BANK ĊENTRALI TA' MALTA
EUROSISTEMA
CENTRAL BANK OF MALTA

EVALUATING THE IMPACT OF TAX REBATES AND EXEMPTIONS ON THE FINANCIAL WELL-BEING OF PENSIONERS

Published in the Quarterly Review 2025:1, pp. 67-70

BOX 3: EVALUATING THE IMPACT OF TAX REBATES AND EXEMPTIONS ON THE FINANCIAL WELL-BEING OF PENSIONERS[1]

This box provides a brief overview of a 2024 Working Paper which evaluates the impact of two policies that are relevant for the financial well-being of pensioners.[2] The two policies are the 2017 Tax Rebate on Pensions and the 2022 Exempt Pension Income measures. Using the EUROMOD microsimulation model, the effects on pensioners' disposable income, work incentives and financial well-being are simulated for the 2017-2027 period.

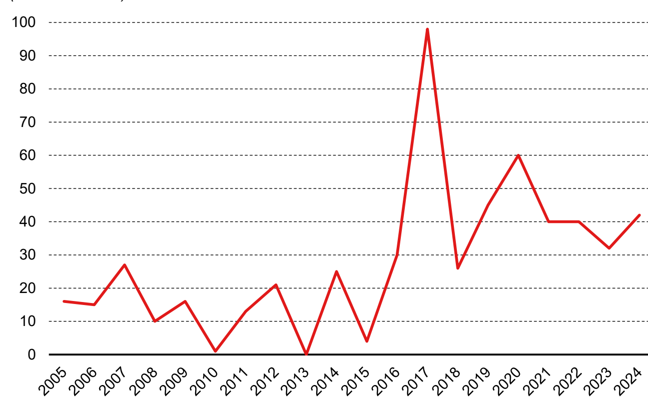
The 2006 Pension Reform and subsequent Budget Measures

Malta's present pension system has been shaped by a series of wide-ranging reforms and budget measures over the years. These reforms are necessary to ensure that the pension system remains sustainable, equitable and adequate, as it faces increasing pressures from various socio-economic factors. One of the primary drivers of these reforms stems from Malta's ageing population.

In December 2006, Parliament adopted a series of parametric reforms that significantly altered key aspects of the pension system. These changes include adjustments to the retirement age, early retirement provisions, the full two-thirds pension rate, the calculation formula, maximum pensionable income and the crediting of contributions. As part of these reforms, the pension age was gradually increased for both men and women.[3]

Beyond the 2006 reforms, pensions have remained a central focus of nearly every annual budget, with several measures introduced or amended to address evolving pension-related challenges. This is illustrated by an increase in the use of the term "pension/s" in recent budgets (see Chart 1).

Chart 1
NUMBER OF MENTIONS OF "PENSION/S" IN BUDGET SPEECHES (2005-2024)
(number of times)



Source: Author's NLP analysis from Ministry of Finance (2004-2023).

A notable measure introduced in the 2017 budget is the Tax Rebate on Pensions, which took effect on 1 January 2017. This rebate applies to individuals receiving any form of taxable pension income – including pensions,

[1] Prepared by Kurt Sant, Senior Economist within the Economic Analysis Department of the Bank. The views expressed in this article represent those of the author and should not be interpreted to reflect those of the Bank. Any errors are the author's own.
[2] Sant, K. (2024) "Evaluating the Impact of Tax Rebates and Exemptions on the Financial Well-Being of Pensioners", Central Bank of Malta *Working Paper* 08/2024.
[3] For further details on the pension reform and on its possible long-term impact see Grech, A.G. (2016) "The possible impact of pension age changes on Malta's potential output", Central Bank of Malta *Policy Note*.

charges, annuities, or annual payments – who were at least 61 years old in the year the pension was received.

Furthermore, in the 2022 budget, Government introduced the Exempt Pension Income measure, which provides a partial exemption on all pension income, gradually increasing to a full exemption by 2026, subject to a cap. According to Government, the aim of the policy is to encourage pensioners to remain active and continue working, with those earning additional income on top of their pension benefitting from a substantial reduction in their tax bill. Previously, under the 2017 tax rebate scheme, individuals received a rebate equal to the tax on their pension income (up to a certain limit). While this rebate exempted pension income from direct taxation, the untaxed portion was still considered/included when calculating tax rates on the remaining taxable income. The 2022 reform, however, fully exempts the specified portion of pension income from being factored into tax calculations.

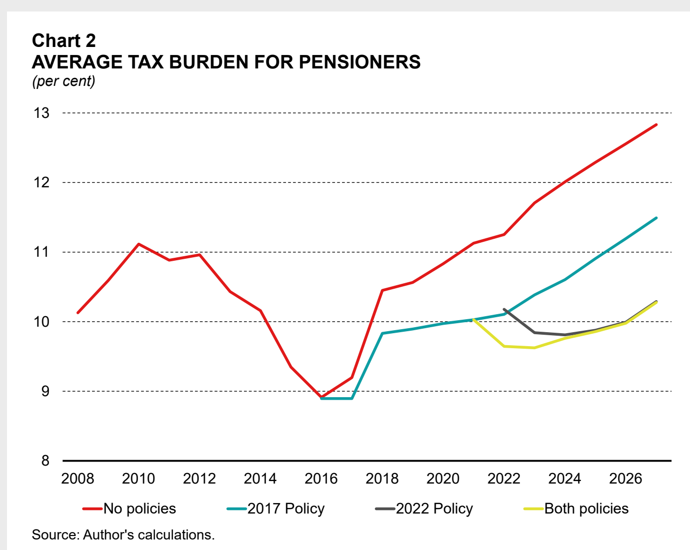
The 2017 Tax Rebate on Pensions implemented targeted tax relief for pensioners, potentially affecting their disposable income substantially. Likewise, the 2022 Exempt Pension Income measure provides a partial to full exemption from tax by excluding a portion of pension income from taxation. Both measures could have considerable implications for retirees' financial well-being and their decisions to remain in the workforce or delay retirement.

Using EUROMOD, a tax-benefit microsimulation model for the European Union, the study simulates the impact of the two policies based on three scenarios over the period 2017-2027, compared to a baseline 'do-nothing' scenario. This approach enables the isolation of effects of each policy, as well as their combined impact on key economic indicators, including household income and poverty rates.

Results

The results show that the tax policies implemented are effectively targeted, primarily benefiting pensioners, while exhibiting limited leakage to other labour status groups. A large majority of policy effects are concentrated among pensioners, with minimal benefits observed amongst self-employed individuals, employees and the unemployed. Crucially, the policies have substantially reduced the average tax burden for pensioners (see Chart 2). Specifically, the average tax burden for pensioners decreased from 11.3% to 9.6% in 2022 due to the combined effects of both policies. By 2027, this is

Chart 2
AVERAGE TAX BURDEN FOR PENSIONERS
(per cent)



Source: Author's calculations.

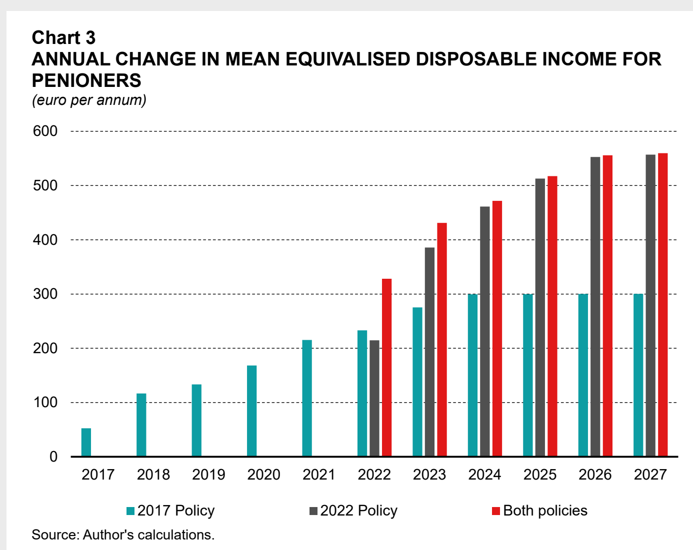
expected to stand at 10.3%, significantly lower than the 12.8% in a no-policy scenario. This reduction could encourage pensioners to postpone retirement and remain in the workforce longer, allowing them to retain a larger share of their income. However, this behavioural change cannot be modelled in EUROMOD and thus is not estimated in this study.

Results also show that over 73% of pensioner households – around 40,000 households – saw a rise in income as a result of these policies. Specifically, pensioner households saw an average increase in their annual equivalised disposable income from €52 in 2017 to €300 by 2025 due to the 2017 policy. The introduction of the 2022 tax exemption policy provided a significant immediate boost of €215, which is projected to rise to €557 by 2027. When both policies are considered together, pensioner households' disposable income rose from €328 in 2022 (2.0% of total income) to €560 by 2027 (3.2% of total income), indicating a substantial positive impact on their financial well-being (see Chart 3).

Despite these clear benefits to pensioners, the policies do not serve as a comprehensive solution for poverty alleviation. The at-risk-of-poverty rates of pensioners decreases from 26.6% in the baseline scenario to 25.6% with both policies in 2022, but other groups have seen negligible improvements, indicating that the current measures are insufficient for broader poverty alleviation. Furthermore, the analysis of income inequality, as measured by the Gini coefficient, shows a limited impact of these policies on the income distribution among lower deciles. In fact, the Gini coefficient under both policies dropped minimally, from 0.3221 to 0.3211 by 2027, highlighting the need for more inclusive reforms to achieve meaningful reductions in income inequality, although the budgetary costs would also be higher. It is worth noting, however, that the Gini coefficient was already relatively low to begin with, indicating a comparatively equitable income distribution even prior to the implementation of these policies.

Indeed, the fiscal cost of these policies remains contained. The 2017 policy was introduced with a cost of just under €5 million (0.04% of GDP). This cost is projected to rise to just below €30 million (0.11% of GDP) per year between 2024 and 2027. In contrast, the impact of the 2022 policy was estimated at €22 million in its first year, with this cost expected to reach around €65 million (0.24% of GDP) in 2027. The fiscal impact of both measures combined remains small when compared with the

Chart 3
ANNUAL CHANGE IN MEAN EQUIVALISED DISPOSABLE INCOME FOR PENIONERS
(euro per annum)



Source: Author's calculations.

level of Maltese economic activity (at approximately 0.24% of GDP per year between 2024 and 2027).

By the later years of the review period (2025-2027), the fiscal impact of the 2017 policy diminishes as the expanded parameters of the 2022 policy dominate. The 2022 exemption becomes so extensive that for many individuals the 2017 tax rebate loses relevance. Nonetheless, keeping in mind that the analysis presented in this paper does not internalise any labour supply decision changes, the overall effect of the 2017 policy may be understated. Indeed, internalising behavioural changes – such as individuals opting to work longer rather than retiring – would boost the impact that the 2017 policy would have on these estimates. On the other hand, these results suggest that if the 2017 policy is in fact administratively complex and costly to maintain, its benefit becomes questionable, especially when weighed against the expanding reach of the 2022 policy, which will eventually exempt 100% of pension income from taxation.

Conclusion

The 2017 Tax Rebate on Pensions and the 2022 Exempt Pension Income measures have had a significant and positive impact on pensioners' disposable income and overall financial wellbeing. They also appear to have achieved the goal of encouraging delayed retirement by substantially reducing the average tax burden. However, the limited benefits for the lowest-income pensioners and the minimal effects on other population groups underscore the fact that these policies alone do not address broader challenges such as poverty and income inequality. As Malta continues to face an ageing population and shifting demographic conditions, it is crucial to continue adapting the pension system to ensure its sustainability. These policies should be complemented by future reforms aimed at making the pension system more resilient in the face of these socio-economic challenges.