment* of the Flexible Spending Accounts is the following. An employee contributes to an FSA by electing an amount to be voluntarily withheld from his/her pay by the employer. This is called a salary reduction agreement. The employer may also contribute to the FSA if specified in the plan. The employee does not pay federal income tax or employment taxes on the salary he/she contributes or the amounts the employer contributes to the FSA. Funds in a health FSA can be used only to reimburse qualified medical expenses of the employee, his/her spouse, or dependants incurred during the plan year.

Employees whose employers declare eligible within statutory guidelines can participate in an FSA. Both employers and employees can contribute to an FSA. Self-employed persons are not eligible for an FSA.

At the beginning of the plan year, the employee must designate how much he/she wants to contribute. Then, the employer will deduct amounts periodically (generally, each

pay date) in accordance with the employee's annual election. Neither excess contributions nor unused contribution room can occur. Unused funds in an FSA at the end of the plan year must be forfeited.

Payments not within the scope of the arrangement are not allowed. Funds in a health FSA can only be used to reimburse qualified medical expenses incurred by the employee, the spouse, or dependants during the period of coverage. The employee must be able to receive the maximum amount of medical reimbursement (the amount the employee has elected to contribute for the year) on the first day of the coverage period. If an FSA provides for payments or benefits irrespective of the scope of the arrangement, all amounts paid by the plan, including prior qualified reimbursements, become taxable for both federal income and employment tax purposes.

There are generally no earnings on an FSA. Rather, FSAs provide a predetermined amount of funds to reimburse the employee's qualified expenses. A "use it or lose it" provision prevents unused reimbursements being carried forward to future years.

2.11.4 Health Reimbursement Arrangements (HRAs)

Health Reimbursement Arrangements (HRAs) are plans established for financing medical expenses. Contributions to HRAs come from gross income. There are normally no earnings in the account. Withdrawals are possible only for qualified medical expenses. Payments outside the scope of the account are not allowed. Unused funds at the end of the year are forfeited.

In June 2002, the US Treasury and the Internal Revenue Service issued guidance that clarified the tax treatment of Health Reimbursement Arrangements (HRAs). More generally, the guidance on HRAs was issued to clarify the tax treatment of HRA-type health benefits. HRAs allow employees to have greater control over their health care spending and provide an additional plan choice for employment-based health coverage.

All employees whose employers declare eligible within statutory guidelines can participate in an HRA. A Health Reimbursement Arrangement (HRA) must be funded solely by the employer. The contribution cannot be paid through a voluntary salary reduction agreement on the part of an employee. Self-employed persons are not eligible for an HRA.

The *fiscal treatment* of Health Reimbursement Arrangements is the following. Contributions made by the employer to an HRA can be excluded from the employee's gross income for federal income tax purposes and from wages for employment tax purposes. HRAs may be used to reimburse employees for qualified medical expense at any time tax-free. If an HRA provides for payments or other benefits irrespective of medical expenses, all amounts paid by the plan, including prior medical reimbursements, become taxable for both federal income and employment tax purposes.

There are no statutory contribution limits for the HRAs but limits may be set by employers. Any unused amounts in an HRA can be carried forward to later years. There are limits on either the number of HRAs by which a person can be covered or on the duration of the account.

If an HRA provides for payments or other benefits irrespective of medical expenses, all amounts paid by the plan, including prior medical reimbursements, become taxable for both federal income and employment tax purposes.

2.11.5 Health Savings Accounts (HSAs)

Health Savings Accounts (HSAs) are plans established for financing medical expenses. Contributions to HSAs come from gross income. Earnings accumulate tax-free in the account. Withdrawals are tax-free if used for qualified medical expenses. Payments outside the scope of the account are taxable. Unused funds at the end of the year can be rolled over to the following year. There are contribution limits.

Health Savings Accounts were introduced on 1 January 2004. The new accounts are linked to high-deductible health insurance plans. The accounts are designed in part to help consumers pay for health expenses until insurance benefits kick in.

HSAs can be opened by any employee (not eligible for Medicare) who is covered by a qualified high-deductible (*i.e.* a minimum deductible of USD 1 000 for singles and USD 2 000 for families) and generally is not covered by low-deductible health insurance. A taxpayer may purchase a health plan on his/her own or through a qualified high-deductible health plan offered by an employer. Both the employer and the employee can contribute to a HSA.

The *fiscal treatment* of the HSA is the following. Contributions to the HSA are 100% deductible from an employee's gross income on federal tax return. Many states also allow the deduction from state income taxes. Interest and other earnings accumulate tax-deferred, and if used for qualified medical expenses, are tax-free. Contributions to a HSA made by an employer (including contributions made through a cafeteria plan) may be excluded from employee's gross income.

Every year employees are allowed to save 100% of the health plan's annual deductible, up to up to USD 2 650 for singles and USD 5 250 for families in 2005. Individuals who are 55 or over are permitted an additional contribution of up to USD 600 in 2005 (increasing to USD 1 000 in 2009). Unused contribution room cannot be carried forward to the following year. Excess contributions are not deductible. Excess contributions made by the employer are included in the employee's gross income. The beneficiary must pay a 6% excise tax on excess contributions.

HSA investors are allowed to hold multiple accounts, but are subject to a single annual contribution limit. One deductible per family is allowed.

There are no age limits on individuals eligible to contribute to an HSA, although individuals who are enrolled in Medicare (which includes most individuals age 65 or older) are not eligible to contribute.

Amounts distributed that are not used to pay for qualified medical expenses will be taxable under the personal income tax, plus, if the distribution is before age 65, a 10% penalty. Only amounts withdrawn erroneously may be re-contributed to an account. However individuals may under limited circumstances roll funds from one HSA over to another HSA. Any other contributions to the account are subject to the contribution limits regardless of whether funds were withdrawn.

After age 65, the investor may make withdrawals from her HSA for any reason without a penalty. However the withdrawals would be included in taxable income. Funds left in the account at the end of the year can be rolled over to grow with any future contributions. Funds left in the account on the death of the owner may continue to be used as an HSA by the owner's surviving spouse. If the spouse is not the beneficiary, the account is taxed to the beneficiary.

An HSA is permitted to last until the later to die of the owner or spouse.

An HSA is “portable” so it stays with the employee if she/he changes employers or leaves the work force. The amount that can be contributed (including any additional contribution) to an HSA has to be reduced by the amount of any contribution made to a Medical Savings Account (including employer contributions) for the year. The employee must reduce the amount she/he, or any other person, can contribute to her/his HSA by the amount of any contributions made by her/his employer that are excludable from income.

The funds may be invested in a wide variety of financial assets, but the funds may not be commingled with other assets except in a common trust fund or a common investment fund and the funds may not be invested in life insurance contracts.

2.11.6 Archer Medical Savings Accounts (MSAs)

Archer Medical Savings Accounts (MSAs) are plans established for financing medical expenses. Contributions to MSAs are deductible from gross income. Earnings accrue tax-free in the account. Withdrawals are tax-free only for qualified medical expenses. Payments outside the scope of the account are taxable and bear a penalty.

Archer Medical Savings Accounts were introduced on 1 January 1997. MSAs were created to help self-employed individuals and employees of certain small employers meet the medical care costs of the account holder, the account holder's spouse, or the account holder's dependant(s).

The beneficiary of an MSA can be: *i*) An employee (or the spouse of an employee) of a small employer that maintains an individual or family High Deductible Health Plan for the employee (or the employee's spouse). *ii*) A self-employed person (or the spouse of a self-employed person) who maintains an individual or family High Deductible Health Plan. The contributor to the plans can be either the employee or the employer, but not both may contribute. To be eligible, individuals generally may not be covered by a low-deductible health plan.

The *fiscal treatment* of MSAs is the following. Contributions are deductible from gross income on federal income tax return for the tax year for which the contributions are made. Many states also allow the deduction from state income taxes. Interest and other earnings accumulate tax-deferred, and if used for qualified medical expenses, are tax-free. Contributions to a MSA made by an employer may be excluded from the employee's gross income. Contributions may not be made through cafeteria plans.

Every year the maximum contribution to an MSA for single coverage is 65% of the deductible (minimum deductible is USD 1 750 and maximum deductible is USD 2 650) on the employee's health plan and 75% of the deductible (minimum deductible is USD 3 500 and maximum is USD 5 250) for family coverage. The investor cannot contribute more than he/she earned for the year from the employer through whom they have a High Deductible Health Plan. If the investor is a self-employed, he/she cannot contribute more than their net self-employment income.

Excess contributions are not deductible. Excess contributions made by the employer are included in the employee's gross income. The beneficiary must pay a 6% excise tax on excess contributions. There is no limit per se on the number of MSAs; however contribution limits apply to the aggregate of a taxpayer MSA contributions. Unused contribution room cannot be carried forward to the following year.

There are no age limits on individuals eligible to contribute to an MSA, although individuals who are enrolled in Medicare (which includes most individuals age 65 or older) are not eligible to contribute.

A taxpayer may keep an MSA until death at which time the account may be rolled over to a spouse, otherwise the funds will be distributed to the beneficiary of the MSA.

Amounts distributed that are not used to pay for qualified medical expenses will be taxable under the personal income tax, plus a 15% penalty. If the employee becomes disabled or reaches Medicare eligibility age (65 years of age), however, distributions for non-medical expenses from the account are subject only to ordinary income tax, not to the penalty tax.

Funds left in the account at the end of the year can be rolled over to grow with any future contributions.

An MSA is “portable” so it stays with the employee if she/he changes employers or leaves the work force. The amount that can be contributed (including any additional contribution) to an MSA has to be reduced by the amount of any contribution made to a Health Savings Account (including employer contributions) for the year. The employee must reduce the amount she/he, or any other person, can contribute to her/his MSA by the amount of any contributions made by her/his employer that are excludable from income.

The funds may be invested in a wide variety of financial assets, but the funds may not be commingled except in a common trust fund or a common investment fund and the funds may not be invested in life insurance contracts.

2.11.7 Tax-preferred life-insurance contracts

Investments in the form of life insurance receive preferential treatment under US income tax. Interest and other amounts credited under a life insurance contract are excluded from current gross income, but the precise statutory basis for this exclusion is obscure, and has been the subject of some debate over the years. The original Income Tax Act of 1913 excluded from gross income both amounts paid by reason of death of the insured and amounts received upon surrender of a life insurance contract. However, the latter exclusion has been limited since 1926 to the aggregate amount of premia or other consideration paid for the policy, and there are limited exceptions to the former. Congress created a statutory definition of life insurance in 1984, which eliminated the tax benefits for certain highly investment-oriented policies. A further modification in 1988 limited the tax benefits associated with certain investment-oriented policies called “modified endowment contracts.”

The original life insurance tax preference was likely the consequence of a decision to tax income only when received as cash, as well as a purposeful decision not to tax benefits received by reason of an insured person’s death. The desire to limit the taxation of investment returns was probably not an important consideration.

Any person or entity, including corporations and partnerships, with an insurable interest under state law in the life of the insured may legally purchase a life insurance policy.

Several provisions affect the *tax treatment* of life insurance contracts:

- All states impose taxes on life insurance premia, often as a substitute for some other form of company taxation, such as the corporate income tax.

- Individuals may not deduct premia paid on life insurance contracts. A taxpayer with a trade or business may not deduct premia if the taxpayer is directly or indirectly a beneficiary under the contract.
- Death benefits in excess of amounts paid as premia or other consideration are generally excluded from gross income, unless the contract has been transferred for a valuable consideration (by assignment or otherwise). This exclusion also applies to benefits paid from a policy on the life of an insured who is a terminally or chronically ill and to amounts received by selling or assigning a policy on the life of such an insured to a viatical settlement provider.
- Amounts obtained from the surrender of the policy or from partial withdrawals of cash value are generally taxed “basis-first.” Distributed amounts first reduce a taxpayer’s “investment in the contract” – in general, the aggregate premia and other consideration paid for the contract – and are treated as taxable receipts only if “investment in the contract” is zero. Policy loans are generally not taxed as distributions, but are treated as bona fide loans. However, distributions from certain life insurance contracts, known as “modified endowment contracts,” are taxed on an “income-first” basis, and policy loans from such contracts are treated as distributions.
- Interest payments on policy loans are not generally deductible, but there are some exceptions to that rule for business policyholders.
- A life insurance policy may be exchanged for another life insurance policy, an endowment policy, or an annuity policy without requiring that gain or loss be recognized with respect to the life insurance policy as a result of the exchange.

There are no annual or aggregate limits established under tax law on the amount of contributions to a single life insurance contract. Therefore, excess contributions do not exist. However, insurance companies may limit the amount of insurance that may be taken out on the life of any one individual.

There is no limit on the number of life insurance contracts that can be taken out on one person.

No age limits apply for contributions to life insurance contracts. However, contributions would no longer be made on policies that have “endowed” due to the insured reaching a specified maximum age.

With respect to general account investments, State laws and regulations specify eligible types of investments, minimum quality criteria for individual investments, and quantitative limits on amounts that can be placed in eligible investments. Major investment categories for insurers include government securities, corporate securities, mortgages, real estate, and policy loans. For variable life insurance contracts, where the assets are placed in a “separate account,” the tax law requires that investments in the account be adequately diversified. The tax-deferral and tax-exclusion protections of life insurance are also lost if a policyholder exercises too much control over the selection of investments within a contract. In this case, the policyholder can be taxed as if he or she owns the underlying assets directly.

No limits are placed on the duration of life insurance contracts other than those imposed by the mortality of the insured.

In general, penalties (in excess of normal taxes) are not imposed on withdrawals of funds held under life insurance contracts. An exception exists for taxable distributions under “modified endowment contracts,” whereby a penalty equal to 10% of the taxable amount is assessed. A modified endowment contract is a life insurance policy that fails to meet a 7-pay test (*i.e.*, a contract that is funded more quickly than a paid-up policy funded with level premia over a seven year period). If a contract fails to meet the definition of life insurance subsequent to its issuance, the aggregate income earned under that contract is subject to immediate inclusion in the policyholder’s gross income. Nevertheless, the contract continues to be recognized as life insurance for other purposes of the tax law.

Funds withdrawn from a life insurance contract may be paid back again into the policy as additional premia, provided the contract permits such additional premia. The withdrawal would have either lowered the policyholder’s “investment in the contract” or would have been included in the policyholder’s gross income. The additional premia will increase the policyholder’s “investment in the contract”.

Amounts received upon the complete surrender of a contract are treated in the same manner as partial surrenders of cash value. Amounts received in excess of the policyholder’s “investment in the contract” are included in the policyholder’s gross income.

NOTES

¹ Legislation was changed several times. An important change took place in 1992: the tax relief (with the advantage valued at the marginal tax rate) was changed into a tax credit valued at the average tax rate, with a minimum of 30% and a maximum of 40%.

² Since 1993, the capital is liable to “advance taxation”. This advanced taxation, or “taxation on long term savings” is assimilated to a stamp duty (an indirect tax); it supersedes PIT. Inasmuch as the tax has been paid, the theoretical capital is not liable to PIT.

³ When the insurance contract is opened or subscribed by a taxpayer of 55 years of age or over, the tax liability arises on the tenth anniversary of the signature of the contract.

⁴ The aforementioned type of income is not included in the global income and it is not subject to progressive taxation.

⁵ The CESG was introduced in 1998.

⁶ Since RESP contributions are not deductible from income, they can be returned to the subscriber at any time without tax consequences. Alternatively, the terms of the plan can require that the refund of contributions be made to the beneficiary, again with no tax consequences.

⁷ The Canada Education Savings Grant (CESG) was introduced as part of the Canadian Opportunities Strategy with the 1998 Budget.

⁸ It is worth noting that the contributions to the RESP are not taxable in the hand of the beneficiary. Only earnings and the government saving bonus are subject to taxation.

⁹ An AIP can be paid under the following conditions:

- The recipient is a resident of Canada.
- The recipient is a subscriber of the RESP, unless the subscriber to the RESP has died.
- Each beneficiary under the RESP for whom the subscriber made contributions has died, or has reached 21 years of age and is not currently eligible to receive educational assistance payments.
- The RESP has existed for at least 10 years. If all the beneficiaries are deceased, the 10-year existence requirement still applies unless each beneficiary was a subscriber, was related to the subscriber, or was the nephew, niece, great-nephew, or great-niece of the subscriber.

- ¹⁰ If the subscriber has unused Registered Retirement Savings Plan (RRSP) contribution room, the earnings can be transferred to an RRSP, with no immediate tax consequences.
- ¹¹ This does not include the Canada Education Savings Grant, CESG or the Canada Learning Bond, CLB.
- ¹² In 1996, the lifetime RESP contribution limit was increased from CAD 31 500 to CAD 42 000 per beneficiary. Starting in 1997, the annual contribution limit was raised to CAD 4 000 to give families flexibility to make “catch-up” contributions within the lifetime contribution limit.
- ¹³ Since the tax year 1960-61 some changes in the legislation regulating the aforementioned accounts occurred.
- Tax year 1963-64: The limit for tax-deductible contributions is increased to DKK 1 500.
- Tax year 1966-67: The limit for tax-deductible contributions is increased to DKK 2 500.
- 1970: The limit for tax-deductible contributions is increased to DKK 3 000 but after some years it is lowered to DKK 2 000.
- 1 July 1987: The tax deductibility of contributions is abolished.
- 1 January 1998: It becomes possible to have more than one depositor per account.
- 1 July 1998: It becomes possible to place funds in pool schemes or in separate safe custodies. (Up to 1 July 1998 only deposits in cash were allowed).
- 1998-1999: Contributions on DKK 9 000 are allowed, but only for these years, and only if the total amount of contributions made remains below DKK 36 000.
- 2000 and forward: Maximum contribution DKK 3 000 per year.
- ¹⁴ This also includes adoptive parents, foster parents and step-parents.
- ¹⁵ There may be more than one depositor since 1 January 1998.
- ¹⁶ When the account is opened, an agreement is made on how long the funds will be tied up (minimum seven years). The period can be extended before the first seven years elapse. The extension must be again for at least seven years.
- ¹⁷ Note that the *Capital Formation Law* was introduced on 1 January 1961 and the last fundamental revision took effect on 1 January 1999.
- ¹⁸ It is worth noting that it is possible to contribute to just one of the baskets.
- ¹⁹ Even though in this work we exclude fiscal incentive for building saving, we describe the German case as the building saving scheme is the same as for productive investment.
- ²⁰ The assets allowed in the account include units in unit trusts, shares in listed companies and employee holdings.
- ²¹ Until 31 December 2004 the matching rate was 22% for new Länder.
- ²² Premia were deductible as so-called provident expenses.
- ²³ It is worth noting that the two conditions must apply together.
- ²⁴ The requirements are identical to those for Pensionskassen analysed in DAF/AS/PEN/WD(2005)1.
- ²⁵ The aforementioned contribution limit does not include the government saving bonus. The government contribution will be 25% of EUR 15 240 = 3 810. Therefore the total maximum contribution to a SSIA from all sources over the term of an SSIA is EUR 15 240 + EUR 3 810 = EUR 19 050.
- ²⁶ For a description of the Special Investment Account, see next Section.
- ²⁷ Decreto Legislativo 18 Febbraio 2000, n. 46.
- ²⁸ It is worth noting that all earnings accruing to financial assets are taxed at 12.5% in Italy. However, we believe that this contract is tax-preferred because these earnings are not taxed every year but only when the contract is redeemed.
- ²⁹ There are life-insurance contracts which could be classified as mixed as they cover both the risk of death (and/or chronic illness) and, at the same time provide for the build-up of assets. The part of the contract covering the risk of death is entitled to the more favourable fiscal treatment here described.
- ³⁰ Corresponding to the geographical area of the Federal district (almost MXN 80 000).
- ³¹ Section VIII in article 38 in the Mexican Income Tax Ruling (MITR) of 1935. This is the background of section XII in article 31, MITL.
- ³² Section XXI of article 49 in MITL of 1979 and Section XVII of article 109, MITL. Until 1978 only dividends and interests paid by insurance companies for the adjustment of insurance were exempt.
- ³³ The MITL of 1979 broadened the definition of taxable income to include the amounts paid by insurance companies as exempt income, along with the income from inheritance, lottery and games prizes, and damage compensations.
- ³⁴ Articles 158 and 161 of the Law of the Insurance Contract (*Ley sobre el Contrato de Seguro*).
- ³⁵ Section XVII of article 109, MITL.

Section XII of article 31, MITL.

This means payments which do not correspond to previously paid premia and their interest.

Subject to some exceptions, such as cheque accounts.

The investment in the aforementioned assets has to be in accordance with the ruling set forth by the Mexican Ministry of Finance and Public Credit (*Secretaría de Hacienda y Crédito Público (SHCP)*) and the National Insurance and Bails Commission (*Comisión Nacional de Seguros y Fianzas (CNSF)*).

Unused contribution room cannot be carried forward to the following year.

Once funds have been withdrawn before the closure of the plan, they cannot be put back again into the account in the same fiscal year.

Contributions are possible for any employee, regardless of age.

This is the figure for 2005. Excess contributions are liable for taxation and social contributions. Unused contribution room cannot be carried forward to the following year.

Note that no contributions were possible after 5 April 1999. Excess contributions were not allowed.

A single company PEP is a Personal Equity Plan in which equity deposited belongs to the same company.

There is actually a small penalty: when funds are withdrawn, they cannot be put back again in the account in the same fiscal year if the account has reached the annual capacity limit. This means that earnings accruing to those funds will be taxable in the same fiscal year. This is the penalty the taxpayer is subject to.

Note that unused contribution room cannot be carried forward to the following fiscal year.

Investors could have paid net interest back in as new subscription if they had chosen to but this would have been included in the annual subscription limit.

In 1995, Follow-up TESSAs were introduced. These allowed those who had built up savings in a TESSA to open a further account on maturity of the first TESSA. The follow-up TESSA allowed the transfer of capital (but not tax free interest accrued on that account) held in the initial TESSA account. A follow-up TESSA was only available if the capital held in the first TESSA amounted to GBP 3 000 or more. This follow-up TESSA was subject to exactly the same tax relief rules as the original TESSA. An individual could not hold a follow-up TESSA and open another TESSA at the same time.

Contributions are possible starting at 16 years of age only for the Cash ISA component.

In a maxi ISA, the investor can subscribe up to GBP 7 000 with one provider of which up to GBP 3 000 can be in cash products, GBP 1 000 in insurance products and the balance of the GBP 7 000 in stocks and share products.

Mini ISA are Individual Savings Accounts invested in only one type of assets. In the Cash mini ISA only cash can be invested up to an overall limit of GBP 3 000. In the Insurance Mini ISA only insurance can be bought up to a limit of GBP 1 000. The Insurance Mini ISA will disappear starting 6 April 2005. In the stock and shares Mini ISA only equity products can be bought.

From 1999 to tax year 2004-05, up to GBP 42 000 could have been subscribed into an ISA.

In other words, funds have to be left outside the account and the accrued earnings are taxable.

FSA approved UCITS schemes are allowed inside the ISAs from 6 April 2005.

The OFEX is a British share trading and information service that enables investors to buy and sell shares in companies whose shares are not traded on the London Stock Exchange.

This is the 2005 allowance for capital gains.

As explained above, this will entail the loss of the entitlement to the government saving bonus until funds are put back into the account.

Under the settlements legislation, if interest generated by a parent's contributions to their child's savings account equals or exceeds GBP 100 per year, the income will normally be taxed as the parent's at their marginal rate.

The Inland Revenue will make an additional payment of GBP 250 into the CTF accounts of eligible children living in families with low incomes. Additional payments will be made where families receive Child Tax Credit (or equivalent benefits) and household income is not greater than the Child Tax Credit threshold. (GBP 13 910 in 2005-2006; GBP 13 480 in 2004-2005; GBP 13 230 in 2003-2004).

Unless the child is terminally ill.

If the holder of a Child Trust Fund dies before she/he reaches age eighteen, funds deposited in the Child Trust Fund can be released to the administrators of the deceased person's estate. The Child Trust Funds Act 2004 directs that funds in a Child Trust Fund may not be assigned to any other person. In the event of bankruptcy funds in Child Trust Fund may not be passed to a child's creditors. Children can manage their CTF accounts when they turn 16.

⁶³ The Stakeholder Child Trust Fund is a stock market-based investment. The CTF Stakeholder account must meet specific requirements, in particular:

- Include at least some exposure to equities (company shares);
- Offer a mix of investments which are appropriate and suitable for a long-term savings plan for a child;
- Allow for adjustment to a lower risk investment mix as the child approaches 18.

The Non-Stakeholder CTF is a savings option paying interest on money saved into the Child Trust Fund.

⁶⁴ Some assets which are allowed in the Non-stakeholder CTF are not allowed in the Stakeholder CTF. The latter does not allow shares and securities in investment trusts, with-profits endowment policies, dual-priced unit trusts or open-ended investment companies, dual-priced insurance contracts, company shares listed on a recognized stock exchange (shares in listed companies may be held via collective investment schemes) and deposit accounts where the rate of interest is more than one per cent below base rate.

⁶⁵ LAPR was abolished for new policies in 1984.

⁶⁶ Even if a policy does not qualify, a policyholder who is liable only at the basic rate would have no tax to pay anyway, because the taxation of the underlying gains and income in the hands of the insurer means the policyholder is treated as having already paid a rate of 20%. So, there is no benefit to a basic rate taxpayer in holding a QP.

However, a higher-rate taxpayer does benefit from holding a QP since if the policy was non-qualifying, he or she would have to pay additional tax of 20% on any gains (*i.e.* higher rate 40% less tax of 20% treated as already paid). But the qualifying status of the policy means that the policyholder is not liable for this tax.

⁶⁷ In the event that funds are invested in personal assets, the policies may fall within the scope of another set of anti-avoidance tax rules (the Personal Portfolio Bond Regulations). But otherwise, the only restriction will be those imposed generally on UK life insurers by the regulatory body, the Financial Services Authority (FSA).

⁶⁸ The conditions for policies to be a TESP have changed over the years. In 1987, the main investment condition changed from a restriction of the sum assured to a restriction to the premia which may be invested. The annual premium limit was then GBP 100. It was raised to GBP 150 in 1990, GBP 200 in 1991 and GBP 270 in 1995 and has since remained at that level.

⁶⁹ ESA tax benefits apply not only to qualified higher education expenses, but also to qualified elementary and secondary education expenses.

⁷⁰ Contributions may be made on behalf of a given beneficiary to both ESAs and 529 plans. Prior to 2001, beneficiaries faced an excise tax if contributions were made to an Education IRA in the same year that a contribution was made to a 529 plan on their behalf.

Annex

Data on Tax-Preferred Accounts in Selected OECD Countries

Table A.1: Belgian tax-preferred life-insurance contract (2002)

Life insurance, housing excluded											
Income class (from to)		Number of participants (C)	Total premia paid	Participation rate (C)	Number of participants, (EC)	Total premia paid, (EC)	Participation rate, (EC)	Number of total participants	Total premia paid	Average premium	Av. Premium as % of income
0	5 000	5 934	1 380 381	1.6%	709	137 436	4.0%	6 643	1 517 817	228	4.57%
5 000	10 000	25 836	9 760 688	4.8%	2 333	541 818	4.1%	28 169	10 302 506	366	4.88%
10 000	12 500	31 742	13 918 193	5.7%	3 392	865 331	3.5%	35 134	14 783 524	421	3.74%
12 500	15 000	42 631	20 184 276	8.9%	5 494	1 530 685	4.4%	48 125	21 714 961	451	3.28%
15 000	17 500	51 310	25 285 656	11.6%	8 874	2 797 086	5.4%	60 184	28 082 742	467	2.87%
17 500	20 000	61 532	32 167 999	15.0%	12 217	4 316 439	8.0%	73 749	36 484 438	495	2.64%
20 000	22 500	66 278	36 876 309	18.2%	15 747	6 002 671	10.8%	82 025	42 878 980	523	2.46%
22 500	25 000	60 552	36 738 885	20.5%	17 489	7 048 620	13.4%	78 041	43 787 505	561	2.36%
25 000	27 500	51 527	32 780 539	22.4%	17 417	7 105 390	15.5%	68 944	39 885 929	579	2.20%
27 500	30 000	45 846	29 928 760	24.2%	18 440	7 446 201	17.6%	64 286	37 374 961	581	2.02%
30 000	32 500	41 954	27 933 848	25.9%	19 689	7 876 132	19.9%	61 643	35 809 980	581	1.86%
32 500	35 000	39 387	26 306 911	28.0%	21 081	8 451 243	22.3%	60 468	34 758 154	575	1.70%
35 000	37 500	36 023	23 575 025	29.5%	21 569	8 836 078	24.2%	57 592	32 411 103	563	1.55%
37 500	40 000	33 833	22 172 415	31.3%	22 076	9 161 809	26.5%	55 909	31 334 224	560	1.45%
40 000	42 500	30 977	20 307 438	32.8%	20 982	8 911 207	27.8%	51 959	29 218 645	562	1.36%
42 500	45 000	28 592	19 173 486	34.8%	19 991	8 864 611	29.5%	48 583	28 038 097	577	1.32%
45 000	50 000	48 256	32 873 091	36.3%	35 708	16 961 537	31.3%	83 964	49 834 628	594	1.28%
50 000	62 500	82 226	60 268 772	39.7%	64 158	34 406 994	34.7%	146 384	94 675 766	647	1.26%
62 500	75 000	43 448	35 257 771	44.2%	34 945	21 798 501	38.9%	78 393	57 056 272	728	1.06%
75 000	100 000	32 894	29 023 127	46.7%	26 414	18 076 488	41.0%	59 308	47 099 615	794	0.91%
100 000	125 000	10 085	9 507 485	47.3%	7 853	5 804 094	40.7%	17 938	15 311 579	854	0.76%
125 000	150 000	4 180	4 117 331	48.1%	3 175	2 400 653	40.8%	7 355	6 517 984	886	0.53%
150 000	250 000	4 087	4 377 628	47.9%	2 902	2 343 503	38.1%	6 989	6 721 131	962	0.48%
250 000		1 181	1 344 590	46.4%	748	635 857	33.9%	1 929	1 980 447	1 027	0.41%
Total		880 311	555 260 604	17.1%	403 403	192 320 384	19.1%	1 283 714	747 580 988	582	

Note: C= taxpayer (single or the husband in a married couple); EC = wife in a married couple.

Table A.2: Participation rates in Belgian tax-preferred life-insurance contracts (1999, 2000)

Income bands ¹		Participation rate (C) ²	Participation rate (EC) ³
0	203	2.6%	13.1%
203	300	6.0%	14.4%
300	400	6.9%	10.0%
400	500	7.6%	11.5%
500	600	11.0%	11.0%
600	700	14.4%	12.3%
700	800	17.8%	15.1%
800	900	21.0%	19.1%
900	1000	23.2%	21.0%
1000	1100	25.7%	23.3%
1100	1200	28.1%	25.7%
1200	1300	30.4%	27.4%
1300	1400	32.8%	29.8%
1400	1500	34.6%	31.5%
1500	1600	36.6%	33.4%
1600	1700	38.4%	35.0%
1700	1800	39.7%	36.4%
1800	1900	41.1%	37.7%
1900	2000	42.8%	39.1%
2000	3000	47.4%	43.8%
3000	4000	53.4%	50.2%
4000	5000	55.3%	53.2%
5000	10000	55.3%	52.1%
10000		54.2%	53.0%

1. Values are in thousands of BEF.

2. Note: C = taxpayer (single or the man in a married couple); EC = wife in a married couple.

3. Note: C = taxpayer (single or the man in a married couple); EC = wife in a married couple.

Figure A.1: Participants by income class in Belgian tax-preferred life-insurance contracts, 2002

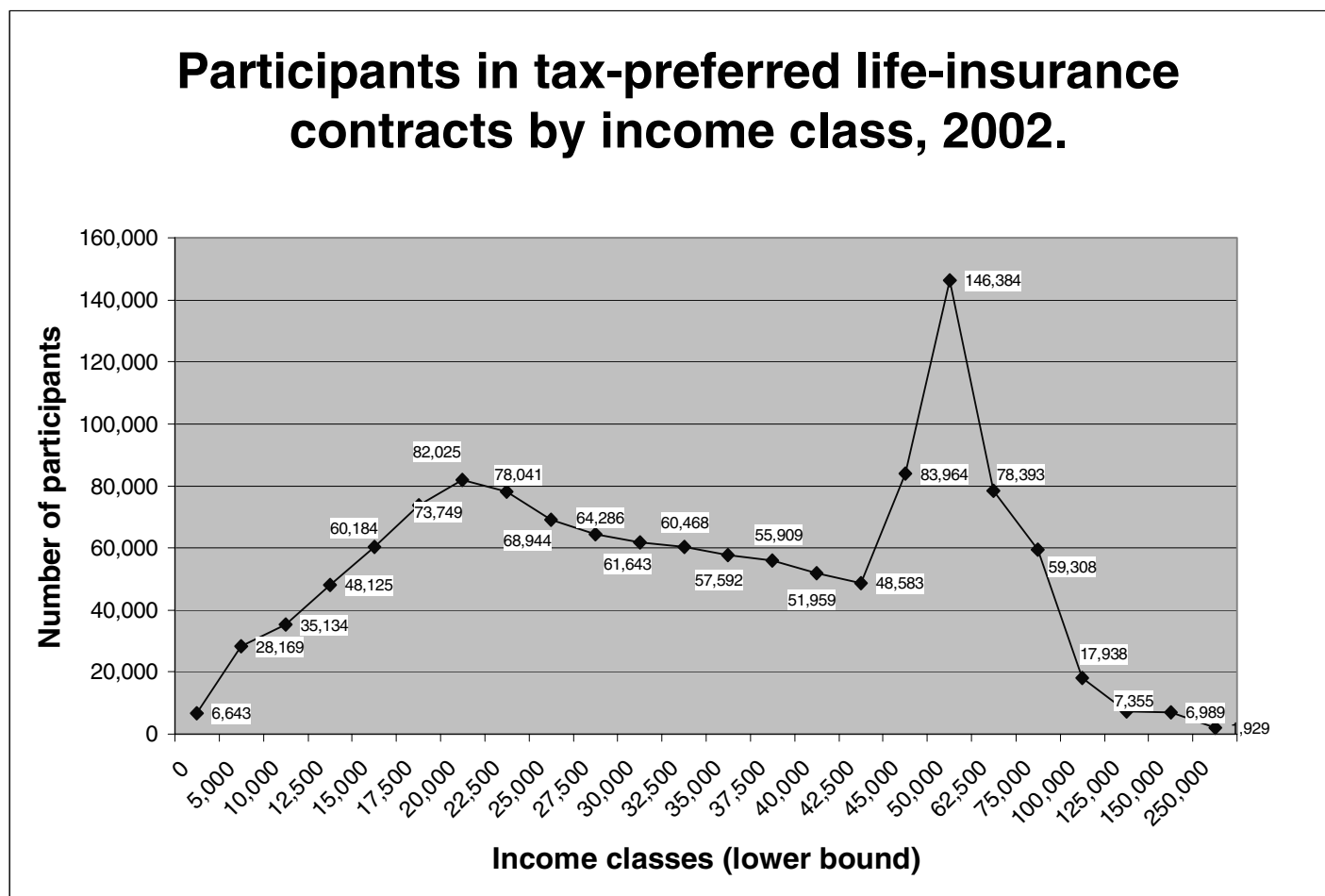


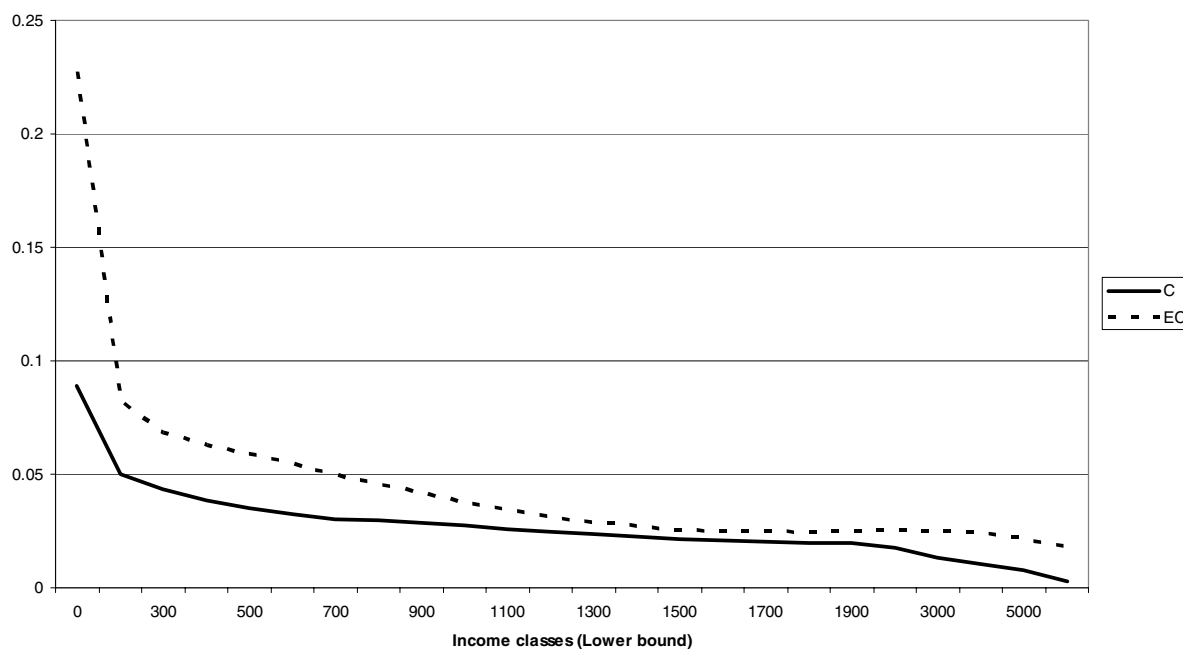
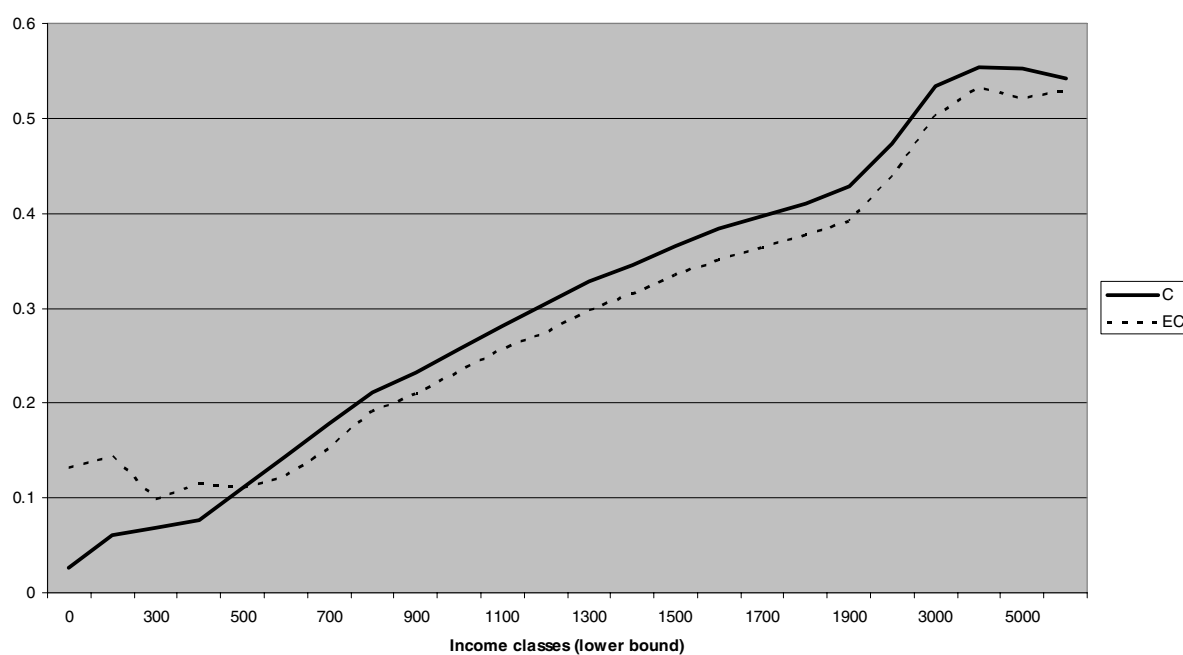
Figure A.2: Belgian life-insurance premia, 1999**Life insurance premium, % net taxable income -1999****Figure A.3: Belgian life-insurance participation rates, 1999****Participation rate - life insurance contracts -1999**

Table A.3: Distributional features of Canadian RESPs, 2001 and 2002

Adjusted Household Income (CAD)	RESPs in 2002			Contributions to RESPs in 2001				
	Incidence (%)	Median ¹ Value (CAD)	investment as % of income ²	Incidence (%)	Median Contribution (CAD)	Contribution as % of income	Median CESG	Received max CESG (% of income)
Less than 15 000	12.9	3.000	4.67	10	700	20	140	25%
15 000 to 25 999	21.7	3.000	4.00	18.3	900	13.33	190	21.8%
26 000 to 39 999	29.8	3.600	3.03	25	1.000	10.91	200	30.8%
40 000 and more	41.6	5.000	3.00	34.5	1.200	12.5	240	41.1%
Total	26.9	4.000	22.3	1.000	-	-	200	32.7%

Note: Statistics Canada uses Adjusted Household Income, which takes into account household income and size.

1. The median value includes interest and the Canada education Savings Grant (CESG).
2. The percentage is calculated using the middle point of the income band as denominator

Table A.4: Historical evolution of Canadian RESPs

Years	Number of RESP contracts (000)	% increase in the no. of contracts	Assets invested in RESPs (CAD millions)	% increase in the amount of assets
1997	708		2 359	
1998	1 056	49.15%	3 994	69.31%
1999	1 430	35.42%	5 586	39.86%
2000	1 717	20.07%	7 193	28.77%
2001	1 910	11.24%	8 236	14.50%
2002	2 209	15.65%	10 002	21.44%
2003	2 314	4.75%	12 137	21.35%
2004	2 514	8.64%	14 575	20.09%

Table A.5: Participants in the German Employee Savings Bonus, 2001

Annual income (EUR)	Number of participants	% on total participants
0 to 3 672	90 000	1.23%
3 673 to 6 120	345 000	4.73%
6 121 to 8 580	380 000	5.21%
8 581 to 11 028	400 000	5.48%
11 029 to 15 324	1 575 000	21.58%
15 345 to 18 396	1 210 000	16.58%
18 397 to 24 528	1 775 000	24.32%
24 528 to 35 800	1 525 000	20.89%
Total	7 300 000	100%

Table A.6: Italian tax-preferred life-insurance premia by income class (2000)¹

Household income bands (EUR)	Life-insurance annual premia (EUR)	Number of contracts	% of total contracts	Average premium (EUR)	Av. Premium as % of income ²	Participation rate
Up to 9 999	707 746	294	17.66%	1 376.69	27.5%	9.17%
10 000 to 14 999	224 863	221	13.27%	1 017.48	8.14%	18%
15 000 to 19 999	301 806	268	16.10%	1 126.14	6.44%	29%
20 000 to 29 999	500 008	389	23.36%	1 285.37	5.14%	30%
30 000 to 39 999	338 142	259	15.56%	1 305.57	3.73%	40%
40 000 to 59 999	242 579	160	9.61%	1 512.12	3.03%	42%
60 000 to 79 999	85 040	42	2.52%	2 024.76	2.89%	53%
80 000 to 99 999	44 338	13	0.78%	3 410.60	3.79%	37%
100 000 to 119 999	10 846	8	0.48%	1 355.70	1.23%	50%
120 000 to 139 999	8 676	4	0.24%	2 169.12	1.67%	80%
140 000 to 159 999	1 549	1	0.06%	1 549.37	1.03%	50%
160 000 to 179 999	7 230	3	0.18%	2 410.13	1.42%	75%
180 000 to 199 999	2 324	1	0.06%	2 324.06	1.22%	50%
More than 200 000	4 132	2	0.12%	2 065.83	1.03%	40%
Total	2 176 280	1 665	100.00%	1 307.08	-	21%

1. Data are taken from the 2000 Bank of Italy Survey of Household Income and Wealth. The sample is made of 8 011 households, 22 268 individuals, of whom 13 814 are income earners.

2. We calculated the average premium as percentage of income referring to the middle point of the income band.

Table A.7: Italian tax-preferred life-insurance premia by income class (2002)¹

Household income bands (EUR)	Life-insurance annual premia (EUR)	Number of contracts	% of total contracts	Average premium (EUR)	Av. Premium as % of income ¹	Participation rate
Up to 9 999	342 167	316	16.70%	1 082.81	21.7%	9.19%
10 000 to 14 999	184 856	194	10.25%	952.87	7.62%	19%
15 000 to 19 999	222 283	221	11.68%	1 005.81	5.75%	26%
20 000 to 29 999	477 094	416	21.99%	1 146.86	4.59%	35%
30 000 to 39 999	380 456	329	17.39%	1 156.40	3.30%	45%
40 000 to 59 999	330 059	282	14.90%	1 170.42	2.34%	67%
60 000 to 79 999	140 063	80	4.23%	1 750.79	2.50%	70%
80 000 to 99 999	42 800	27	1.43%	1 585.19	1.76%	82%
100 000 to 119 999	27 828	13	0.69%	2 140.62	1.95%	87%
120 000 to 139 999	3 550	4	0.21%	887.50	0.68%	40%
140 000 to 159 999	3 700	2	0.11%	1 850.00	1.23%	29%
160 000 to 179 999	3 000	2	0.11%	1 500.00	0.88%	100%
180 000 to 199 999	0	0	0.00%	0.00	-	0%
More than 200 000	18 750	3	0.32%	3 125.00	1.56%	75%
Total	2 176 606	1 892	100%	1 150.43	-	24%

1. Data are taken from the 2002 Bank of Italy Survey of Household Income and Wealth. The sample is made of 8 011 households, 22 148 individuals of whom 13 536 are income earners.

Table A.8: Italian tax-preferred life-insurance participation rates by income class, 2001 and 2002

Individual income bands (EUR)	Participation rate 2001	Participation rate 2002
Up to 5 000	7.13%	6.64%
5 000 to 10 330	10.26%	9.24%
10 330 to 14 590	22.35%	20.20%
15 490 to 20 000	33.25%	30.43%
20 000 to 30 990	43.37%	40.67%
30 990 to 40 000	54.54%	51.96%
40 000 to 60 000	58.79%	55.60%
60 000 to 80 000	62.84%	59.45%
80 000 to 100 000	65.51%	62.17%
100 000 to 120 000	65.95%	62.31%
120 000 to 150 000	65.92%	62.50%
150 000 to 200 000	65.49%	62.61%
More than 200 000	64.19%	61.12%
Total	24.37%	22.71%

Table A.9: Distributional features of Irish SSIA's, 2004

Individual income (EUR)	% of total SSIA's holders
20 000 or less	27.70%
20 000 to 50 000	49.10%
More than 50 000	23.20%

Table A.10: Dutch Payroll Savings Scheme, 2005

Combined household income (EUR)		No. Households <65 years	Participants	Participation rate	% of participants	Average investment	Av. Investment as % of income	Net benefit	Benefit as % of income
From	to								
Less than	0	27 398	1 110	4.1%	0.05%	618		0	0.00%
0	5 000	173 836	5 074	2.9%	0.21%	711	14.22%	335	6.70%
5 000	10 000	161 093	8 971	5.6%	0.37%	702	9.36%	252	3.36%
10 000	15 000	469 244	22 589	4.8%	0.92%	661	5.29%	241	1.93%
15 000	20 000	470 616	70 672	15.0%	2.89%	677	3.87%	279	1.59%
20 000	25 000	512 435	162 632	31.7%	6.64%	706	3.14%	299	1.33%
25 000	30 000	538 794	222 825	41.4%	9.10%	728	2.65%	317	1.15%
30 000	35 000	508 537	254 324	50.0%	10.39%	782	2.41%	308	0.95%
35 000	40 000	487 730	274 427	56.3%	11.21%	840	2.24%	371	0.99%
40 000	45 000	427 488	265 373	62.1%	10.84%	874	2.06%	392	0.92%
45 000	50 000	354 056	237 482	67.1%	9.70%	906	1.91%	415	0.87%
50 000	62 500	581 940	417 043	71.7%	17.03%	946	1.68%	446	0.79%
62 500	75 000	307 886	224 963	73.1%	9.19%	998	1.45%	480	0.70%
75 000	100 000	247 802	180 254	72.7%	7.36%	1 040	1.19%	512	0.59%
Over 100 000		162 459	100 955	62.1%	4.12%	1 007	1.01%	514	0.51%
Total		5 431 314	2 448 694	45.1%	100.00%				

Source: Central Bureau of Statistics / Data from the Dutch fiscal authorities.

Table A.11: Contributors to Norwegian AMS by income class

Gross income, NOK	Number of contributors AMS	% of total contributors	Number of contributors AMS	% of total contributors	Number of contributors AMS	% of total contributors	Number of contributors AMS	% of total contributors
	1999		1998		1997		1996	
- 49 999	5 932	1.28%	7 047	1.62%	11 765	2.40%	8 320	2.27%
50 000 - 99 999	20 929	4.51%	23 296	5.35%	34 254	6.98%	26 957	7.35%
100 000 - 149 999	42 389	9.13%	43 659	10.02%	57 548	11.73%	45 150	12.31%
150 000 - 199 999	55 621	11.98%	55 766	12.80%	70 843	14.44%	55 834	15.22%
200 000 - 299 999	147 868	31.84%	142 810	32.77%	163 693	33.37%	122 827	33.49%
300 000 - 399 999	94 678	20.39%	81 501	18.70%	77 497	15.80%	55 099	15.02%
400 000 - 599 999	63 192	13.61%	53 714	12.32%	49 445	10.08%	35 211	9.60%
600 000 - 799 999	18 457	3.97%	15 532	3.56%	13 848	2.82%	9 453	2.58%
800 000 - 999 999	6 930	1.49%	5 624	1.29%	5 151	1.05%	3 355	0.91%
1 million and more	8 377	1.80%	6 868	1.58%	6 435	1.31%	4 563	1.24%
TOTAL	464 373		435 817		490 479		366 769	

Source: Tax statistics 1996-1999, Statistics Norway.

Table A.12: Average contribution to Norwegian AMS by income class

Gross income, NOK	Average savings, AMS	Av. Contribution as % of income	Average savings, AMS	Av. Contribution as % of income	Average savings, AMS	Av. Contribution as % of income	Average savings, AMS	Av. Contribution as % of income
	1999		1998		1997		1996	
In all	6 000		6 000		6 000		6 000	
- 49 999	4 667	9.33%	4 667	9.33%	4 667	9.33%	4 667	9.33%
50 000 - 99 999	5 333	7.11%	5 333	7.11%	5 333	7.11%	6 000	8.00%
100 000 - 149 999	6 000	4.80%	6 000	4.80%	6 000	4.80%	6 000	4.80%
150 000 - 199 999	6 000	3.00%	6 000	3.00%	6 000	3.00%	6 000	3.00%
200 000 - 299 999	5 333	2.13%	5 333	2.13%	6 000	2.40%	6 000	2.40%
300 000 - 399 999	6 000	1.71%	6 000	1.71%	6 000	1.71%	6 000	1.71%
400 000 - 599 999	6 000	1.33%	6 000	1.33%	6 667	1.48%	6 667	1.48%
600 000 - 799 999	6 667	1.03%	6 667	1.03%	6 667	1.03%	7 333	1.13%
800 000 - 999 999	6 667	0.74%	7 333	0.81%	7 333	0.81%	7 333	0.81%
1 million and more	7 333	0.73%	7 333	0.73%	7 333	0.73%	7 333	0.73%

Source: Tax statistics 1996-1999, Statistics Norway.

Table A.13: Distribution of participants in UK ISAs by income class, 2000-01 and 2001-02

Income classes (GBP)	No of participants 2000-01 (millions)	% of total participants	No of participants 2001-02 (millions)	% of total participants	% increase from 2000-01 to 2001-02.
Under 5 000	1.75	14.02%	2.32	16.29%	40%
5 000 to 9 999	2.39	19.15%	2.63	18.47%	-3%
10 000 to 19 999	3.8	30.45%	4.24	29.78%	12%
20 000 to 29 999	2.25	18.03%	2.41	16.92%	3%
30 000 to 49 999	1.4	11.22%	1.64	11.52%	7%
50 000 to 99 999	0.66	5.29%	0.73	5.13%	0
100 000 and over	0.23	1.84%	0.26	1.83%	0
Total	12.48	100.00%	14.24	100.00%	14%

Table A.14: Participants and contributors to UK TESSAs in 1998-99 and in PEPs in 2001-02

Income classes (GBP)	Number of participants in TESSAs (millions)	Number of contributors in TESSAs (millions)	% over total participants/ contributors.	Number of participants in PEPs (millions)	% on total participants in PEPs (millions)
Under 5 000	0.81	0.81	14.36%	0.6	13.04%
5 000 to 9 999	1.17	1.17	20.74%	0.79	17.17%
10 000 to 19 999	1.77	1.77	31.38%	1.28	27.83%
20 000 to 29 999	0.96	0.96	17.02%	0.8	17.39%
30 000 to 49 999	0.60	0.60	10.64%	0.64	13.91%
50 000 to 99 999	0.26	0.26	4.61%	0.35	7.61%
100 000 and over	0.09	0.09	1.60%	0.14	3.04%
Total	5.64	5.64	100.00%	4.6	100.00%

Table A.15: Participants in all UK tax-favoured accounts by deciles of income, 1997-98 to 2002-03

Deciles of net income	Frequency	Percent	Participants in tax-free accounts	Participation rate for each decile class
1	6 332	10.36%	1 268	20.03%
2	5 935	9.71%	1 237	20.84%
3	6 111	10.00%	1 270	20.78%
4	6 096	9.97%	1 411	23.15%
5	6 192	10.13%	1 575	25.44%
6	6 047	9.89%	1 628	26.92%
7	6 093	9.97%	1 601	26.28%
8	6 171	10.09%	1 704	27.61%
9	6 063	9.92%	1 878	30.97%
10	6 098	9.97%	1 868	30.63%
Total	61 138	100.00%	15 440	25.25%

Table A.16: Percentage of Participants in all UK tax-preferred accounts by decile class

Years	Deciles of net income									
	1	2	3	4	5	6	7	8	9	10
1997-98	12.7%	13.2%	11.8%	13.3%	16.9%	17.3%	17.4%	18.7%	21.3%	24.3%
1998-99	13.7%	13.1%	14.5%	14.3%	18.1%	18.7%	17.9%	18.5%	24.5%	25.4%
1999-2000	15.9%	17.9%	20.7%	19.9%	23.1%	22.9%	24.9%	24.6%	26.7%	27.1%
2000-01	23.4%	24.4%	23.7%	25.7%	29.5%	30.7%	30.7%	28.6%	32.7%	33.3%
2001-02	26.6%	28.6%	29.2%	31.5%	32.8%	33.0%	35.7%	33.5%	33.2%	33.0%
2002-03	28.7%	33.1%	29.0%	29.8%	32.6%	32.1%	33.1%	36.8%	38.0%	33.7%
% increase from 1997 to 2002	126.3%	151.7%	146.4%	124.3%	93.3%	86.2%	89.8%	96.5%	78.6%	38.9%

Source: our calculations come from the UK Family Resources Survey.

Table A.17: Participants in all tax-favoured accounts by education and year

Participants in different years	% participants in the class with higher education	Increase from previous year	% participants in the class with lower education	Increase from previous year
1997-98	22.03%		15.69%	
1998/99	24.26%	10.12%	16.66%	6.18%
1999-2000 ¹	28.09%	15.79%	21.21%	27.31%
2000-01	35.91%	27.84%	26.73%	26.03%
2001-02	36.87%	2.67%	30.51%	14.14%
2002-03	39.89%	8.19%	31.18%	2.20%
Total ²		81.07%		98.73%

Source: our calculations come from the UK Family Resources Survey.

1. This is the year when the ISAs were introduced. They replaced the TESSAs and PEPs and they did not bear any penalties on early withdrawals.
2. Note that in the last row we calculate the increase from 1997-98 to 2002-03.

Table A.18: Probit regression

Variables	All years			Before 1999 reform			After 1999 reform		
	Coef	S.E.	Signif	Coef	S.E.	Signif	Coef	S.E.	Signif
Higher education	0.1655	0.0151	Yes***	0.1601	0.0294	Yes***	0.1581	0.0177	Yes***
Age	-0.0003	0.0004	No	-0.0017	0.0007	Yes**	-0.0002	0.0004	No
Female	0.1681	0.0118	Yes***	0.136	0.0231	Yes***	0.1769	0.014	Yes***
Taxpayer	0.3639	0.0139	Yes***	0.3687	0.0271	Yes***	0.3487	0.0164	Yes***
Constant	-1.1927	0.0329	Yes***	-1.349	0.0636	Yes***	-1.0931	0.0389	Yes***

*** the estimation is significant at the 1% level.

** the estimation is significant at the 5% level

* the estimation is significant at the 10% level.

Table A.19: Logit regression

Variables	All years			Before 1999 reform			After 1999 reform		
	Coef	S.E.	Signif	Coef	S.E.	Signif	Coef	S.E.	Signif
Higher education	0.2811	0.0251	Yes***	0.2933	0.0510	Yes***	0.2625	0.0291	Yes***
Age	-0.0002	0.0006	No	-0.0022	0.0013	Yes*	-0.0005	0.0007	No
Female	0.2859	0.0199	Yes***	0.2437	0.0411	Yes***	0.2957	0.0231	Yes***
Taxpayer	0.6278	0.0242	Yes***	0.6769	0.0503	Yes***	0.5891	0.0279	Yes***
Constant	-2.0105	0.0563	Yes***	-2.359	0.1149	Yes***	-1.8172	0.0653	Yes***

*** the estimation is significant at the 1% level.

** the estimation is significant at the 5% level

* the estimation is significant at the 10% level.

Table A.20: Average investment in UK ISAs as a percentage of income ¹

Income classes (GBP)	Av. Investment 2000-01	Av. Investment as % of income.	Av. Investment 2001-02	Av. Investment as % of income.
Under 5 000	4 260	85.20%	5 280	105.60%
5 000 to 9 999	4 810	64.14%	5 710	76.14%
10 000 to 19 999	4 540	30.27%	5 540	36.93%
20 000 to 29 999	4 580	18.32%	5 660	22.64%
30 000 to 49 999	4 980	12.45%	5 970	14.93%
50 000 to 99 999	5 710	7.61%	7 010	9.35%
100 000 and over	6 590	6.59%	8 120	8.12%
Total	5 270		6 300	

1. Figures are calculated using the middle point of the income band.

Table A.21: Average investment in UK PEPs as percentage of income ¹

Income classes (GBP)	Average investment	Av investment as % of income
Under 5 000	12 360	247.20%
5 000 to 9 999	15 590	207.88%
10 000 to 19 999	14 820	98.80%
20 000 to 29 999	15 920	63.68%
30 000 to 49 999	17 970	44.93%
50 000 to 99 999	22 220	29.63%
100 000 and over	29 800	29.80%
Total	19 950	

1. Figures are calculated using the middle point of the income band.

**Table A.22: Characteristics of Education Savings Account Investor Households with Children (USA).
2001 Survey of Consumer Finances**

	All households w/ children 16 or under	Education savers (529 or ESA)	Retirement savers (IRA or Keogh)	Education Savers vs. Retirement Savers	Education Savers vs. All households
Has 529 or ESA	3%	100%	5%	-	-
Has IRA or Keogh	38%	70%	100%	-	-
Median Income	50 000	91 000	75 000	16 000	41 000
Median Net Worth	61 830	281 200	227 600	53 600	219 370
Mean Balance in IRA Accounts	20 132 (108 599)	89 400 (276 948)	56 523 (174 129)	32 877 (28 073)	69 268 (17 480)
Mean Balance in 529 Accounts	126 (2 239)	4 664 (12 951)	148 (3 045)	4 516 (694)	4 538 (465)
Age of Oldest Parent	38.78 (8.50)	40.98 (6.59)	41 (8.05)	-0.02 (1.22)	2.2 (1.26)
Age of Oldest Child	10.71 (5.88)	9.42 (5.23)	10.46 (5.74)	-1.04 (0.87)	-1.29 (0.88)
Number of Children	2.08 (1.05)	1.99 (0.86)	2.07 (0.99)	-0.08 (0.15)	-0.09 (0.16)
Highest Education of parents	13.89 (2.49)	16.19 (1.18)	14.91 (2.3)	1.28 (0.34)	2.30 (0.37)
Parent BA or Higher	0.37 (0.48)	0.91 (0.29)	0.59 (0.49)	0.32 (0.07)	0.54 (0.07)
Number of observations	1533	46	588	-	-

Notes: Standard deviations in parentheses in first three columns. Standard errors in parentheses in last two columns.

Source: Dynarski S. M., 2004.

**Table A.23: Incidence of Saving for College among Responding Households by
Income and Education (percent of respondents) (USA)**

(USD)	Saving for college (%)	Not saving for college (%)
All	64	36
Household income		
- less than 50 000	40	60
- 50 000 to 74 999	65	35
- 75 000 or more	72	28
Highest Level of Education in Household		
- High school or less	51	49
- Some college or associate's degree	53	47
- Four year college or postgraduate degree	74	26

Source: ICI, 2004.

Table A.24: Types of Investment used to Save for College (USA)

	% of respondents saving for college
Taxable investments (total)	93
US Savings Bonds (total)	42
Education-targeted savings programs (total)	20
UGMA or UTMA accounts (total)	15
One type of investment	44
-Taxable investments only	39
-US Savings Bonds only	1
-Education-targeted savings programs only	3
UGMA or UTMA accounts only	1
Two types of investments	43
-Taxable investments and US Savings Bonds	29
-Taxable investments and education-targeted savings programs	7
-Taxable investments and UGMA or UTMA accounts	6
-UGMA or UTMA accounts and education-targeted savings programs	1
Three types of investments	11
-Taxable investments, US Savings Bonds and education-targeted savings programs	5
-Taxable investments, US Savings Bonds and UGMA or UTMA accounts	4
-Taxable investments, UGMA or UTMA accounts and education-targeted savings programs	2
All four types of investments	2
Number of respondents	766

Source: ICI, 2004.

Table A.25: Characteristics of households saving for college expenses (USA)

	Using Education-Targeted Savings Program	Not Using Education-Targeted Savings Program
Median		
Age	41 years	42 years
Household income	USD 99 200	USD 74 500
Household financial assets	USD 129 100	USD 70 000
Current college savings	USD 15 000	USD 10 000
Year saving for college	6 years	6 years
Age of oldest or only child	9 years	12 years
Percent		
Married or living with a partner	94%	90%
College or postgraduate degree	73%	51%

	Using Education-Targeted Savings Program	Not Using Education-Targeted Savings Program
Employed	89%	84%
Number of Children		
- One	29%	33%
- Two	51%	44%
- Three or more	20%	23%
Participate in or covered by employer-sponsored retirement plan	89%	83%
Have traditional or Roth IRA	73%	47%
Sources consulted about saving for college:		
- Newspaper, newsletter, or magazine articles	72%	58%
- Professional financial adviser	65%	52%
- Friends or family members	55%	55%
- Brochures or printed advertisements	58%	41%
- The internet	51%	32%
Very or somewhat likely to meet college savings goal	81%	86%
Very or somewhat likely to rely on college funding from:		
- Academic or athletic scholarships	62%	72%
- Student loans	57%	68%
- Income or savings earned by child	53%	63%
Expect financial assistance from adult (relative(s) for college expenses	32%	37%

Source: ICI, Profile of Households Savings for College, Investment Company Institute Research Series, Fall 2003.

Table A.26: Households asset in Education-Targeted Savings Programs (USA)
(Percent of respondents owning each type of education-targeted savings program)

(USD)	State-Sponsored 529 Prepaid Tuition Plans	State-Sponsored 529 College Savings Plans	Coverdell ESAs
Less than 2 500	31	26	32
2 500 to 4 999	16	19	26
5 000 to 9 999	22	21	23
10 000 or more	31	34	19
Mean per household	14 500	11 200	7 400
Median per household	5 000	5 000	4 000
Number of respondents	113	250	119

Source: ICI, Profile of Households Savings for College, Investment Company Institute Research Series, Fall 2003.

Table A.27: Danish Savings Accounts for Children

	2002	2001	2000	1999	1998	1997	1996	1995	1994
Financial assets, billions DKK	2.071	2.155	2.235	2.042	1.924	1.937	1.704	1.530	1.392
Deposits on child account as pct. of total financial assets	0.47%	0.43%	0.41%	0.45%	0.46%	0.44%	0.51%	0.58%	0.68%

Table A.28: Dutch Payroll Savings Schemes

Year	Average amount (EUR)	% workers with payroll schemes	Average amount participants (EUR)	Maximum amount participants (EUR)	Percentage participants contributing maximum amount
1995	190	28.53%	650	717	91%
1996	230	34.70%	670	733	91%
1997	260	37.54%	690	743	93%
1998	290	40.81%	700	758	92%
1999	300	41.47%	720	774	93%
2000	310	42.23%	730	788	93%
2001	320	43.22%	730	788	93%
2002	320	43.00%	740	788	94%
2003	240	41.03%	590	613	96%

Source: Statline, Dutch Central Bureau of Statistics / survey employment and wages

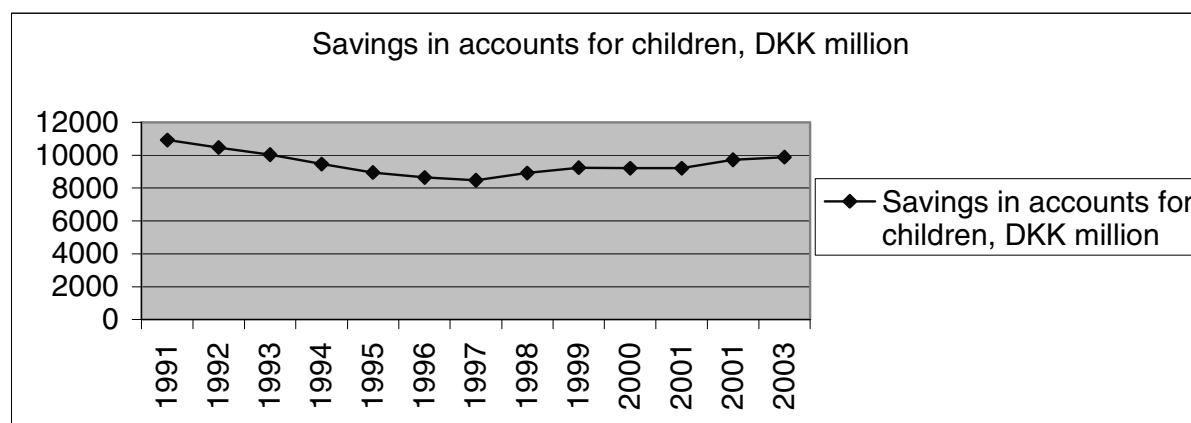
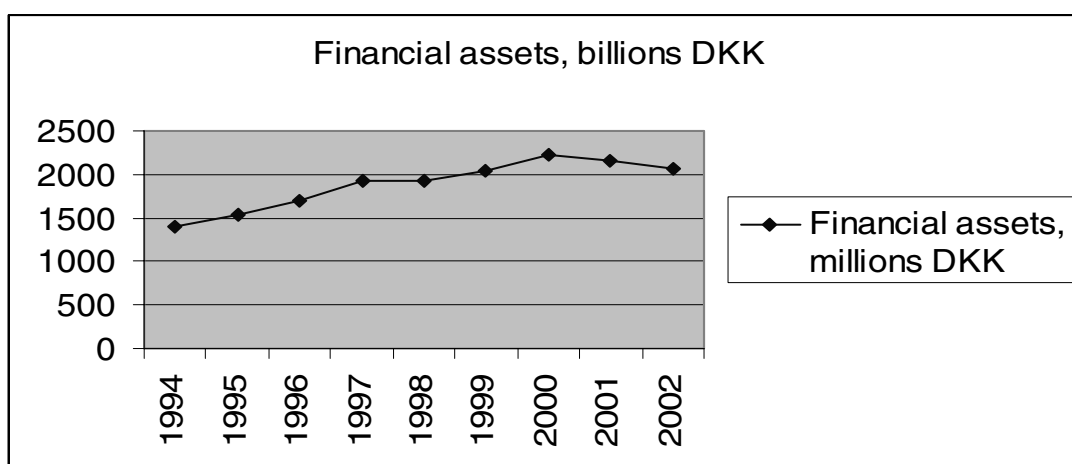
Figure A.4: Historical evolution of funds located in Danish tax-preferred accounts for children/grandchildren

Figure A.5: Historical evolution of private financial assets in Denmark**Table A.29: Gross financial, real, total and AMS wealth for AMS holders (Norway), 1996-1999**
Millions of NOK

	Gross financial capital	Real wealth	Total wealth	AMS wealth
1996	123 842	87 792	211 634	2 240.0
1997	159 192	115 093	274 285	2 940.0
1998	167 902	105 807	273 709	2 553.3
1999	202 336	110 853	313 189	2 726.7

Source: Tax statistics 1996-1999, Statistics Norway.

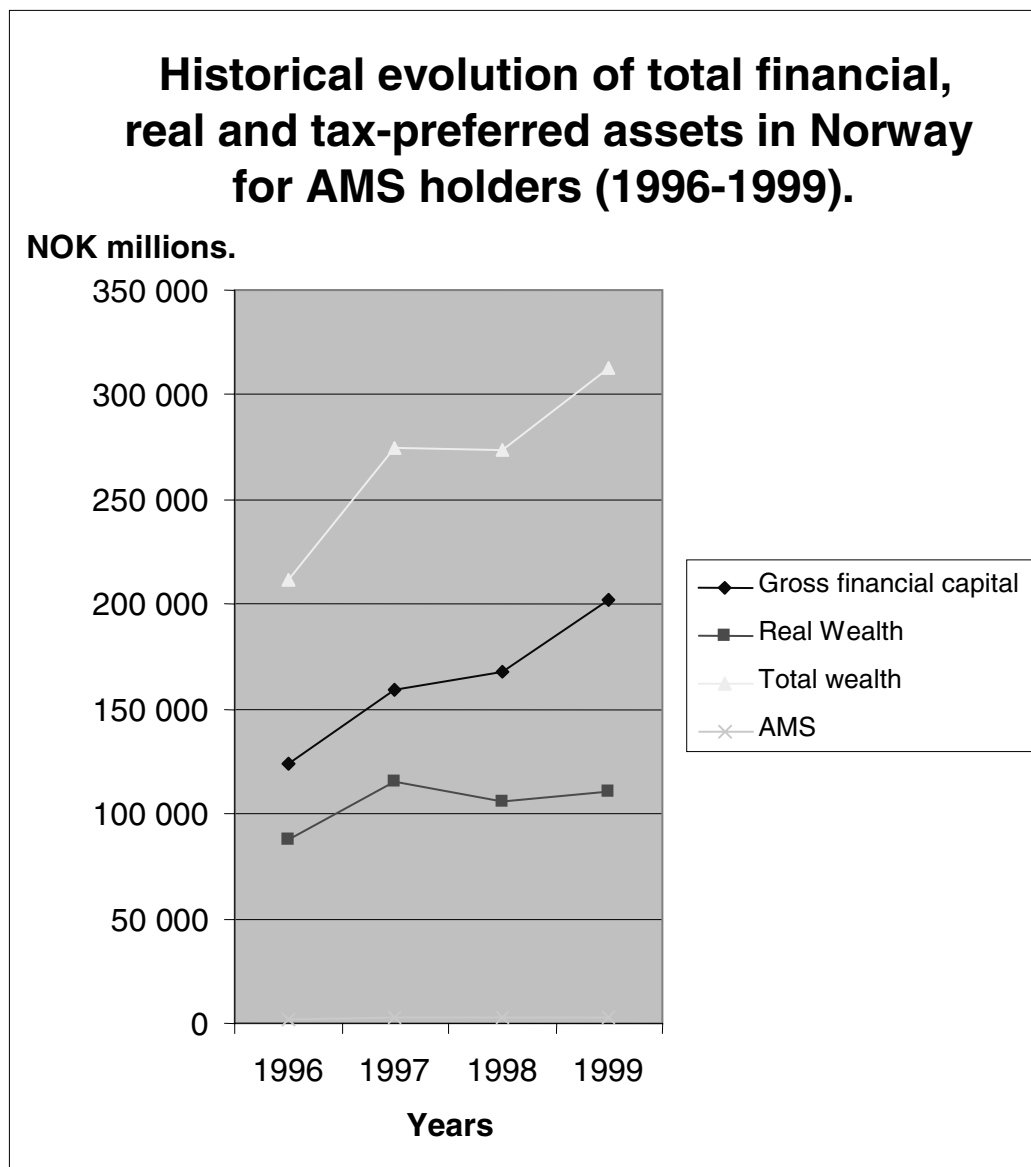
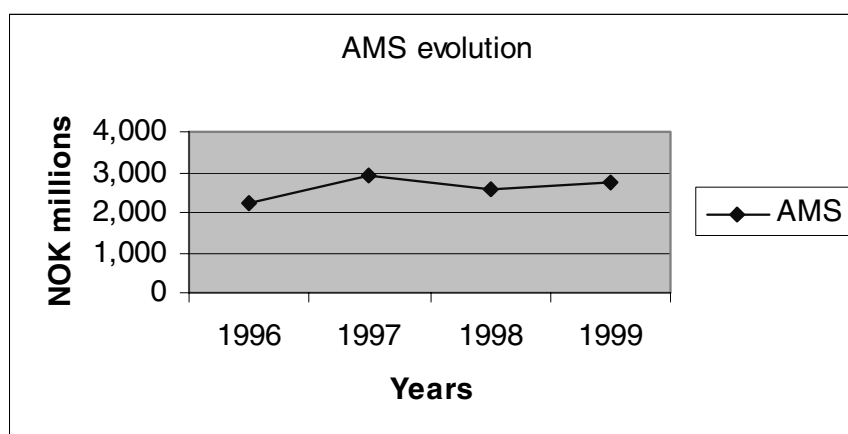
Figure A.6: Historical evolution of financial, real, total and AMS wealth for AMS holders in Norway

Figure A.7: Historical evolution of AMS wealth in Norway**Table A.30: Contributors eligible to the maximum deduction for Norwegian AMS**

	Maximum deduction entitled: 750 NOK			Maximum deduction entitled: NOK 1500		
	Total no. contributors	Contributors with highest deduction	Contributors with highest deduction (% total contributors)	Total no. contributors	Contributors with highest deduction	Contributors with highest deduction (% total contributors)
1997	132 002	110 425	83.7%	131 908	86 808	65.8%
1998	120 351	96 024	79.8%	115 056	70 108	60.9%
1999	124 317	99 802	80.3%	128 163	77 917	60.8%

Table A.31: Wealth invested in tax-free accounts in the UK

Year	Wealth invested in risk-free taxable accounts (GBP 000)	Wealth in taxable risky assets (GBP 000)	Wealth in tax-free accounts (GBP 000)	% of tax-free accounts on total taxable wealth
1997-98	25 403.19	34 274.66	7 063.914	10.58
1998-99	24 807.86	34 287.06	9 392.317	13.71
1999-2000	25 097.89	34 404.60	10 521.28	15.02
2000-01	25 794.55	32 780.03	13 724.41	18.98
2001-02	20 972.32	28 060.50	16 967.38	25.71
2002-03	23 385.93	30 708.36	16 740.60	23.63

Table A.32: Funds under management in ISAs in the UK

Year	Amount (GBP millions)	% increase
1999-2000	28 708	
2000-01	61 976	115.88%
2001-02	82 813	33.62%
2002-03	104 768	26.51%
2003-04	126 313	20.56%

Table A.33: Funds under management in TESSAs in the UK

Year	Amount (GBP millions)	% increase
March 1991	5 141	-
March 1992	10 412	102.53%
March 1993	16 016	53.82%
March 1994	21 383	33.51%
March 1995	25 586	19.66%
March 1996	24 545	-4.07%
March 1997	26 147	6.53%
March 1998	27 784	6.26%
March 1999	30 244	8.85%
March 2000	29 816	-1.42%
March 2001	18 637	-37.49%
March 2002	12 177	-34.66%
March 2003	6 523	-46.43%
March 2004	Not Available	-
March 2005	Nil	-

Table A.34: Average contributions in ISAs by income class (UK)

Income classes	Av. Contribution 2000-01 (GBP)	Av. Contribution 2001-02 (GBP)	% increase
Under 5 000	2790	2310	-17.20%
5 000 to 9 999	2860	2470	-13.64%
10 000 to 19 999	2800	2370	-15.36%
20 000 to 29 999	2940	2560	-12.93%
30 000 to 49 999	3290	2860	-13.07%
50 000 to 99 999	4360	3820	-12.39%
100 000 and over	5340	4790	-10.3 %
Total	3660	3050	-16.67%

Table A.35: Age, Social Class and Household Income by what respondents would have done with the money that they saved in the ISAs if ISAs had not existed (UK)

	Row Percentages				
	Financial arrangements for money saved in ISAs if ISAs had not existed				
	Not save/ invest	Save the money	Invest the money	Other	Total
Age					
18-24	39	55	6	1	100
25-34	24	58	15	2	100
35-44	17	61	17	5	100
45-54	11	71	13	6	100
55-64	11	60	23	6	100
65+	11	67	14	8	100
Social Class					
AB	11	69	18	3	100
C1	15	62	17	5	100
C2	17	63	14	7	100
DE	25	58	10	7	100
Household Income					
Under GBP 9 499	14	70	9	7	100
GBP 9 500 – GBP 19 999	23	57	15	5	100
GBP 20 000 – GBP 34 999	11	66	18	4	100
GBP 35 000+	12	70	15	3	100
Total	15	64	16	5	100

Notes: Social Class Codes: AB Upper middle and middle class; C1 Lower middle class; C2 Skilled working class; DE Working class and those at the lowest level of subsistence. Overall 39% of survey respondents refused to provide details of their household income. 32% of those who did not reveal their household income had an ISA. Base: All adults with an ISA – Age 1260, Social Class 1260, Household Income 672.

Table A.36: Belgium Tax Expenditures for Tax-preferred Deposit Accounts

	Years	Accrued interest on regulated deposit accounts	Private households outstanding amount of regulated deposits	Private household/total outstanding deposits	Revenue foregone for private households	Intr/outst
	2001	2 449	89 299.3	94.9%	348.4	2.60%
	2002	2 796	100 034.3	94.1%	394.6	2.63%
	2003	3 061	119 760.0	93.9%	430.9	2.40%
	2004	3 145	133 906.3	93.5%	441.1	2.20%
Ratio to GDP	2001	0.9%	34.5%		0.13%	
	2002	1.0%	27.4%		0.15%	
	2003	1.1%	43.6%		0.16%	
	2004	1.1%	46.5%		0.15%	

Note: figures are in millions of EUR.

Table A.37: Belgium tax expenditure for Tax-preferred Life-Insurance contracts (1999)

Income (EUR)	Bands (EUR)	Tax Expenditure (EUR)
0	203	23 736
203	300	48 038
300	400	103 098
400	500	205 289
500	600	299 868
600	700	391 151
700	800	479 833
800	900	527 643
900	1000	488 151
1000	1100	472 602
1100	1200	471 558
1200	1300	457 647
1300	1400	440 402
1400	1500	416 209
1500	1600	395 359
1600	1700	367 670
1700	1800	346 174
1800	1900	323 706
1900	2000	301 149
2000	3000	1 841 121
3000	4000	523 678

Income (EUR)	Bands (EUR)	Tax Expenditure (EUR)
4000	5000	177 567
5000	10000	159 091
10000		26 850
Total		9 290 592

Table A.38: Tax expenditure for Belgian Tax-preferred Life-Insurance contracts (2002)

Income (EUR)	Bands (EUR)	Tax Expenditure (EUR)
0	5 000	455 345
5 000	10 000	3 090 752
10 000	12 500	4 435 057
12 500	15 000	6 514 488
15 000	17 500	8 424 823
17 500	20 000	10 945 331
20 000	22 500	12 863 694
22 500	25 000	13 136 252
25 000	27 500	12 191 265
27 500	30 000	11 725 645
30 000	32 500	11 447 737
32 500	35 000	11 249 086
35 000	37 500	10 566 863
37 500	40 000	10 295 665
40 000	42 500	9 684 037
42 500	45 000	9 457 960
45 000	50 000	17 044 923
50 000	62 500	33 430 365
62 500	75 000	20 783 690
75 000	100 000	17 148 290
100 000	125 000	6 185 878
125 000	150 000	2 633 266
150 000	250 000	2 715 337
250 000	and more	800 101
Total		247 225 848

Note: Figures are in EUR.

Table A.39: Canadian Tax Expenditure per RESPs

	Expenditure (CAD millions)	Expenditure per contract (CAD)	Expenditure per CAD 1 invested (CAD)	Expenditure as % of GDP
1999	75	52.44755245	0.013426423	0.008%
2000	97	56.49388468	0.013485333	0.009%
2001	105	54.97382199	0.012748907	0.010%
2002	115	52.05975555	0.0114977	0.010%
2003	125	54.01901469	0.010299085	0.010%
2004	125	49.72155927	0.008576329	0.010%
2005	140	-	-	-
2006	145	-	-	-

Note: figures for 1999, 2000, and 2001 are estimated. Figures for the following years are projections.

Table A.40: Canadian RESPS Tax Expenditure, including CESG and CLB

	General expenditure for RESPs ¹	Expenditure for CESG only	Expenditure for the enhanced CESG ²	Expenditure for CLB	Total expenditure (CAD millions)	Total expenditure per contract	Total expenditure per CAD 1 invested	Total expenditure as % of GDP
1997	--	--	--	--	--	--	--	--
1998	--	149.725	--	--	--	--	--	--
1999	75	290.058	--	--	365.058	255.2853147	0.065352309	0.038%
2000	97	316.483	--	--	413.483	240.8171229	0.057484082	0.039%
2001	105	345.946	--	--	450.946	236.0973822	0.054753035	0.041%
2002	115	367.698	--	--	482.698	218.5142598	0.048260148	0.042%
2003	125	386.152	--	--	511.152	220.8954192	0.042115185	0.043%
2004	125	420.786	--	85	630.786	250.9093079	0.043278628	--
2005	140	388.00	80	85	693	--	--	--
2006	145	--	--	--	--	--	--	--

Source: Figures in column 3 (*i.e.* Expenditure for CESG only) are drawn for Quarterly Statistical Review, 1st Quarter 2005, Canada Education Savings Grant Program, Human Resources and Skills Development Canada. Figures in columns four (*i.e.* Expenditure for the enhanced CESG) and five (Expenditure for CLB) are drawn from Canada 2004 Budget Plan, p.118.

1. The tax expenditure for RESPs represents the federal tax revenue that would have been generated on the tax-sheltered investment income earned by assets deposited in RESPs had that income been taxed. From this amount the federal tax revenue that was generated through the taxation of taxable withdrawn (Educational Assistance Payments and Accumulated Income Payments) from RESPs.
2. The Canada learning Bond (CLB) along with the enhanced Canada Education Savings Grant program was proposed in the March 2004 federal Budget, and both programs became operational on 1 July 2005. CLB entitlements have accumulated since January 2004 and eligible contributions made to RESPs since January 2005 have attracted enhanced CESG. For further details on enhanced CESG and CLB, see Chapter 2.

Table A.41: Norwegian Tax Expenditure for AMS

	AMS total amount (millions NOK)	Total tax expenditure (millions NOK)	% increase	Expenditure as a % of GDP	Tax expenditure per participant (NOK)	Tax expenditure per NOK invested
1996	2 240.0	336.0		0.033%	916.107959	0.15
1997	2 940.0	441.0	31.25%	0.040%	899.1210633	0.15
1998	2 553.3	383.0	-13.15%	0.034%	878.809225	0.15
1999	2 726.7	409.0	6.79%	0.033%	880.7574945	0.15

Note: Tax expenditure is calculated as 15% of total funds invested in the AMS.

Table A.42: UK ISAs Tax Expenditure

Year	Tax expenditure (GBP millions)	% increase	Expenditure as % of GDP	Tax expenditure per participant (GBP)	Tax expenditure per pound invested ¹ (GBP)
1999-00	120		0.01%	-	0.0042
2000-01	420	250%	0.04%	-	0.0068
2001-02	725	72.62%	0.07%	33.65	0.0088
2002-03	800	10.34%	0.08%	50.91	0.0076
2003-04	1000	25%	0.09%	-	0.0079

1. We calculate the tax expenditure per pound invested by dividing the total yearly tax expenditure by the total amount of funds invested in ISAs.

Table A.43: UK ISAs Tax Expenditure per Income Class 2000-01

Income classes (GBP)	No. of participants 2000-01 (millions)	Av. Investment 2000-01 (GBP)	Total investment 2000-01 (GBP millions)	Tax expenditure ¹ 2000-01 (GBP millions)
Under 5 000	1.75	4260	7455	50.69
5 000 to 9 999	2.39	4810	11495.9	78.17
10 000 to 19 999	3.8	4540	17252	117.31
20 000 to 29 999	2.25	4580	10305	70.07
30 000 to 49 999	1.4	4980	6972	47.41
50 000 to 99 999	0.66	5710	3768.6	25.63
100 000 and over	0.23	6590	1515.7	10.31
Total	12.48	5270	65769.6	447.23

1. We calculate the tax expenditure for each income class by multiplying the total amount of investment for each class for the tax expenditure per pound invested.

Table A.44: UK ISAs Tax Expenditure per Income Class 2001-02

Income classes	No of participants 2001-02 (millions)	Av. Investment 2001-02 (GBP)	Total investment (GBP millions)	Tax expenditure (GBP millions)
Under 5 000	2.32	5280	12249.6	107.80
5 000 to 9 999	2.63	5710	15017.3	132.15
10 000 to 19 999	4.24	5540	23489.6	206.71
20 000 to 29 999	2.41	5660	13640.6	120.04
30 000 to 49 999	1.64	5970	9790.8	86.16
50 000 to 99 999	0.73	7010	5117.3	45.03
100 000 and over	0.26	8120	2111.2	18.58
Total	14.24	6300	89712.0	789.47

Table A45: UK Tax Expenditure for PEPs

Year	Tax expenditure (GBP millions)	% increase	Tax expenditure as % of GDP ¹	Tax expenditure per participant (GBP)	Tax expenditure per pound invested (GBP)
1997-98	800	-	0.10%	N/A	0.010276172
1998-99	1 000	25.00%	0.12%	N/A	0.010879025
1999-00	1 000	0.00%	0.11%	N/A	0.010638298
2000-01	875	-12.50%	0.09%	N/A	0.010786489
2001-02	700	-20.00%	0.07%	152.17	0.009358289
2002-03	625	-10.71%	0.06%	N/A	0.010892297
2003-04	625	0.00%	0.06%	N/A	0.009282638

1. GDP figures used are at current market prices.

Table A46: UK PEPs Tax Expenditure per Income Class, 2001/02

Income classes	Number of participants in PEPs (millions)	Average investment (GBP)	Total investment (GBP millions)	Tax expenditure (GBP millions)
Under 5 000	0.6	12 360	7 416	69.41376
5 000 to 9 999	0.79	15 590	12 316.1	115.278696
10 000 to 19 999	1.28	14 820	18 969.6	177.555456
20 000 to 29 999	0.8	15 920	12 736	119.20896
30 000 to 49 999	0.64	17 970	11 500.8	107.647488
50 000 to 99 999	0.35	22 220	7 777	72.79272
100 000 and over	0.14	29 800	4 172	39.04992
Total	4.6	19 950	91 770	858.9672

Table A.47: UK Tax Expenditure for TESSAs

Year	Amount (GBP millions)	% increase	Tax expenditure as % of GDP	Tax expenditure per participant (GBP)	Tax expenditure per pound invested ¹ (GBP)
1997-98	400	-	0.049%	N/A	0.014396775
1998-99	400	0.00%	0.047%	70.92	0.013225764
1999-00	375	-6.25%	0.042%	N/A	0.01257714
2000-01	400	6.67%	0.042%	N/A	0.021462682
2001-02	150	-62.50%	0.015%	N/A	0.012318305
2002-03	100	-33.33%	0.010%	N/A	0.015330369
2003-04	50	-50.00%	0.005%	N/A	N/A

1. We calculate the tax expenditure per pound invested by dividing the total yearly tax expenditure (Table 9) by the total amount of funds invested in TESSAs (Table A.8).

Table A.48: US Tax Expenditure for 529 plans

	Expenditure (USD millions) ¹	Amount invested (USD millions)	Number of accounts (millions)	Expenditure per USD 1 invested	Expenditure per contract (USD)
1999	120	6200	-	0.019354839	
2000	100	8600	1.3	0.011627907	76.92307692
2001	190	15600	2.6	0.012179487	73.07692308
2002	270	26800	4.4	0.010074627	61.36363636
2003	50	45800	6	0.001091703	8.333333333
2004	210	64700	7.2	0.00324575	29.16666667

Note: The data for each year N is from the Federal Budget for year N+2. For example, 1999 is a tax expenditure estimate from the 2001 budget. Data on the number of contracts and on the amount of assets deposited in 529 plans are taken from the Investment Company Institute website, www.ici.org.

1. Tax expenditures are defined in the US law as ‘revenue losses attributable to provisions of the Federal tax laws which allow a special exclusion, exemption, or deduction from gross income or which provide a special credit, a preferential rate of tax, or a deferral of liability’. These exceptions may be viewed as alternatives to other policy instruments, such as spending or regulatory programs. Identification and measurement of tax expenditures depends importantly on the

baseline tax system against which the actual tax system is compared. Each tax expenditure estimate here was calculated assuming other parts of the tax code remained unchanged.

Table A.49: USA Tax Expenditure for ESAs

	ESAs Expenditure (USD millions)	Amount invested (USD millions)	No. of accounts (millions)	Expenditure as % of GDP	Expenditure per account (USD)
2000	20	1135	1.57	0.00020%	12.73885
2001	30			0.00030%	
2002	50			0.00048%	
2003	70			0.00064%	
2004	110			0.00094%	

Table A.50: Italian Tax Expenditure for Life-Insurance contracts

Year	Total expenditure (EUR)	No. participants	Expenditure per participant
2001	1 662 199 800	9 453 591	175.8273443
2002	1 546 793 420	9 034 510	171.2094425

Table A.51: Italian Tax Expenditure per Income Class, 2001

Income class	Premia attracting tax credit	Tax expenditure (19% tax credit)
up to 5 000	380 083 000	72 215 770
from 5 000 to 10 330	990 524 000	188 199 560
from 10 330 to 15 490	1 597 765 000	303 575 350
from 15 490 to 20 000	1 703 850 000	323 731 500
from 20 000 to 30 990	2 365 473 000	449 439 870
from 30 990 to 40 000	630 655 000	119 824 450
from 40 000 to 60 000	554 854 000	105 422 260
from 60 000 to 80 000	246 615 000	46 856 850
from 80 000 to 100 000	114 952 000	21 840 880
from 100 000 to 120 000	57 381 000	10 902 390
from 120 000 to 150 000	43 005 000	8 170 950
from 150 000 to 200 000	30 397 000	5 775 430
more than 200 000	32 866 000	6 244 540
Total	8 748 420 000	1 662 199 800

Note: Figures are in EUR.

Table A.52: Italian Tax Expenditure per Income Class, 2002

Income class	Premia attracting tax credit	Tax expenditure (19% tax credit)
up to 5 000	426 494 000	81 033 860
from 5 000 to 10 330	784 222 000	149 002 180
from 10 330 to 15 490	1 394 077 000	264 874 630
from 15 490 to 20 000	1 565 637 000	297 471 030
from 20 000 to 30 990	2 274 289 000	432 114 910
from 30 990 to 40 000	636 715 000	120 975 850
from 40 000 to 60 000	546 867 000	103 904 730
from 60 000 to 80 000	242 188 000	46 015 720
from 80 000 to 100 000	110 883 000	21 067 770
from 100 000 to 120 000	55 442 000	10 533 980
from 120 000 to 150 000	41 863 000	7 953 970
from 150 000 to 200 000	29 713 000	5 645 470
more than 200 000	32 626 000	6 198 940
Total	8 141 018 000	1 546 793 420

Note: Figures are in EUR.

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Encouraging Savings through Tax-Preferred Accounts

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