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*Newsletter – October 2020*

# *Pillar 3a – Is it really "worth it"?*

Pillar 3a is part of your private pension scheme. It has been proven to be one of the most flexible ways to reduce your tax liability and increasing your pension assets. Pillar 3a savings can further facilitate the purchase or renovation of self-used real estate property as well as leading to a double tax benefit through "indirect amortization" of your mortgage liability. The following newsletter explains the general pros and cons of the Pillar 3a and highlight the differences of a banking and insurance solution.

## Pros

Tax privileges on Pillar 3a contributions are granted in order to support individual retirement savings. Therefore, savings on a Pillar 3a account or insurance policy are typically blocked until the age of 60. Using these assets in the private pension scheme enables early retirement up to 5 years (men) resp. 4 year (women). Even before reaching the age of 60, it is possible to withdraw these pension savings in certain cases. Pillar 3a savings can be withdrawn in order to purchase or renovate self-used real estate property, paying off a mortgage, starting self-employment or in case you decide to permanently leave Switzerland. Despite the assets generally being blocked, Pillar 3a currently provides a large degree of flexibility compared to other social security schemes.

Pillar 3a grants the option to break tax progression during years of employment with typically high taxable income. Depending on the individual marginal tax rate, tax benefits can be a significant percentage of the contributions made. In addition, future distributions will not be subject to regular income tax rates but will be taxed at separate lower tax rates. In a way, Pillar 3a contributions can therefore enable double tax advantage. Similar to regular income tax rates, cantonal differences in capital distribution tax rates vary significantly. As a result, it can be more beneficial to transfer Pillar 3a assets to a bank resident in a more tax beneficial canton, for instance when leaving Switzerland permanently.

Although banks currently do not grant significant interest rates on regular current accounts and savings accounts, they still provide at least a small interest rate on Pillar 3a accounts. Certain banks even offer having the assets invested based on various risk profiles to be chosen, which should on the long term provide a larger return on investment. The income earned on Pillar 3a assets are not subject to normal income tax and the total amount of savings is not subject to wealth tax as the assets are part of social security savings. That said, only the yearly contributions made need to be declared in your annual tax return.

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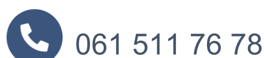
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Often underestimated is the impact of the annual return on investment on the projected future savings. An annual contribution of CHF 5’000 for an employment duration of 40 years and an interest payment in arrear results in the following projected pension savings:

| *Ø Annual interest* | **0.0%** | **0.5%** | **1.0%** | **1.5%** |
|---|---|---|---|---|
| *Future savings* | 200’000 | 220’794 | 244’432 | 271’339 |
| *Difference* | | **+20’794** | **+44’432** | **+71’339** |

Considering the accumulated assets only being taxable at lower tax rates when withdrawing them, Pillar 3a provides financial benefits on several layers.

## Cons

With certain exceptions, the Pillar 3a savings are generally blocked until the age of 60. Those assets are therefore not accessible for private investments or personal emergencies such as accident. It is therefore recommended to accumulate additional savings that are accessible anytime or to take out insurance to sufficiently cover risks.

The maximum tax-deductible amount for employed taxpayers has been regularly increased during past years, the annual contribution is though mostly quite limited compared to potential buy-ins into the company pension fund (Pillar 2). Nevertheless, large additional pension savings can be accumulated within the Pillar 3a for the duration of employment. The earlier Pillar 3a contributing is started, the higher potential benefits will be during the years of contributions.

## Bank or insurance?

A Pillar 3a account at a bank relates to the conventional principle of saving money. The future assets equal the total amount of contribution as well as accumulated return. The most conventional solution, a Pillar 3a savings account at a bank, provides maximum security respectively the lowest risk as the future assets sum up to at least the amount of contributions made. Having the savings being invested bears the risk that at a certain stage the assets are lower than the total amount of contributions made despite legal restrictions on the risk banks are allowed to take during the investment. In general, the payment timing and amount can be chosen individually, which provides great flexibility.

Insurances on the other hand provide Pillar 3a insurance policies, which contain both a savings part as well as an insurance against certain risk, such as death or disability. In case of loss of income due to accident or sickness, the insurance provider would bear the annual contribution on your behalf or in case of death pay a onetime compensation to the surviving dependents. A Pillar 3a insurance policy states both payment amount and timing and the insured person is obliged to stick to this payment schedule. Due to this “forced saving” as well as the exemption from payment of premium in the event of disability, it is guaranteed to reach the savings goal.

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## Forecast

Both the National Council and the Council of States decided early June 2020 to allow retroactive contributions to the Pillar 3a in the future. The principle of closing pension savings gaps is already known from company pension funds (Pillar 2) and should be applied to Pillar 3a in the coming years too. Among others, mothers would be allowed to close former savings gaps due to interruption of employment while taking care of their children.

As especially the state pension (Pillar 1) is having funding issues and future pensions both from Pillar 1 and Pillar 2 will be drastically reduced, private pension saving will become much more important. If the known standard of living should be maintained, there will be absolutely no way around voluntary private pension savings within Pillar 3.

## Conclusion

It is recommended to start private pension saving as early as possible to optimize the effect of accrued profits. Whether having a Pillar 3a bank account or an insurance policy is mainly depending on your personal background, future goals and financial planning. We definitely recommend to first consult a professional financial advisor and discuss the benefits of Pillar 3a in your individual situation as there are certain factors that could even lead to a negative financial impact of having private pension savings.

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