PRIVATE PENSION TAX RELIEF

A paper on the Irish pensions taxation landscape

Roma Burke and Tony Gilhawley

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1 Introduction

In this Paper:

- we use the term 'private pension provision' to refer to the provision of supplementary (to the State Pension) retirement income;
- 'private pension tax relief' to refer to the tax incentives/reliefs available to individuals and employers to provide for this supplementary retirement income; and
- when referring to pension tax relief on 'contributions', we refer (unless stated to the contrary) to personal and employer contributions (actual and implicit) and not just to personal contributions only.
- when we refer to 'ARFs' we do not include AMRFs unless stated to the contrary.

There are various arguments for and against private pension tax relief as it currently exists.

1.1 Arguments for reduction/reform of private pension tax relief

Those who argue for one or more reductions/reforms of private pension tax relief make one or more of these points:

- **Marginal rate income tax relief on personal contributions is inequitable**: For example, a €1,000 personal contribution to a pension arrangement "costs" a higher-rate taxpayer €600, a standard-rate payer €800, and a non-taxpayer €1,000.

  The relief should be reformed to provide equity between higher rate and standard rate taxpayers, either by standard rating tax relief on personal contributions for all or by replacing the current tax relief on personal contributions with a fixed matching Government contribution to the individual's retirement fund (similar to the Special Savings Incentive Accounts of 2001/02 and proposed for the Automatic Enrolment scheme).
- **A relatively small number of higher earners benefit disproportionately from the relief**. The OECD Review of the Irish Pension System 2013 stated: '*Tax deductions give the greatest incentive to save for retirement to those with the highest level of income, while those most in need get the lowest incentive*[1].'
- **Private pension tax reliefs 'cost' €2.5bn pa, are one of the highest tax expenditures by the Government and represents poor value for money.** The sums involved could be better spent, e.g. to help make the State Pension more sustainable in the longer term or to pay for incentives for the proposed Automatic Enrolment scheme. The Minister for Finance (31st May 2018) referred to the relief as '*… a large and generous tax expenditure'*[2].
- **There is a substantial deadweight cost of the relief;** higher earners, who it is suggested disproportionately use the relief would likely save for retirement in a different way, if private pension tax relief was not available.
- **The relief has failed to produce significant or an appropriate level of private pension coverage in the private sector and the quality of the coverage is on average poor**. For example, just 35%[3] of private sector workers have private pension provision. For those in Defined Contribution (DC) schemes, the average employer contribution rate is circa 7%[4] of salary, while the 2014 average employee contribution rate was estimated to be in the region of 5.4%[5].

[1] http://www.welfare.ie/en/downloads/OECD-Review-of-the-Irish-Pensions-System.pdf
[2] Answer to Dáil Question, 31st May 2018
[3] https://m.welfare.ie/en/pressoffice/pdf/sp020317.pdf
[4] https://paycommission.gov.ie/wp-content/uploads/DPER-pensions.pdf, section 1.3.7
[5] IAPF DC Contribution Survey - May 2014

1.2 Arguments in favour of maintaining the status quo

Those who favour the retention of the current private pension tax relief regime, i.e. maintain the status quo, make these points:

- **The relief encourages private pension provision, which is good for society**; without it, or at least without relief at marginal rate on personal contributions, financial provision for retirement could be significantly reduced, putting greater pressure on the State Pension and other public service supports for older people. For example, more people might qualify for means-tested Medical Cards, etc. in retirement, if they save less for their retirement.
- **Pension tax relief granted is substantially a deferral of tax**, as the tax relief obtained is repaid in retirement by tax on taxable retirement benefits.
- **Middle income earners benefit most from private pension tax relief and reducing tax relief on personal contributions would impact most on this group, including all in the public sector**. Any changes to the system could trigger a pay increase demand from the public sector (or a demand for lower contributions) and a reduction in pension savings in the private sector.
- **There has already been a substantial number of cutbacks in private pension tax relief since 2009, particularly impacting on higher earners and those with larger funds.** For example, the Standard Fund Threshold (introduced in 2005 and reduced from a high of €5.4m in 2010 to its current €2m) imposes an overall maximum capital limit on the value of tax-relieved retirement benefits from all sources and for high earners acts as a disincentive to fund/accrue benefits likely to exceed the Threshold limit.

The purpose of this Paper is to establish as many relevant facts about private pension tax relief, as available to us and to test as far as possible various arguments made by both sides.

Roma Burke & Tony Gilhawley

15 November 2018

2 Executive Summary

Policy objective

The Irish Longitudinal Study on Ageing (TILDA) from 2017 confirms that '*Income is positively associated with quality of life in older age. Those in the highest household income quintile scored 13% higher for quality of life than those in the lowest quintile. All aspects of quality of life (control, autonomy, self-realisation and pleasure) increase consistently with household income."*

In the private sector, private pension tax relief is designed to act as a financial incentive to encourage voluntary supplementary retirement provision, while in the public sector, it acts as a subsidy to a compulsory superannuation contribution.

The EET system

Ireland operates the Exempt Exempt Taxed model for private funded pensions, providing tax relief on contributions and investment gains (funded schemes) and taxing emerging income in retirement. There are several exceptions and limits, such tax-free lump sums (subject to a limit), monetary annual caps on tax-relieved personal contributions and an overall monetary cap (€2m currently) on the capital value of tax-relieved benefits which can be taken from tax-relieved arrangements.

There are numerous anomalies in the current system including:

- Marginal rate income tax relief on personal contributions provides a larger tax rebate to higher rate taxpayers than for a similar gross pension contribution made by a standard rate taxpayer.
- Employer contributions, being exempt from a benefit in kind charge for the employee, benefit from more favourable tax treatment, and hence cost the Exchequer more than personal contributions. We found that the difference is so significant, that an employer contribution for a standard rate taxpayer costs more in lost tax and PRSI revenues than a personal contribution by a higher rate taxpayer, funded from the same gross employer income.
- There are differences between arrangements in the level of lump sum which can be taken at retirement and the level of death benefit which can be paid out as a lump sum prior to retirement.
- Defined Benefit (DB) pensions and, in particular, public service pensions are valued for the purposes of the Threshold limit considerably lower than current annuity rates and hence favour DB retirees over Defined Contribution (DC) retirees.

Several changes to the private pension tax system over the last decade have led to the reduction of the value of private pension tax reliefs, particularly for higher earners and those accumulating higher levels of benefits:

- Personal contributions are no longer deductible for PRSI purposes;
- Personal contributions are not deductible for USC purposes;
- A Net Relevant Earnings Limit for personal contributions was introduced which reached a high of €275,253 before being reduced to its current €115,000 level;
- A Standard Fund Threshold was introduced in 2005 and then reduced in stages from a high of €5.4m to €2.0m today;
- A limit on tax-relieved lump sum was introduced in 2005 and then reduced from a high of €1.35m to €200,000 + next €300,000 taxed at standard rate;
- Various monetary limits referred to above have not increased, meaning that their value in real terms is eroding; and
- A temporary Levy (raising €2.4bn) was payable by all funded schemes for 2011 – 2015.

Private pension coverage

Our analysis shows that private pension coverage in the workforce (private + public sector) has fallen from a high of 54% in 2009 to an estimated 43% in 2017.

We estimate coverage in the private sector only in 2017 at just under 30%, down from a high of 42% in 2009. This coverage figure does not include those in the workforce with preserved benefits only.

Coverage in the private sector has fallen across all age categories and economic sectors and has largely flatlined over the last 4 years, not recovering in line with the recovery in earnings and numbers employed.

Coverage in the private sector is higher than the 30% estimate above if those on low incomes are excluded:

- If we exclude the 450,000 in the private sector proposed to be excluded from the Automatic Enrolment scheme[6], our estimated 30% private pension coverage rate in the private sector would increase to circa 41%.
- If we exclude all those in workforce without private pension cover who have gross earning of less than €25,000 (circa 2 x State Pension), our estimated 30% private pension coverage rate in the private sector would increase to circa 47%.

Private pension cover amongst smaller employers/smaller schemes has reduced and proportionately more people are now members of larger schemes (1,000+ members). The reduction in pension cover for self-employed people was three times that of employed people.

The reasons for fall-off in cover in the private sector and its failure in recent years to recover in line with the economic recovery in numbers at work and earnings is less easy to explain and may reflect interplay between multiple factors, such as:

- Individuals and small employers jettisoning private pension funding following the onset of the crash and not recommencing, even when income and employment prospects improved.
- Individuals focussing on immediate non-pension saving/debt reduction rather than saving for retirement.
- Affordability; additional taxes such as USC over the period 2009 to 2016, reduced income at all levels for those at work of between 7.5% to 10%. In 2015, 39% of those without a private pension cited ‘could not afford a pension’ as the reason for not having a private pension.
- More employers not offering a pension scheme, particularly smaller employers.
- Delayed entry to employment as people stayed longer in education to avoid the economic recession.
- Cut backs in pension tax relief limits.
- The pension levy in 2011-15 may have encouraged the cessation of voluntary contributions during that period.
- There may be a lag/lead effect at play; voluntary pension funding may be abandoned early in the event of a major economic downturn, but it takes a longer time to reinstate it even after the economic situation improves. Once the pensions saving habit is broken, it may become harder to reinstate, given other pressures on the family income.

We found that private pension cover in the private sector is highly correlated with gross income; the lower your income the less likely you are to have a private pension.

[6] Because the person’s income is less than €20,000 and/or they are under age 23 or over age 60.

According to the CSO 2016 SILC data, the distribution of *full-time* employees with and without private pension cover by *gross* income was:

	1st Quartile	Median	3rd Quartile
With private pension (public + private sector)	€41,065	€54,586	€72,170
Without private pension (private sector only)	€21,850	€28,540	€39,122

75% of those with private pension cover had gross income in 2016 of less than €72,000 pa.

For full-time self-employed, 75% with private pension cover had gross income of less than €63,000 pa. We therefore conclude that the bulk of those with private pension cover can be fairly described as middle income, even if approximately 70% are estimated to be higher rate taxpayers.

An estimated 9% of those with private pension cover had gross income of more than €100,000 in 2016.

Of those in the private sector *without* private pension cover we estimate:

- 39% fall outside the scope of the proposed Automatic Enrolment Scheme;
- 53% have gross income less than 2 x State Pension.

Private pension cover in the private sector of less than 100% is not necessarily a failure of the system because some may not need a private pension and others who do may choose to save or provide for retirement in a different way. For example, the Revenue Commissioners published statistics in September 2018 which show that 34% of taxpayer units subject to self-assessment in 2016 declared rental income with an average of €21,830 pa.

In addition to numbers covered, quality of cover is also an important issue. This affects DC members and the self-employed much more so than public sector workers or members of DB schemes.

For DC members, employer funding tends to be lower (7% on average for DC schemes compared to 22% for funded DB schemes and 29% (gross of PRD[7]) for pre-2013 public sector employees) and benefits at retirement are not known in advance with much certainty. The self-employed do not benefit from an employer contribution and may also fall outside of the Automatic Enrolment system.

Taxation of retirement benefits

The taxation system contains a number of measures which discriminate in favour of older people as a consequence of social policy measures; in particular the income tax exemption limit applying to those over age 65 exempts from income tax those whose total income is less than €36,000 (married couple/civil partnership) or €18,000 (single person).

Consequently, we found that most (by number) retirees with private pension income (particularly Approved Retirement Fund (ARF) income) are unlikely to pay any tax (or very low levels of tax) on their private pension income unless they have income other than the State Pension and their private pension income.

We considered the distribution of retirement income. While there does not appear to be any available official source to show the distribution of private pension income by level of income, we did observe that the average public sector pensioner is in receipt of a pension of €19,908 pa.

We obtained data from several ARF providers, covering 36,000 ARF holders and total ARF funds of €5bn. We found that the median ARF value is circa €70,000 and the average value is €142,000.

[7] Pay Related Deduction. This is due to be replaced by the Additional Superannuation Contribution from 1 January 2019 and will apply to public sector earnings over €34,500 (€32,000 for 2019).

ARFs are however split into two distinct camps, broadly those with ARF values less than €250k and those with larger ARFs. For the smaller ARFs (86% of all cases), the average ARF income is €3,190 pa, while for the larger ARFs (14% of all cases), the average income is €25,140 pa.

Therefore, many ARF retirees over 65 may not pay any income tax on their ARF withdrawals, because of the available income tax exemption limit.

	Single Person	Married one State Pension	Married two State Pensions
Income tax exemption limit	€18,000 pa	€36,000 pa	€36,000 pa
State Pension (Contributory)	€12,695 pa	€12,695 pa	€25,390 pa
Available exemption limit for private retirement income	€5,305 pa	€23,305 pa	€10,610 pa

There are some circumstances in which private pension benefits may be totally tax-free, for example, a small DC pot may be able to be taken entirely tax-free under the commutation rules.

The cost of private pension tax relief

The cost of private pensions tax relief is estimated at €2.5bn in 2015 based on Revenue data, down from almost €3bn in 2007. However, there are several significant qualifications to this cost estimate including that the cost is:

- gross of tax recovery on taxable retirement benefits, from both current and future pensioners; and
- it does not include a cost for accrual of public service superannuation benefits (i.e. the BIK exemption in respect of a notional public service employer contribution), nor the cost of paying pensions to current public service pensioners.

  In 2018, the ESRI estimated the cost of tax relief on notional public service employer contributions to be €778m, based on a notional public sector employer contribution rate of 15.5% of earnings.

  However, other sources estimate the notional public service employer contribution rate to be higher (29%, gross of PRD, was quoted for the pre-2013 cohort in the Actuarial Review of Pension Provision In the Irish Public Service and a Comparison with the Private Sector, March 2017, while 20% was quoted in the Report of the Public Service Benchmarking Body 2007).

  Taking account of these different estimated rates, the cost of relief on these imputed public service employer contributions could lie somewhere between €778m and €1,456m, in addition to the €2.5bn cost of tax relief on explicit contributions.

The cost of tax relief provided to PRSA/RAC holders (private sector only) has fallen significantly from €469m in 2007 to €215m in 2015 and has not recovered.

The cost of tax relief on employee scheme contributions (public and private sector) is trending within a range (€543m in 2007, rising to a high of €729m in 2009 and was €581m in 2015). Similarly, the cost of relief on explicit employer contributions (private sector only) is also within a range (€630m in 2007, rising to a high of €760m in 2008 and was €706m in 2015).

We estimated that 715,100 individuals claimed income tax relief on personal contributions in 2015, at an average tax saving of €1,894 per person. We estimate that 53% of this number were public sector employees.

The numbers claiming income tax relief on personal contributions displays largely the same trend as the overall cost of tax relief on such contributions, however in terms of PRSA/RAC holders, the numbers claiming relief has fallen by 43% since 2007.

We estimated that 681,400 individuals benefitted from the BIK exemption for employer contributions (explicit and implicit) in 2015. We estimate that 56% of this number were public sector employees.

In terms of who benefits the most, all those who contribute to pension arrangements benefit to a greater or lesser degree:

- The largest volume of pension contribution tax relief cost is likely to be consumed by public service employees recruited before 1st January 2013 (261,000 people) mainly because their salary levels are higher than the private sector, and they benefit from a higher implicit employer contribution (29%, gross of PRD) than private sector funded DB members (22%) and DC members (7%).
- Funded DB scheme members (63,000) benefit more than DC members (330,000) as the employer contributions are higher (22% vs 7%).
- Self-employed (96,000) do not benefit from employer contributions.
- Higher rate taxpayers benefit more than standard rate taxpayers, because relief is granted at the higher marginal rate.

  However, single persons become higher rate taxpayers on gross income of more than €34,550 pa, while for married couple the figure can be as low as €43,550 pa. So, it is not appropriate in our view, to conflate 'higher rate' taxpayers with 'high earners'. There are several highly effective restrictions built into the private pension tax relief system that limit the ability of very high earners to use pension tax relief, e.g. the current €2m Standard Fund Threshold limit.
- Overall, at least 50% of the cost of private pension tax relief relates to public service employees.
- The unincorporated self-employed benefit least of all groups from private pension tax relief as they cannot benefit from highly tax-efficient employer contributions and are subject to an annual cash limit (related to their age and earnings) on their tax-deductible contributions.

Our conclusions

Marginal rate relief on personal contributions is inequitable but it is just one of many inequities in the system and the BIK exemption for employer contributions gives rise to greater inequity. For example, the taxes forgone by exempting an employer contribution of €1,000 from a BIK charge for a standard rate taxpayer are greater than the value of relief provided to a higher rate taxpayer paying a personal contribution funded from the same employer income of €1,000.

The benefit of private pension tax relief is spread over a large number of people, most of whom could be fairly described as middle-income earners, and significant measures have been introduced to limit the benefit of pension tax relief to high earners and those accumulating high levels of benefits.

The estimated cost of private pension tax relief at €2.5bn pa currently is one of the major tax expenditures but the benefit of the relief is spread over a large number of people. The published cost is also gross of tax recoveries on taxable retirement benefits, does not include any implicit employer cost for the accrual of public sector benefits, nor the cost of paying those benefits and assumes no change in behaviour, all of which are significant qualifications to the description of €2.5bn as a 'cost'.

Public sector employees recruited before January 2013 (261,000) benefit from private pension tax relief more than any other group because they benefit from an implicit average employer contribution rate of 29% pa (gross of PRD), compared to 22% pa for those in private sector DB schemes (63,000 people) and just 7% pa for those in private sector DC schemes (330,000 people). Studies show that they also earn more on average than private sector workers.

To the extent that private sector private pension coverage is currently only 30%, with provision predominantly DC at an inadequate contribution rate, it could be said that private pension tax relief is failing in its primary objective of increasing adequate private pension coverage in the private sector. However, we found that:

- Not everyone in the private sector may need a private pension. E.g. full-time employees in the private sector *without* private pensions had in 2016 a median gross income of just €28,540, with 75% having a gross income of less than €39,122. We estimate that 53% of those in the private sector without private pension cover have gross income less than 2 x State Pension and hence currently the State Pension may replace 50% or more of their gross income.

  Excluding this group leaves some 33% of the private sector who have income over €25,000 pa and who do not have a private pension.

- Some may be using other means to provide for their retirement, e.g. rental property investment, after-tax savings or tax-efficient investment schemes.

We do not find any evidence in an Irish context to support the assertion that if private pension tax relief was removed (or reduced/limited in some way), higher earners would continue to save for their retirement at a similar level in other ways. Indeed, as far back as 2007, the Green Paper on Pensions said *"the removal of the reliefs would represent a fundamental adjustment to the current balance of the tax system and would have very significant implications in terms.. of the economic and behavioural impacts which would ensue. These impacts would be difficult to model in advance".*

We find that the link in the EET system between EE and T is very weak principally because of low levels of funding combined with a highly progressive income tax system and tax concessions provided to older people.

Reform

We outline at the end of this Paper a number of possible reforms of the current private pension tax system which could be considered to:

- reduce or eliminate inequities;
- improve the connection between EE and T, in the EET model; and
- control or reduce the cost of the reliefs to the Exchequer.

Some options which might improve the tax connection in EET are these:

- Provide tax relief on contributions at 75%, to reflect the fact that normally 25% of emerging benefits will be tax-free;
- Limit the lump sum option in all DC arrangements to 25%, i.e. remove the current salary/service lump sum option in DC schemes.
- Impose a non-refundable withholding tax on private pension income, to ensure that regardless of the income tax exemption limit and other tax concessions to older people, a minimum rate of tax is paid on taxable income emerging from private pension arrangements.

However, we are not advocating any of the options outlined and some may have significant negative potential financial consequences for some individuals and could lead to undesirable changes in behaviour in relation to private pension provision.

We did look in more detail at the often-recommended option of providing income tax relief on personal contributions at a fixed rate, say 25%, instead of at marginal rate. However, we find that a number of issues arise with this proposal:

- Unless employer contributions (explicit, and in the case of the public service implicit) are imputed to the employee for income tax purposes and fixed rate relief provided on the imputed BIK[8], the proposal would *increase* the existing level of inequity as between the tax treatment of employer and personal contributions.
- The proposal would swap the current inequity which favours higher rate taxpayer with a new inequity favouring standard rate taxpayers over higher rate taxpayers.

  There are two ways in which this inequity could be fixed:

  a) personal contributions be made from net income, with the fixed 25% relief, say, added to the fund, in a manner similar to that envisaged for the Auto Enrolment scheme and which applied to SSIAs. However, applying this approach would present many difficulties:

     - It could not be applied to the public service as there is no fund;
     - It could not be applied to funded DB schemes as there is no segregation of the fund between individual members;
     - It would require a complete change in the tax relief system for personal contributions to funded DC arrangements for both the schemes/providers and Revenue.

  OR

  b) We estimate 35% fixed income tax relief for higher rate taxpayers and 25% for standard rate taxpayers would almost equalise the value of tax relief provided per €1,000 of gross income.
- The proposal to provide relief on personal contributions at a fixed rate could trigger one or more of the following reactions:

  - Private sector: Reduction in higher rate taxpayer personal contributions in order to maintain the same net outlay as before; in the case of DC schemes reducing employee contributions could also drag down matching employer contributions.
  - Private sector DC schemes, the swapping of less tax-efficient employee contributions for more tax-efficient employer contributions (funded by a voluntary cut in the employee's gross contractual remuneration); this would *increase* the cost of pension tax relief over its previous level as employer contributions cost more in lost tax revenues than personal contributions.
  - Private and public sector: Some higher rate taxpayers (e.g. AVCs and unincorporated self-employed) may react by stopping discretionary personal contributions altogether due to a perception that they will only benefit from, say 25% relief, on contributions but emerging benefits will be taxed in retirement at higher rate income tax (40%) + USC, even if in reality this perception for many will be invalid.
  - Public sector: it could lead to demands for a corresponding pay rise to compensate for those impacted by the change or a demand for reduced contribution rates.
  - PRSA holders: It would, in effect, reintroduce a tax on employer contributions to an employee's PRSA, for higher rate taxpayers, being the difference between the imputed tax charge at marginal rate and the fixed relief obtained within the age related and the €115,000 earnings limits for tax relief.

[8] Which would give rise to a significant income tax liability for higher rate taxpayers

3 Private pension provision

3.1 Origin of private pensions and tax relief

Formal private pensions date back to the 1600's. The first known British public service pension was awarded in 1684.[9] The British Superannuation Act, 1859 established a standard pension accrual of 1/60th pension accrual over 40 years for British civil servants[10]. In 1909, a 1/30th gratuity accrual over 45 years[11] was introduced for civil servants and the pension accrual rate was reduced to 1/80th over 40 years. This created the benchmark for private sector pension benefits, which largely exists to this day.

The current Exempt Exempt Taxed (EET) tax system for private pensions largely dates from the UK Finance Act 1921, which introduced tax free investment returns and codified tax relief on contributions, with annuities emerging liable to income tax. Indeed, some provisions of the UK Finance Act 1921 exist today almost word for word in Part 30 of the Irish Taxes Consolidation Act 1997 dealing with approved retirement benefit schemes.

Tax relief on Retirement Annuity Contracts (RAC) contributions for the self-employed was introduced in the UK in 1956 and in Ireland in 1958. RACs were amended in 1974 to allow 25% to be taken as a tax-free lump sum.

A 'new code' for retirement benefit schemes was introduced in 1974 which allowed a lump sum gratuity, either stand alone or by commutation of pension, of 3/80ths for each year of service, maximum 40 years but with scope for Revenue to approve higher lump sum scales (which they did) with the uplifted scale providing the maximum 150% x final remuneration lump sum after 20 years' service (inclusive of retained lump sums). Indeed, under the 'new code' from 1974 it is possible for a pension scheme to provide only a lump sum, without the need to also provide a pension as before.

Private pension tax relief in the private sector is therefore substantially based on the emergence of the public service superannuation schemes and tax relief on insurance premiums.

3.2 The policy objective of private pension tax relief?

The State Pension (Contributory), €243.30 per week in 2018, targets a replacement income in retirement of 34% of average earnings and is designed to protect recipients from the effects of poverty.

It is a longstanding State policy[12] to encourage workers to 'top up' their State Pension in retirement with private pensions. In the private sector, private pension tax relief is therefore designed to act as a financial incentive[13] to encourage voluntary supplementary retirement provision. There may also be an associated objective to provide the private sector with the opportunity and incentive to fund pensions and gratuities in line with those provided by the State to those who work in the public service

[9] *"… when a senior Port of London official (Martin Horsham) became too ill to carry on, and his successor was appointed on a salary of £80pa on condition that £40pa of this was paid to his predecessor. And so began the first 50% pension, paid out of the salary of a younger employee*". www.civilservant.org.uk

[10] http://www.irishstatutebook.ie/eli/1967/act/6/section/222/enacted/en/html And the first contribution rate was 50% pa!

[11] Changed in Ireland to 3/80ths gratuity accrual over 40 years, from 1st June 1973.

[12] "*The overall objective of our pensions system is to provide an adequate basic standard of living through direct State supports and to encourage people to make supplementary pension provision so that they may have an adequate income in retirement" Green Paper on Pensions Executive Summary, http://www.welfare.ie/en/downloads/greenpaperexecsummary.pdf*

[13] '*it is considered that marginal relief represents a significant incentive to encourage pension savings and to a degree represents a deferral of taxation*.'. Minister for Finance Mr Paschal Donohoe, Dáil Question 31st May 2018

In the public sector, where membership of unfunded superannuation schemes is a condition of employment, private pension tax relief provided on employee contributions might be more accurately described as a subsidy to a contractual commitment, rather than an incentive to make voluntary retirement provision.

3.3 The benefits of private pension provision

There are several potential benefits to Society where private pension provision is incentivised.

The Irish Longitudinal Study on Ageing (TILDA) 2017[14], identified that a retiree's level of retirement income is positively associated with quality of life in retirement. The key findings were:

- *Income is positively associated with quality of life in older age. Those in the highest household income quintile scored 13% higher for quality of life than those in the lowest quintile.*
- *All aspects of quality of life (control, autonomy, self-realisation and pleasure) increase consistently with household income.*
- *On average, individuals with higher socio-economic status have higher pre-retirement incomes, higher post-retirement incomes and lower retirement income replacement rates than individuals with lower socio-economic status.*
- *Retirement income replacement rates are not associated with quality of life post-retirement. It is actual income in retirement, rather than retirement income replacement rates, that seems to affect quality of life of Irish retirees.*

A better quality of life in older age can lead to greater autonomy and better control of certain pathologies and physical limitations[15]. This, in turn, may lead to lower demands on the State (e.g. health) than might otherwise be the case.

Those with private pension income in retirement are less likely to qualify (or qualify for the full amount) for certain means-tested financial supports such as the Fuel Allowance, Household Benefits Package, Medical Cards, etc.

[14] http://tilda.tcd.ie/publications/reports/pdf/Report_IncomeAdequacy.pdf

[15] Luis Miguel Rondón García and Jose Manuel Ramírez Navarrro, "The Impact of Quality of Life on the Health of Older People from a Multidimensional Perspective," Journal of Aging Research, vol. 2018, Article ID 4086294, 7 pages, 2018. https://doi.org/10.1155/2018/4086294

4 Private pension tax system in Ireland

4.1 Exempt Exempt Taxed ("EET") model

The taxation of private pensions in Ireland is based on an "EET" (exempt, exempt, taxed) model. This means that, subject to certain limits, contributions to private pension arrangements are tax deductible, investment growth on invested contributions is exempt from income and capital gains tax, and retirement income is taxed at an individual's marginal tax rate.

The EET system is a feature of many (but not all) developed economies around the world:

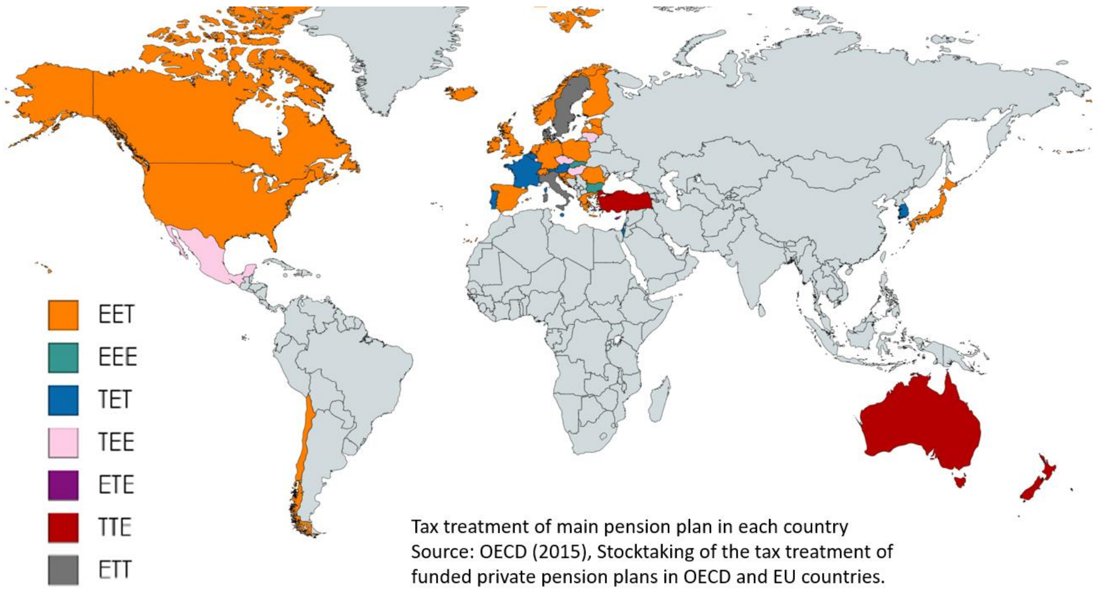

Figure 4:1 Tax treatment of main pension plan in each counry. Source OECD (2015)

The tax treatment of private pension arrangements is summarised as follows:

4.2 Private pension tax relief

The main provisions of the current system of tax relief are:

- Personal contributions to occupational pension schemes (private and public sector) and Revenue-approved contracts are deductible against relevant employment/self-employed trade or profession income at the person's marginal rate of income tax (but not for USC or PRSI), within the following limits:

Table 1: Income relief limits by age

Age attained during calendar year	Income relief limit (as a % of Net Relevant Earnings (NRE))
Less than 30	15%
30 to 39	20%
40 – 49	25%
50 – 54	30%
55 – 59	35%
60 and over	40%

There are two minor exceptions to the above age-related limits:

- A fixed 30% limit applies to certain categories of professional sportspeople in respect of their sport income under age 50.
- An individual who is not in pensionable employment can claim income tax relief on PRSA contributions of up to €1,525 pa, even if the contribution exceeds the age percentage limit above.

  The maximum net relevant earnings (NRE) which can count for income tax relief on all personal contributions to private pension arrangements is currently €115,000.

  Individuals can, in certain circumstances, backdate a personal contribution to the immediately prior tax year for income tax relief purposes, within the limits referred to above in that prior year. Where an individual contributes more than the limit allowed in a year, he or she can carry forward the claim for relief on the excess to the next tax year, and so on, but the excess can only be offset against the same source of employment/self-employed trade or profession income.

- Employer contributions to exempt approved occupational pension schemes are:
  - deductible for the employer as a business expense in the accounting period in which the contributions are paid[16] and are *not* subject to the age and NRE related limits outlined above; and are
  - not treated as a benefit in kind for income tax, PRSI or USC purposes for the relevant employee.

  Employer special contributions can be made in respect of unfunded past service liabilities. However, employer and employee combined contributions to occupational pension schemes are indirectly limited by the maximum approvable benefits which the scheme can provide for a member, as set out by Revenue.

- Employer contributions to a PRSA held by an employee are treated as a Benefit in Kind (“BIK”) for income tax purposes[17] but the employee can then claim income tax relief on the BIK amount as if it were a personal contribution. This means that if the combined employer and employee contributions to the PRSA are less than the age/NRE related limits, the payment of the employer PRSA contribution does not give rise to any income tax, PRSI or USC liability for the employee.
- Occupational pension schemes, Revenue-approved contracts, Approved Retirement Funds (“ARFs”) and Approved Minimum Retirement Funds (“AMRFs”), are exempted from:
  - Irish income tax on investment income;
  - Irish capital gains tax (“CGT”) on realised gains;
  - Deposit Interest Retention Tax (“DIRT”) on deposit interest from Irish credit institutions;
  - Dividend Withholding Tax on distributions from Irish resident companies;
  - Exit tax[18] on Irish domiciled collective investment funds; and
  - Exit tax on life assurance policies[19] issued by life companies established in the State or operating here through a branch.

There are several restrictions or ‘brakes’ built into the system which limit the ability of high earners to over-use pension tax relief:

- A current earnings limit for tax relief on all personal contributions of €115,000.

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[16] Subject to certain Revenue practice restrictions on relief on special one-off contributions, where relief may be spread forward for up to 5 years.
[17] Albeit not taxed through the PAYE system and hence not subject to PRSI. Also, not subject to USC.
[18] Currently 41%
[19] Pension arrangements can invest in life company pension business funds.

- A limit of €2m (the SFT) on the maximum capital value of private pension benefits. Any benefits in excess of this limit are subject to double tax at a penal rate of up to 69%.

  The main effect of the SFT is to force high earners to cease pension funding sometime before expected retirement, as investment growth alone can carry the value of their benefits over the SFT.

  For example, the table below shows the expected period of years based on the assumed investment return shown, by which future investment growth with **no** future contributions will cause the fund to reach €2m at the end of the period:

Current DC Fund	**Assumed investment return: 2% pa**	**Assumed investment return: 4% pa**
	Number of years to reach SFT	**Number of years to reach SFT**
€1,300,000	21.8	11.0
€1,400,000	18.0	9.1
€1,500,000	14.5	7.3
€1,600,000	11.3	5.7
€1,700,000	8.2	4.1
€1,800,000	5.3	2.7
€1,900,000	2.6	1.3

  Discouraging future contributions/accrual is therefore the main way by which SFT controls the cost of private pension tax relief and not the chargeable excess tax which results from the SFT limit.

  When an individual stops funding in anticipation of reaching the Threshold limit later on, the cost of tax relief on contributions ceases immediately but the individual continues to benefit from tax-free investment returns until benefits are taken.

- Private sector employers are limited by statue and Revenue Practice to not fund/provide benefits in excess of equivalent value to that which would be provided to a pre-April 1995 civil servant with similar income, i.e. 2/3rds of final remuneration[20].

The above describes the *current* (2018) tax relief system applying to private pension arrangements. However there have been several reductions and curtailments of reliefs over the last decade or so to arrive at the current system:

- Personal contributions were once deductible for employee and employer PRSI purposes, but no longer are.
- The Net Relevant Earnings (NRE) limit applying to tax relief on personal contributions was as high as €275,239 in 2008 before being reduced in stages to its current €115,000 level.
- The Standard Fund Threshold (SFT) was indexed up to 2008 to €5.4m before being reduced in stages to its current level of €2m.
- A tax-free lump sum limit was introduced in 2005 at 25% of the SFT, i.e. initially €1.25m. It was indexed up to 2008 to a high of €1.35m before being reduced in stages to its current limit of €200,000 with the next €300,000 taxed at standard rate.
- The monetary limits referred to above have not increased in line with inflation/earnings in recent years. As earnings/inflation increases, the real values of these limits decrease.
- A Levy was applied to all funded pension arrangements (other than ARFs and AMRFs) for the years 2011 to 2015. This resulted in a total of €2.4bn of funded private pension assets paid to the Exchequer over that period.

[20] Subject to a minimum service requirement of 10 years

There has therefore been a restriction of private pension tax relief, mainly around the 2010/11 period, probably in response to a need to raise immediate tax revenues. Many of these restrictions impacted proportionately more on higher earners and those funding higher benefits.

4.3 Taxation of benefits

Benefits emerging from private pension arrangements are taxed as follows:

- Cumulative lump sums taken since 7th December 2005 from all private pension arrangements are subject to a tax-free limit of €200,000, with the next €300,000 of such sums liable to a fixed standard rate income tax charge, and any lump sums in excess of €500,000 are subject to PAYE at the taxpayer's marginal rate as well as USC (but not PRSI).
- Pensions and annuities in payment arising from private pension arrangements are subject to Schedule E income tax and USC (but not PRSI).
- ARF, AMRF and vested PRSA withdrawals are subject to Schedule E income tax as well as USC. PRSI is payable if the ARF/AMRF holder is under age 66 and a Class S contributor.

  ARF and vested PRSA holders are taxed on a minimum of 4% pa of the value of their ARF/vested PRSA up to age 70, rising to 5% thereafter. For those holding an ARF or vested PRSA with a total value of more than €2m, the withdrawal percentage increases to a minimum of 6% pa at all ages.
- Any benefit taken above the Standard Fund Threshold (SFT) is subject to a chargeable excess tax charge at the higher rate of income tax and is deducted from the excess before providing taxable retirement benefits to the retiree. This approach is equivalent to a combined tax rate of close to 69% for a higher rate taxpayer.

  The chargeable excess tax payable is reduced by any income tax paid at the standard rate on lump sums taken from private pension arrangements since 1st January 2011, and not previously offset against a chargeable excess tax charge. Therefore, the effective Threshold limit can be as high as €2.15m before a chargeable excess tax charge arises.

  In some cases, a (higher) Personal Fund Threshold ("PFT") applies to individuals who applied to Revenue for a PFT where they held retirement benefits valued at more than the SFT before it was introduced in 2005 and also where the SFT was reduced in 2010 and again in 2014.
- Benefits payable on death are broadly taxed as follows:
  - Lump sums: paid gross but treated as a taxable inheritance for Capital Acquisitions Tax (CAT) purposes from the deceased, when inherited by a person other than the deceased's spouse or civil partner;
  - Annuities: subject to PAYE
  - Post-death ARF and vested PRSA balances: generally taxable under PAYE but at a flat 30% income tax charge when inherited by an adult child of the deceased ARF holder. A gross transfer can be made to an ARF held by the surviving spouse or civil partner of the deceased ARF or vested PRSA holder.
- There are several other tax charges applying to other benefit payments, such as total commutation of pension, etc.

4.4 Anomalies & inequities

The current private pension tax pension tax relief system contains many anomalies and inequities:

- **Marginal rate tax relief on personal contributions provides more relief for the same contribution than a standard rate taxpayer paying a similar contribution**:

  This inequity is often presented as:

	Higher rate taxpayer	Standard rate taxpayer
Pension contribution	€1,000	€1,000
Less tax relief @ marginal rate	**€400**	**€200**
Net cost of pension contribution	€600	€800

The higher rate taxpayer appears to get tax relief at 40% (€400 in our example) while the standard rate payer appears to get 20% (€200) for the same pension contribution, a difference of 20%.

However, this picture is not complete as it fails to allow for the fact that personal contributions are not deductible for USC and PRSI purposes. This means that the individual must earn more than the pension contribution, in order to cover the cost of the USC, PRSI and the pension contribution. He/she also must pay income tax on the extra earnings required to cover this cost.

For example, a higher rate taxpayer has to earn €1,250 gross income to be able to afford a €1,000 pension contribution while a standard rate taxpayer has to earn €1,123 to afford the same level of contribution. (See Appendix 1).

The pension tax relief obtained as a % of gross income is 32% for a higher rate taxpayer and 17.8% for a standard rate taxpayer, a difference of 14.2% instead of the perceived 20%.

We therefore feel that comparisons of tax relief obtained on personal contributions as between higher rate and standard rate taxpayers should be based on a common gross income figure, in order to be valid.

If we standardise the comparison to €1,000 of gross income and then take the maximum gross pension contribution which can be funded from that gross income (after allowing for USC, PRSI, Income tax and the pension tax relief) we get:

Table 2 Maximum gross pension contribution that can be funded from €1,000 of gross income

		Higher Rate taxpayer		Standard rate taxpayer
Gross income		**€1,000**		**€1,000**
Used as follows:				
USC	8%	€80	4.75%	€48
Employee PRSI	4%	€40	4%	€40
Income tax	40%	€400	20%	€200
Gross pension contribution		€800[21]		€891[22]
Total outlay before pension tax relief		€1,320		€1,178
Deduct tax relief on pension contribution	40%	-€320	20%	-€178
Total outlay after pension tax relief		**€1,000**		**€1,000**
Pension tax relief as a % of gross income		32.0%		17.8%

[21] €1,000 * (1-8%-4%-40%)/(1-40%)

[22] €1,000 * (1-4.75%-4%-20%)/(1-20%)

- **Tax- relief limits: personal vs employer contributions** Personal contributions are subject to an annual age related % limit and NRE limit of €115,000 for tax relief, but employer contributions are not.

  The latter is unlimited other than by Revenue restrictions on funding to the level to provide the estimated maximum approvable benefits at normal retirement age.

  An unincorporated self-employed individual, for example, is subject to several limits; the annual NRE and age related % limits on his or her own tax relieved contributions and the Standard Fund Threshold limit on emerging benefits.

- **Tax-relief limits: occupational pension scheme vs PRSA contributions** Employer contributions to an employee's PRSA are a BIK for income tax in the hands of the employee (with employee income tax relief restricted to the age and NRE related limits) but an employer contribution to an occupational pension scheme is not a BIK. This means that more tax-deductible employer contributions can be made to an occupational pension scheme for an employee than to a PRSA.

- **Back-funding opportunities: personal vs employer contributions** Employers can contribute tax-efficiently for employees and former employees to occupational pension schemes for past service liabilities, stretching back many years, but personal contributions (employed and self-employed) can only be backdated one year for tax relief purposes.

  Therefore, an employee or unincorporated self-employed individual has significantly lower scope for backdating tax-deductible pension funding, and receives less relief on that funding, than an employer who can make substantially higher employer contributions on behalf of an employee to a scheme for past service liabilities, limited only to funding for Revenue maximum approvable benefits.

- **USC and PRSI treatment: personal vs employer contributions** Personal contributions are not deductible for USC and PRSI purposes, but employer contributions to an occupational pension scheme are, in effect, as the employer contribution is not a Benefit in Kind (BIK) for the employee.

  This gives rise to a disparity in the level of *gross* pension contribution and associated tax relief & PRSI cost as between employer and employee contributions, which can be funded from the same €1,000 of employer gross trading income:

Table 3 Cost to the Exchequer of pension contributions per €1,000 of gross employer income

	Higher rate taxpayer	Standard rate taxpayer
Employer gross trading income	€1,000	€1,000
Employer pension contribution to an occupational pension scheme (not a BIK)	€1,000	€1,000
Tax relief cost (income tax, PRSI (employer + employee), and USC foregone by BIK exemption)	**€567**[23]	**€357**[24]
Alternatively: €1,000 gross trading income paid (less employer PRSI @ 10.85%) to PRSI Class A employee as gross income of	€902	€902
Gross employee pension contribution which can be funded by that employee from that gross remuneration. (See App 2)	€722	€803
Tax relief cost (income tax relief provided at marginal rate on gross pension contribution) (See App 2)	**€289**	**€161**

The amount forgone by the Exchequer under various pension contribution scenarios arising from €1,000 of employer gross trading income is therefore summarised as:

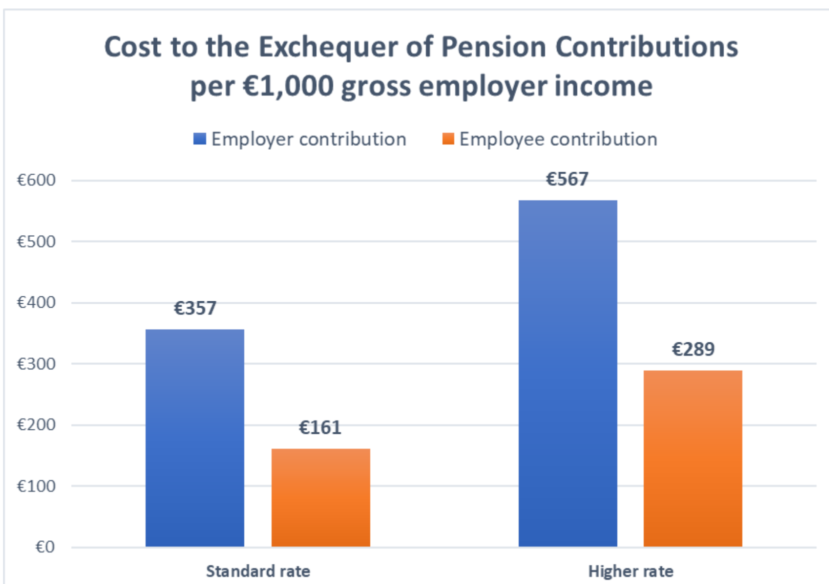


Figure 4:2 Cost to the Exchequer of pension contributions per €1,000 of gross employer income

[23] Gross employee income which can be paid from €1,000 gross trading income = €1,000/1.1085 (employer PRSI) = €902. Employee taxes and PRSI on €902 income tax @ 40% + USC @ 8% + PRSI @ 4% + employer PRSI @ 10.85% = = €567.

[24] Gross employee income which can be paid from €1,000 gross trading income = €1,000/1.1085 (employer PRSI) = €902. Employee taxes and PRSI on €902 income tax @ 20% + USC @ 4.75% + PRSI @ 4% + employer PRSI @ 10.85% = €357.

The table and chart above provide some useful insights:

- Employer contributions are significantly more tax-efficient for the employee (and hence cost the Exchequer more) than a personal contribution funded by the *same* level of gross trading income, i.e. out of €1,000 gross employer trading income, a €1,000 gross employer contribution can be paid as against a personal contribution of €722 for a higher rate taxpayer and €803 for a standard rate taxpayer.
- For the same gross trading income, an employer contribution for a standard rate taxpayer costs the Exchequer more in lost taxes and PRSI revenues (€357) than a personal contribution by a higher rate taxpayer (€289).
- The quantum of inequity between the tax benefit and cost of employer contributions over personal contributions is greater than that between standard and higher rate relief on personal contributions, i.e. the tax treatment of employer contributions versus personal contributions is more of an inequity than marginal rate relief on personal contributions.

- **PRSI treatment: Annuity vs ARF/AMRF** For retirees under age 66, pension and annuity payments are not subject to PRSI, but AMRF and ARF withdrawals are subject to PRSI for Class S (as they are not classified as being in the nature of a 'pension').

- **Tax-relieved lump sum options: Defined Contribution vs Defined Benefit vs PRSA** Members of Defined Contribution ("DC") occupational pension schemes can take *either* 25% of their fund or up to 1.5x final remuneration[25] (salary/service) as a tax-efficient lump sum at retirement. (If they choose the salary/service option, they must use the balance to purchase an annuity.) Members of Defined Benefit ("DB") schemes or public sector schemes do not have the 25% lump sum option, while holders of PRSAs do not have the salary/service lump sum option.

- **Lump sums on death in service: PRSA/RAC vs DB/DC.** PRSA and RAC funds are payable in full as a lump sum if the holder dies before drawing the benefits. However, lump sum death in service payments from a DB or DC occupational pension scheme are subject to a limit of 4 x final remuneration plus the accumulated value of any employee contributions. The excess, if any, must be used to purchase taxable annuities for the deceased dependant(s), if any.

- **Chargeable excess tax: DC vs DB/public sector** The chargeable excess tax system values DB or public sector pension benefits at terms substantially lower than the current open market cost to provide those benefits. This means that significantly higher value benefits can be provided under a DB/public sector pension than by a DC scheme, before any excess tax charge arises.

  This can be demonstrated by way of an example of a DB/public service-type pension of €50,000 pa payable from age 65:

[25] Assuming at least 20 years completed service by normal retirement age

Table 4 Value of €50,000 pa pension for Threshold purposes

Pension of €50,000 pa	Multiple	Capital Value used for Threshold purposes	Chargeable excess?
Valued for Threshold limit, accrued before 1st January 2014	20.0	**€1,200,000**	No
Valued for Threshold limit, accrued from 1st January 2014	26.0[26]	**€1,560,000**	No
Cost to provide pension if purchased on the open market by a DC scheme	42.3[27]	**€2,115,000**	Yes

- **Chargeable excess tax: DB/public sector benefits accrued pre-2014 vs benefits accrued thereafter benefits** The chargeable excess tax system values DB/public-sector pensions accrued up to 1st January 2014 at a fixed 20:1 but values such pensions accrued after that date at higher age-related multiples. This benefits those who substantially accrued their DB pension prior to 1st January 2014. There are no equivalent grandfathering arrangements for DC pension savings.

- **Chargeable excess tax: DB pensions with v without indexation increases or survivor's pension.** The chargeable excess tax system values DB pensions at the same rate, regardless of whether the pension will or will not increase in retirement, and regardless of whether a survivor's pension is payable or not. This particularly benefits public service pay parity pensions with 50% survivor's pension, which are valued the same as a funded DB pension with no increases and no survivor's benefits.

- **Avoiding chargeable excess tax: public sector vs DB/DC** Public service employees who hold private sector pension benefits likely to exceed the relevant Threshold limit due to a combination of their private and public sector benefits, can encash[28] these private sector benefits prior to retirement with one tax charge, currently 42%. In effect such public sector employees can hand back the income tax relief assumed to have been obtained on the 'excess' private benefits, and hence avoid a double tax charge on those benefits as chargeable excess.

  This allows such public service employees avoid (or reduce) the double tax charge (approximately 69%) on retirement. There is no corresponding provision for those in the private sector holding only private pension benefits.

- **Paying the chargeable excess tax: public sector vs private sector.** Public service employees who incur a chargeable excess tax liability on public service superannuation benefits can opt to pay the tax by way of equal annual instalments (no interest added) via a reduction in their gross pension over a period of up to 20 years. On death within this 20-year period, there is no recovery of outstanding instalments and no reduction in the spouse's death in retirement pension.

  Chargeable excess tax on funded private sector pension arrangements is payable in full within 3 months of the end of the month in which the benefits giving rise to the chargeable excess tax are crystallised. There is no refund on early death.

[26] *See Table of relevant age-related factors at end of Schedule 23B TCA 1997*
[27] Based on 6 October 2018 open market annuity rates for a joint life pension, 50% reversion, increasing at CPI, subject to a cap of 5% pa, nil commission
[28] S787TA TCA 1997

5 Private pension coverage

5.1 The impact of private pension tax incentives on coverage

The level of private pension coverage in the private sector, measured as a percentage of the total number at work, is generally taken as the measure of the effectiveness of private pension tax incentives. There have been several recent official statements which suggest that private pension tax incentives are not working, or not working as well as they were expected to, in the private sector:

'Despite existing tax incentives in place to encourage pension saving, private pension coverage in Ireland remains at below 50% (reducing to circa 35% when the private sector is considered in isolation).'[29]

The Automatic Enrolment (AE) Strawman consultation document[30] states:

'Despite significant State incentives being available through tax relief to employers, employees and the self-employed, private pensions coverage has not increased to an appropriate level'. The term appropriate was not defined but the office target coverage in the workforce (public and private sectors combined) is 70% for those between 30 and 65.

At official level there therefore appears to be a view that private pension tax incentives have not delivered in terms of increasing private pension coverage in the private sector to '*an appropriate level*'.

5.2 CSO QNHS Pension Modules coverage

The CSO periodically include a pension module in its Quarterly National Household Surveys (QNHS). These estimate the total private pension coverage of those at work at relevant dates[31]:

Table 5: CSO QNHS Pension Modules private pension coverage by year

	Q1 2005	Q4 2005	Q1 2007	Q1 2008	Q4 2009	Q4 2015
Private Pension Coverage	51.9%	55.9%	53.0%	53.6%	51.2%	46.7%

However, the coverage rates above are potentially misleading as they represent a blended coverage rate between public sector (full coverage) and private sector (much lower coverage). Also, they are only available at selected dates with a large gap between Q4 2009 and Q4 2015.

There are also some doubts about the accuracy of the Survey results because those surveyed were asked to say if they had a private pension or not, and some may have answered incorrectly out of confusion as to whether or not they had a private pension, and what type, e.g. what did the respondents understand a 'personal pension scheme' to be?

5.3 Estimating private pension coverage using other information sources

We estimated private pension coverage among those at work, by:

- taking the total number of *active* members of funded occupational pension schemes[32], plus

[29] IDPRTG Consultation on Supplementary Pensions Reform, July 2018, page 9

[30] A Strawman Public Consultation Process for an Automatic Enrolment Retirement Savings System for Ireland, page 7

[31] The questions posed in the QNHS Pension module survey were: *'Are you a member of your employer's pension scheme?'* with the self-employed required to answer '*No*', and *'Do you contribute to a personal pension scheme?'* The questions imply current active private pension accrual only.

[32] Taken from the Pensions Authority Annual Reports. We assumed that these all relate to the private sector, including commercial semi-state organisations.

- the total number employed in the public service (excluding commercial semi-state[33]) where we assume 100% private pension coverage; plus
- the number of individuals claiming income tax relief on RAC and PRSA contributions[34]

to arrive at a total of those with 'active' private pension accrual (public & private sector combined) during the relevant year.

We expressed this number as a % of the total 'in employment' (public + private sector) at the end of the relevant year from the QNHS Surveys[35].

This gives an annual picture of estimated total private pension coverage (private + public sector) among those at work:

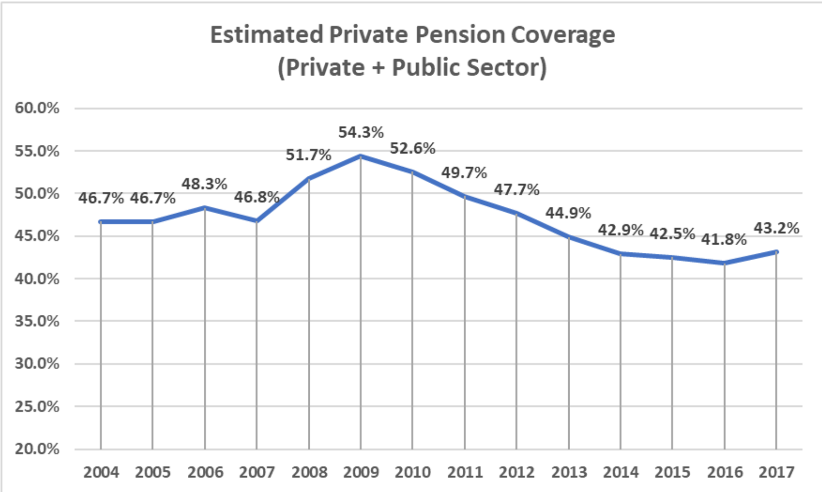


Figure 5:1 Estimated private pension coverage (private + public sector)

These estimated coverage rates are broadly consistent with the QNHS private pension coverage rates above, in that both suggest a significant reduction in coverage from a high in 2008/09. However, our estimates also clearly show a 'boom-bust' pattern in private pension coverage between 2007 and 2012.

Our total coverage estimate for Q4 2016 of 42% is also broadly consistent with the CSO SILC 2016 estimate of private pension coverage of 44.4%[36].

[33] We assume all commercial semi state employees are in funded occupational pension schemes.
[34] Taken from the Revenue Commissioners Cost of Tax Expenditures data for 2004 to 2015. We estimated 2016 and 2017 numbers by taking an annual increase of 3% over the 2015 numbers.
[35] Q2 2017 taken for year end 2017.
[36] However, the CSO SILC 2016 estimate includes those '*participating in a pension scheme or will receive a pension other than the State Pension on retirement*', i.e. includes those with preserved benefits.

Our estimate is also consistent with the Aviva Pensions Index August 2018 of private pension coverage between ages 25 and 55 (noting that the survey population for the Index is significantly smaller):

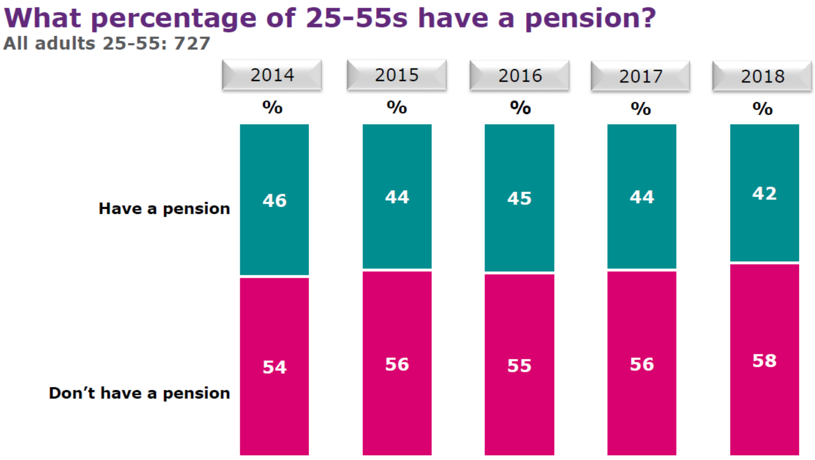


Figure 5:2 Aviva Pensions Index, August 2018

Using our approach, we estimated private pension coverage in the **private sector (including commercial semi state)** by excluding the public service and non-commercial semi state, over the period since 2008[37]:

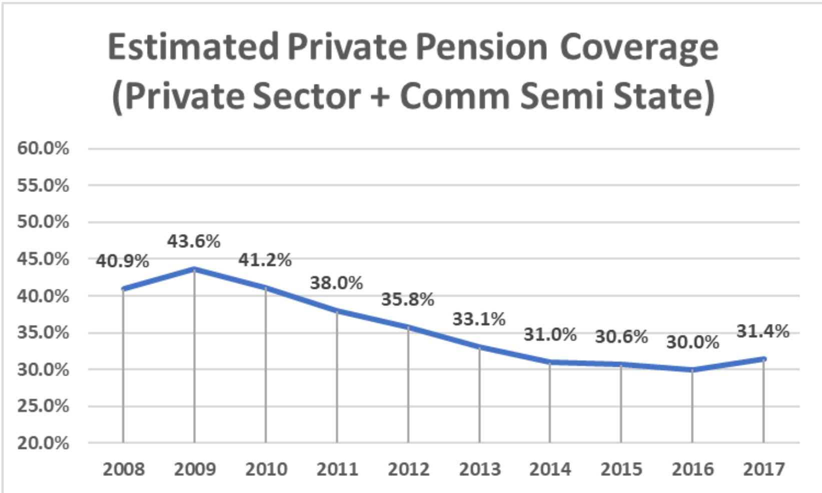


Figure 5:3 Estimated private pension coverage (private sector + commercial semi State)

Our 2017 estimated private sector coverage of 31.4% is lower than the DEASP estimate of private sector coverage of 35%, which is widely used currently[38].

If we assume that commercial semi state has 100% funded private pension coverage and take them out of the funded scheme count, we can estimate the pure private sector pension coverage (i.e. excluding commercial semi state) since 2008:

[37] The start of the CSO QNH10 data series of the numbers (i.e. not whole-time equivalents) employed in the public service.

[38] *'just 35% of the private sector workforce has such cover'*, A Roadmap for Pensions Reform, page 6

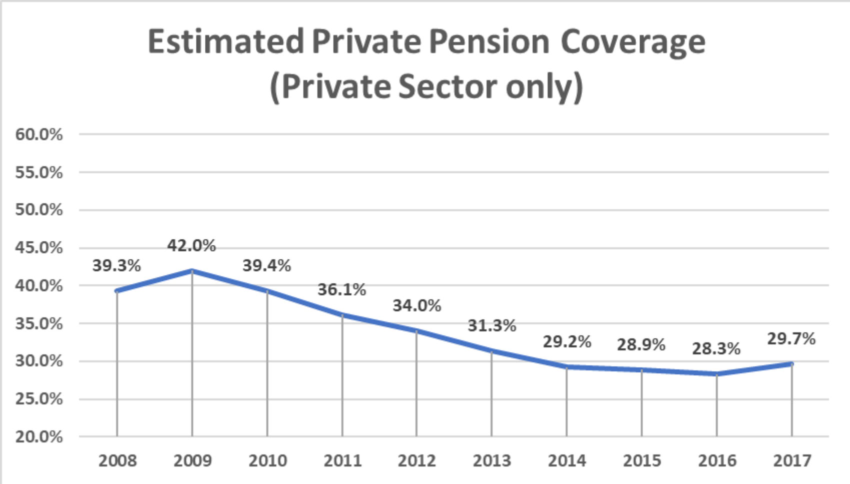


Figure 5:4 Estimated private pension coverage (private sector only)

There are several factors which could increase our 30% estimated 2017 private pension coverage rate for the private sector:

- Including those in the workforce with preserved private pension benefits only (i.e. not accruing further benefits but still at work);
- If we exclude the 450,000 in the private sector proposed to be excluded from the Automatic Enrolment scheme[39], our 2017 estimated 30% private pension coverage rate in the private sector would increase to circa 41%.
- If we exclude all those in workforce without private pension cover who have gross earning of less than €25,000 (circa 2 x State Pension), our estimated 30% private pension coverage rate in the private sector would increase to circa 47%.

However, using any measure, there has been a substantial reduction in private pension coverage in the private sector over the last decade:

- In 2008, 169,900 people claimed income tax relief on RAC and PRSA contributions[40]. By 2014 this had fallen to 93,700, a 45% fall, before recovering slightly to 96,200 in 2015.
- At the end of 2008 there were 526,000 active members of funded occupational pension schemes, but by 2014 this has fallen to a low of 403,000, down 23%, before recovering to 435,000 by the end of 2017.

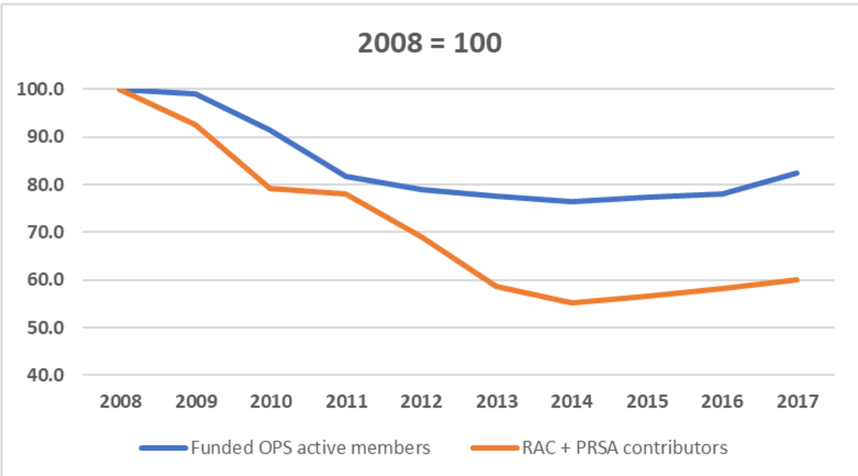


Figure 5:5 Number of active private sector contributors by year

[39] Because the person's income is less than €20,000 and/or they are under age 23 or over age 60

[40] Source: Revenue Commissioners Cost of Tax Expenditures (Credits, Allowances and Reliefs), 2005 to 2015

There has therefore been a proportionately larger fall off in coverage in individual pension contracts than in funded occupational pension scheme coverage, although both fell to a low in 2014 followed by a shallow recovery in numbers since.

The change in coverage by type of arrangement (DB, DC and RAC/PRSA) is shown in the following table:

Table 6 Change in coverage from 2008 to 2017 by type of arrangement

	2008	2012	CHANGE 2008 TO 2012	2017	CHANGE 2012 TO 2017
Active DB members (funded schemes)	254,385	183,260	-71,725	105,414	-77,846
Active DC members[41]	272,197	232,939	-39,258	329,297	+96,358
Total funded scheme actives	**526,582**	**416,199**	**-110,383**	**434,711**	**18,512**
RAC/PRSA contributors claiming tax relief	169,900	117,300	-52,600	96,200*	-21,100
	696,482	**533,499**	**-162,983**	**530,911**	**-2,588**

Source: Pensions Authority Annual Reports and Revenue Commissioners Cost of Tax Expenditure

** relates to 2015, the latest available information from Revenue Commissioners.*

If we exclude one-member schemes from the data, there is a relatively close relationship between the decline of DB active members over the period 2012-2017 (77,800) and the rise in active DC membership (82,600, excluding one-member schemes). This may suggest that that a considerable part of the DC increase in membership numbers over that period is in fact caused by a transfer of DB to DC accrual in group schemes.

5.4 Changes to private sector pension coverage

If we take 2008 as the base 100 and look at the estimated number at work in the private sector[42], we can see that over the period 2008 to 2017 the numbers at work (private sector only) displayed a U shape pattern with the bottom of the U occurring in 2010-2012 period.

Figure 5:6 Private sector at work (with and without private pension cover) by year

We might have expected the number with private pension coverage to have followed a broadly similar trend, i.e. a dip and then a recovery since 2012.

[41] Including one-member arrangements
[42] Excluding commercial semi state

However, we see that while pension coverage fell broadly in line with the trend in the number at work until about 2010, thereafter private pension coverage continued to fall until 2014 after which there has been a gradual increase in the number with private pension cover.

The CSO QNHS Pensions Modules allow us to pinpoint *where* the largest and smallest falls in private pension coverage occurred between Q1 2008 and Q4 2015. However, the data is, as we pointed out earlier, a blend of private and public sector.

Gender The reduction in cover was more significant for males than for females.

Table 7 Private pension cover by gender

	2008Q1[43]	2015Q4	Change
Male	56.3%	47.2%	-9.1%
Female	50.0%	46.2%	-3.8%

Source: CSO QNHS Pension Module Q4 2015, Table 1.1

Age The largest falls were generally at the younger ages but not exclusively so. Note a surprisingly large fall in cover for the 45-54 age cohort.

Table 8 Private pension cover by age cohort

Age Cohort	2008Q1	2015Q4	Change
20 - 29 years	36.6%	22.1%	-14.5%
25 - 34 years	48.9%	36.1%	-12.8%
35 - 44 years	61.1%	55.3%	-5.8%
45 - 54 years	65.5%	54.4%	-11.1%
55 - 69 years	55.2	49.3	-5.9
30-65	60.6	52.1	-8.5

Source: CSO QNHS Pension Module Q4 2015, Table 1.1

We also looked at age cohorts in Q4 2005 and compared their pension coverage in Q1 2008 with that in Q4 2015 (10 years older):

Table 9 Private pension cover as cohort ages

Age cohort in Q4 2005	2005Q4	**Age of cohort in Q4 2015**	2015Q4	Change
25 - 34 years	53.5%	**35 - 44 years**	55.3%	1.8%
35 - 44 years	66.3%	**45 - 54 years**	54.4%	-11.9%
45 - 54 years	64.8%	**55 - 64 years**	49.3%	-15.5%

Source: CSO QNHS Pension Module Q4 2015, Table 1.1

The biggest drop in coverage happened in those who were aged 45-54 in 2005; the private pension coverage for this cohort dropped from 65% to 49% over the decade since 2005.

This may reflect a significant ‘culling’ of full-time pensionable employment jobs in this 2005 age group (through termination/early retirement packages etc.) following the onset of the financial crisis, with the working survivors of this group more likely to be now in non-pensionable employment or self-employment.

We would also have expected the 25-34 20015 age cohort to have increased their private pension coverage as became 35-44 by more than 1.8% shown over the last decade.

43 https://www.cso.ie/en/media/csoie/releasespublications/documents/labourmarket/2008/qnhs_pensionsupdateq12007&q12008.pdf

Economic sector Over the period from Q1 2008 to Q4 2015, pension coverage fell across all NACE economic sectors, except Human Health and Social Work Activities, which increased slightly (+1.8%).

There was a significantly higher fall in private pension coverage in those areas of the private sector with already (in 2008) low private pension coverage, i.e. where cover could be said to have been 'soft' even before the economic crash, e.g. Agriculture, Forestry and Fishing (A), Construction (F), Wholesale and Retail Trade(G), and Accommodation and Food Service Activities (I).

Table 10 Private pension cover by NACE category

	2008Q1	2015Q4	Change
Agriculture, forestry and fishing (A)	44.9%	28.5%	-16.4%
Industry (B to E)	61.2%	52.1%	-9.1%
Construction (F)	47.5%	34.1%	-13.4%
Wholesale and retail trade; repair of motor vehicles and motorcycles (G)	36.2%	26.5%	-9.7%
Transportation and storage (H)	53.3%	42.6%	-10.7%
Accommodation and food service activities (I)	22.7%	13.1%	-9.6%
Information and communication (J)	63.5%	58.9%	-4.6%
Financial, insurance and real estate activities (K, L)	80.5%	75.2%	-5.3%
Professional, scientific and technical activities (M)	56.0%	49.5%	-6.5%
Administrative and support service activities (N)	37.9%	24.9%	-13.0%
Public administration and defence; (O)	93.6%	89.1%	-4.5%
Education (P)	76.1%	72.6%	-3.5%
Human health and social work activities (Q)	56.7%	58.5%	+ 1.8%

Source: CSO QNHS Pension Module Q4 2015, Table 1.1

Average earnings

We looked at the change in average earnings between 2008 and 2015, by the same categories as above:

Table 11 Average earnings by NACE category

	2008	2015	Change
Agriculture, forestry and fishing (A)			
Industry (B to E)	€41,314	€44,003	6.5%
Construction (F)	€39,026	€37,030	-5.1%
Wholesale and retail trade; repair of motor vehicles and motorcycles (G)	€26,610	€28,006	5.2%
Transportation and storage (H)	€40,148	€38,923	-3.1%
Accommodation and food service activities (I)	€18,099	€16,605	-8.3%
Information and communication (J)	€50,113	€55,966	11.7%
Financial, insurance and real estate activities (K, L)	€53,502	€52,877	-1.2%
Professional, scientific and technical activities (M)	€42,197	€41,954	-0.6%
Administrative and support service activities (N)	€25,672	€26,928	4.9%
Public administration and defence; compulsory social security (O)	€50,428	€48,173	-4.5%
Education (P)	€45,119	€41,940	-7.0%
Human health and social work activities (Q)			

Source: CSO Statbank Labour Force Survey EHA05

As expected, in sectors where average earnings fell, pension coverage also fell, e.g. Construction (F), Transportation and Storage (H) and Accommodation and Food Service Activities (I).

However, it is interesting to note that some sectors where average earnings *increased* over the period 2008 to 2015 private pension coverage still *fell* over that period, e.g. Industry (B to E), Wholesale & Retail (G) and IT (J).

Numbers at work

We looked at the change in the numbers at work in the economic sectors above, between 2008 Q1 and 2015 Q4:

Table 12 Numbers at work by NACE category

	2008 Q1 (000)	2015 Q4 (000)	Change
Agriculture, forestry and fishing (A)	117.0	106.2	-9.2%
Industry (B to E)	298.7	264.5	-11.4%
Construction (F)	222.8	109.9	-50.7%
Wholesale and retail trade, repair of motor vehicles and motorcycles (G)	335.8	298.3	-11.2%
Transportation and storage (H)	92.3	91.0	-1.4%
Accommodation and food service activities (I)	139.8	153.0	9.4%
Information and communication (J)	87.8	104.2	18.7%
Financial, insurance and real estate activities (K, L)	109.0	103.0	-5.5%
Professional, scientific and technical activities (M)	123.4	133.5	8.2%
Administrative and support service activities (N)	103.9	83.9	-19.2%
Public administration and defence, compulsory social security (O)	96.0	91.9	-4.3%
Education (P)	136.9	152.3	11.2%
Services (G to U)	1572.0	1597.6	1.6%

Source: CSO Statbank Labour Force Survey QLF03

Broadly in those sectors where the numbers at work fell, average earnings for those still working also fell, but there are some exceptions.

In sectors where the numbers at work *increased* over that period, private pension cover still fell over the same period. Example: Professional, scientific and technical activities (M)

Of particular note: Information & Communication (J) both the numbers at work and average earnings *increased* over the period 2008 to 2015, but private pension coverage still fell.

Employee/ Self employed

Table 13 Percentage with private pension cover (employed and self-employed)

	2008Q1	2015Q4	Change
Self employed	45.8%	29.9%	-15.9%
Employee (private + public)	55.5%	50.2%	-5.3%

Source: CSO QNHS Pension Module Q4 2015, Table 1.1

The largest fall in coverage was in the self-employed category. This is backed up by the earlier (5.3) findings on the fall in the numbers paying PRSA and RAC contributions since 2008 as compared with employee scheme contributions.

Employer size We looked at the change in employment numbers by employer size to understand the impact on pension coverage. The proportion of employees working in organisations with less than 50 people fell marginally from 51.8% in 2008 to 51% in 2012 and to 48.7% in 2016, while the proportion employees employed by larger organisations (250+) has increased over the period (from 28.9% in 2008 to 31.6% in 2016).

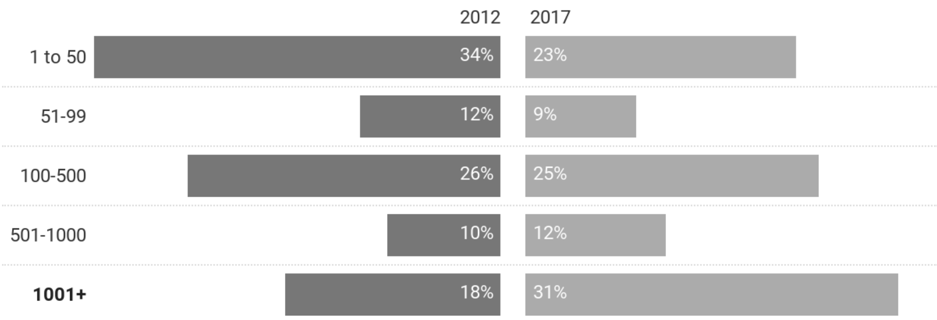
Table 14 Percentage working by employer size

Employer size	2008	2012	2016
Under 10	28.1%	29.3%	26.6%
10 to 19	10.6%	9.8%	9.7%
20 to 49	13.1%	11.9%	12.4%
50 to 249	19.3%	18.1%	19.7%
250 +	28.9%	30.9%	31.6%
	100.0%	**100.0%**	**100.0%**

Source: CSO Business Demography 2016, Table 3

We then compared this to the Pensions Authority data for group DC scheme active members (i.e. ignoring one-member schemes) and noticed how it changed, particularly since 2012:

Table 15 Distribution of DC membership by scheme size



Source: Pensions Authority Annual Reports 2012 & 2017

- In 2017, just 23% of active group DC members were in smaller schemes (less than 50 members), compared to 34% in 2012.
- Schemes with 1,001+ members have experienced the largest increase in membership since 2012 (from 18% in 2012 to 31% in 2017).
- This suggests that if you are an employee of a larger organisation, you are more likely to be in a pension scheme.

But the details above, while describing *where* the fall in private pension coverage occurred, don't really explain in *why* cover continued to fall after 2011 and remains low, even though the numbers at work and average earnings have recovered.

There are several possible explanations, including:

- 2008, i.e. top of the Celtic Tiger boom, may be the wrong starting point. For example, our 2004/07 estimate of total private pension coverage averages around 46%, with our latest estimate for 2014/17 period averages at around 43%. This may be the "truer" longer-term trend coverage.
- Some in the private sector who continued working throughout the period, may have jettisoned private pension funding with the onset of the financial crisis from 2009 onwards (where they could) and have

not yet recommenced funding, possibly on grounds of affordability, access, and uncertainty about the permanence of the recovery and/or their own employment.

The QNHS 2015 Pensions Module reported reasons for not having a pension, including:

- could not afford a pension (39%)
- never got around to organising a pension (22%)

- The rebuilding of the private sector employee 'balance sheet' since 2008 may have been concentrated on reducing debt and building up readily accessible deposits, rather than saving for retirement.

  Central Bank Table A.18 of Credit Advanced to and Deposits from Irish Private Households shows total household lending reduced from €138bn at the end of 2008 to €82bn at the end of June 2018, while household deposits over the same period grew from €94bn to €96bn.

- New employees who joined the private sector since 2009 may have largely eschewed private pension funding, even where such funding was offered.

  Issues of affordability may be relevant[44] with other pressures and demands on the family budget such as child care, rent, accumulating a deposit to buy a first home, mortgage repayments, etc. Also, the long-term permanency of their new employment may be in doubt, at least in the employee's mind; there are few if any 'for ever' jobs in the private sector.

- An increase in the proportion of employers *not* offering an occupational pension scheme.

  Figures from the QNHS Pension Modules of Q4 2009 and Q4 2015 show for private sector employees[45], not included in an occupational pension scheme at those dates, a significant increase in the proportion of employers *not* offering an occupational pension scheme, particularly small employers:

Table 16 Proportion of employees not in an occupational pension scheme (OPS) who cite their employer did not offer an OPS, by employer size

Employer size by number of employees	Q4 2009	Q4 2015	Change
1 to 4	74%	92%	18%
5 to 49	66%	79%	13%
50 to 99	51%	61%	10%
100 to 499	38%	49%	11%
500+	33%	44%	11%

Source: CSO QNHS Pension Module Survey Q4 2015, Table 3.2

- Delayed entry to employment (young people staying longer in 3rd level education, unpaid internships, and gap years abroad etc.) may mean that on eventual entry into the workforce they cannot afford immediate optional pension funding. Therefore, the commencement of pension funding may be delayed longer than would have been the case pre-2008.

- Increase in taxes since 2011 (e.g. introduction of USC) squeezing disposable income.

  The ESRI Distributional Impact of Tax, Welfare and Public Service Pay Policies: Budgets 2009-2016 stated: " … *budgets over the 2009 to 2016 period have given rise to substantial income losses at all income levels, as budget deficits were reduced. These may be termed "policy induced losses" to distinguish them from falls in income arising from unemployment, lower wages or falling self-*

[44] The QNHS Penson Module 2015 stated in relation to those without a private pension at that time: '*Affordability was the main reason given by both full-time (36%) and part-time (44%) workers for not having a pension. However, full-time workers were more likely than their part-time counterparts to report that they never got around to organising a pension (26% versus 16%)."*

[45] Aged 20 to 69

employment incomes. For most income groups, these losses were between 7½% and just over 10%. The greatest policy-induced losses were for the top income group, at just over 14%t, and the lowest income group, at 12¾%."

- Cut backs and reduction in private pension tax reliefs, reducing the tax effectiveness and attraction of pension contributions.
- The pension levy applied between 2011-15 period, which withdrew €2.4bn of private pension funds, may have discouraged the payment of further contributions by those already with private pension cover, while those without private pensions may have delayed starting pension funding until the levy was terminated (in 2015).
- There may be a lag/lead effect at play; voluntary pension funding may be abandoned early in the event of a major economic downturn, but it may take a longer time to reinstate it even after the economic situation improves. Once the pensions saving habit is broken, it may become harder to reinstate, given other pressures on consumer income.

5.5 Coverage by gross income distribution (public and private sector)

Based on the CSO QNHS Pensions Modules coverage data for Q4 2015 and average earnings in 2015, both classified by NACE status of industrial activity, we detect a strong link between the level of earnings and likely private pension cover. Excluding those NACE sectors dominated by public service workers, e.g. education, health, defence, etc., the distribution of average earnings and private pension coverage in 2015 was:

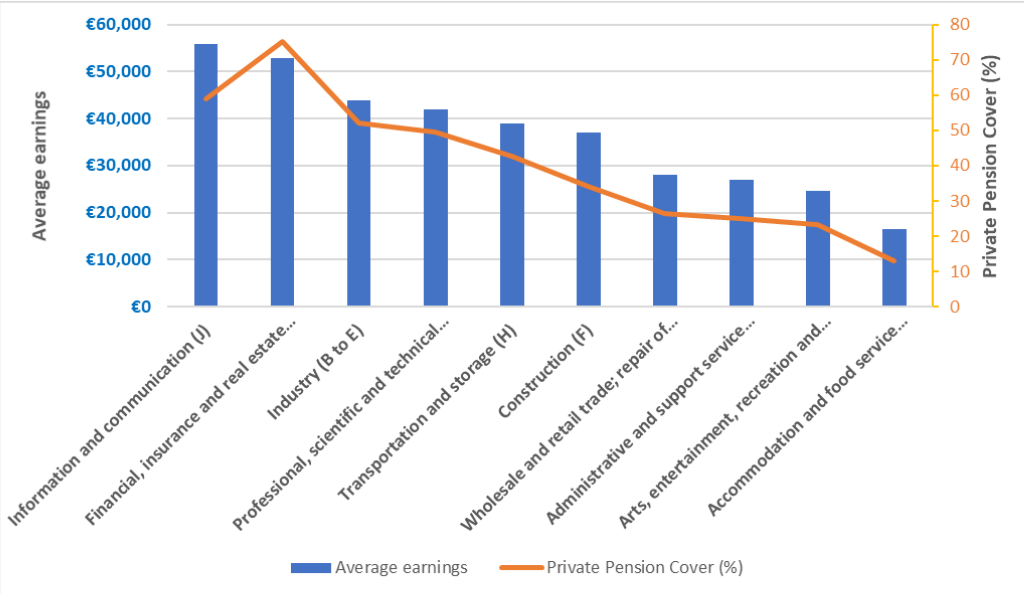


Figure 5:7 Average earnings by employment sector and pension cover

The chart suggests that the higher the level of earnings in the private sector, the more likely the individual is to have private pension cover.

The CSO kindly gave us a copy of their '*Investigation of the earnings distribution based on the participation in a pension scheme'* study, based on SILC 2014 and 2016 data. However, the CSO qualify the results: '*This dataset (i.e. SILC) is not designed specifically to measure pension participation but an estimate is possible based on the data collected. The data is sample data and the results, whilst weighted to the overall population, are best taken as indicative only.*'

In relation to employees, the data is in effect a blend of public and private sector employees and hence obscures to some extent the profile of private sector coverage. The data for self-employed refers to private sector only.

For full time employees ***with* private pension**, the distribution by gross income was

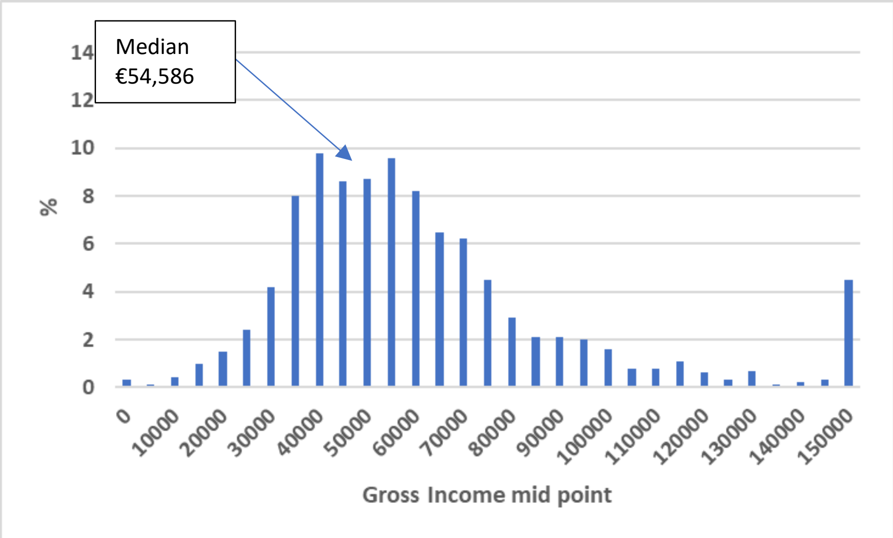


Figure 5:8 Distribution of full-time employees (public + private sector) with private pension cover by gross income 2016

For **full time employees *without* private pension**, the distribution by gross income was:

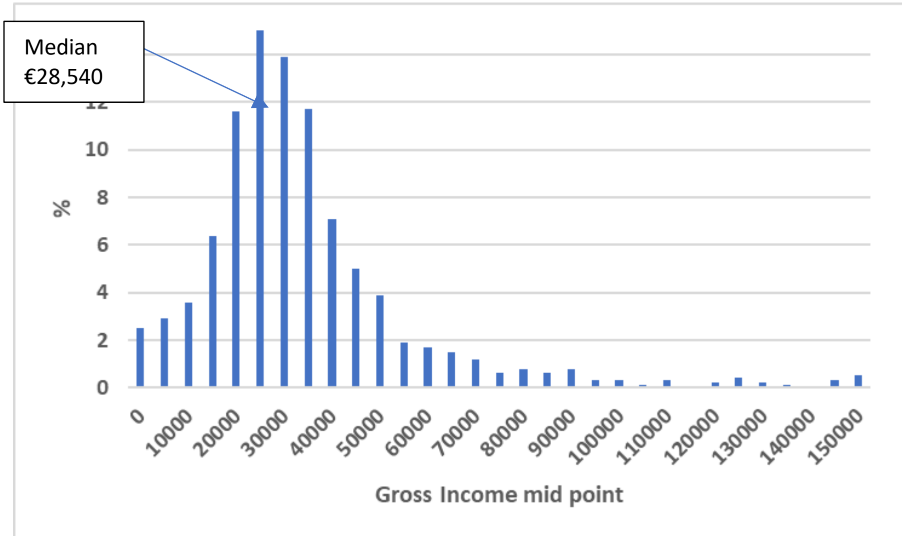


Figure 5:9 Distribution of full-time employees (private sector) without private pension cover by gross income 2016

Table 17 Gross income of Full-time employees – with and without private pension cover

	1st Quartile	Median	3rd Quartile
With private pension (public + private sector)	€41,065	€54,586	€72,170
Without private pension (private sector only)	€21,850	€28,540	€39,122

For full-time employees, it is interesting to observe that the two groups (with and without private pension coverage) do not significantly overlap each other in gross income terms. E.g. if we take the middle 50% (the interquartile range) they do not overlap at all:

Figure 5:10 Full-time employees with and without private pension cover

There are two possible points of view of the above chart:

- Marginal rate pension tax relief doesn't work as an incentive with those on low incomes who are either not paying income tax at all or at standard rate, as they will either get no tax relief or relief at just 20%.

  Or

- It's not just down to tax relief. With a median income of €28,540 affordability may be the key issue, along with potential transient employment patterns, proportionately more younger people in casual employment, and/or working for a small employer who may not be willing to or able to provide private pension provision for its employees.

  We are inclined more towards the latter view.

Therefore in 2016 it is estimated that:

- 75% of full-time employees *with* private pension cover had gross income less than €72,170.

- 75% of full-time employees *without* private pension cover had a gross income of less than €39,122.

The corresponding data for **full-time self-employed** was:

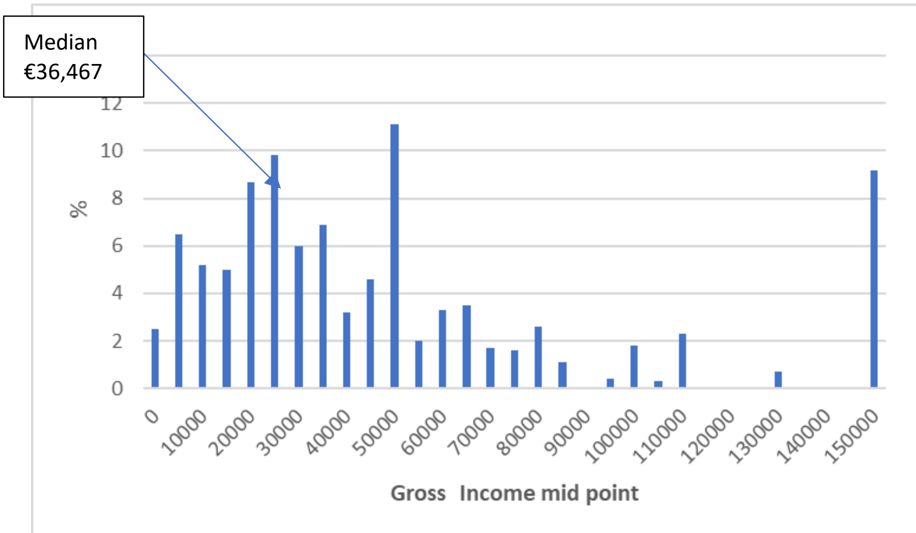


Figure 5:11 Distribution of full-time self-employed with private pension cover by gross income 2016

There is a noticeably more dispersed distribution by gross income for those with private pension cover for the self-employed than for employees.

For **full time self-employed *without* private pension,** the distribution by gross income was:

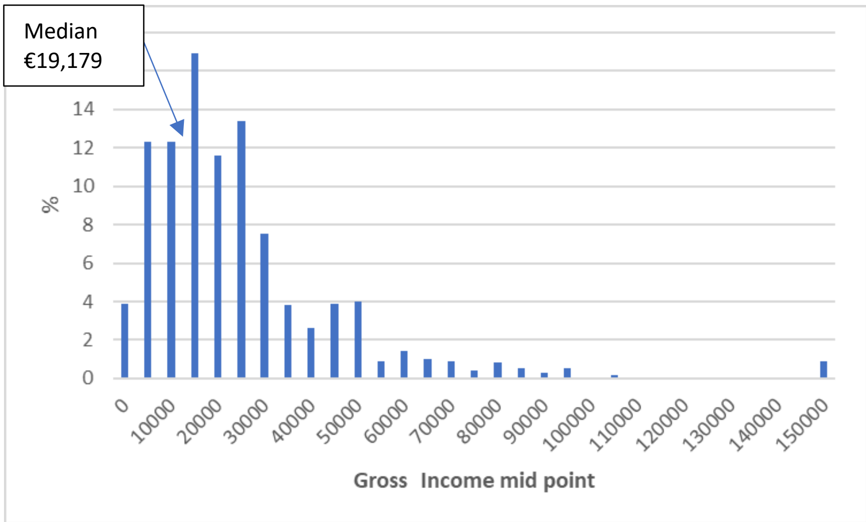


Figure 5:12 Distribution of full-time self-employed without private pension cover by gross income 2016

Table 18 Gross income of Full time self-employed – with and without private pension cover

	1st Quartile	Median	3rd Quartile
With private pension	€20,000	€36,467	€63,000
Without private pension	€10,501	€19,179	€30,779

Therefore, it is estimated that in 2016:

- 75% of full-time self-employed people *with* private pension cover had gross income less than €63,000
- 75% of self-employed *without* private pension cover had a gross income of less than €30,779.

It is noticeable that some 25% of the full-time self-employed *with* private pension cover had a gross annual income of less than €20,000. This may reflect the variable nature of self-employed income from year to year.

The CSO data also shows a distinct difference in private pension coverage and gross earnings as between full time and part time employees, which is not surprising:

Table 19 CSO pension coverage data by status and gross income

	Employees		Self employed	
	Full time	**Part time**	**Full time**	**Part time**
Private pension coverage	56%	20%	29%	30%
Median gross income – *with* private pension cover	€54,586	€26,345	€36,467	€16,680
Median gross income – *without* private pension cover	€28,540	€12,156	€19,179	€7,200
Proportion of those with private pensions with gross income of more than €100,000	6%	1%	5%	nil

Several points emerge:

- The bulk of those *with* private pension coverage could be fairly described as *middle income*, e.g. in 2016, 75% of full-time employees with private pension cover had gross annual income less than €72,170 or less than twice average earnings[46]. For full time self-employed with private pension cover, 75% had a gross annual income less than €63,000.

  Only 9% of all those with private pension coverage (employee and self-employed combined) had a gross income in 2016 of more than €100,000.

- There is a clear disparity in gross income profile between those with and without private pension coverage, e.g. for full-time employees *with* private pension coverage the median gross income is €54,586 but for full-time employees *without* private pension coverage, the median is €28,540, significantly less than the average earnings for full-time employees.

- Using the Automatic Enrolment proposed gross income cut-off point of €20,000 p.a. would, based on the CSO SILC figures for 2016, imply that at least 39%[47] of employees *without* private pension coverage would also fall outside the Automatic Enrolment scheme.

- The 2018 "A Roadmap for Pensions Reform"[48] said that "*private savings arrangements are voluntary and generally aim to secure a payment level in retirement that, when combined with the State pension, replaces a sufficient proportion (e.g. 50% – 60%) of an individual's pre-retirement earnings so as to enable the individual concerned to maintain a reasonable standard of living after retirement*".

  Based on the current level of State Pension (€243.30 per week or €12,695 per annum increasing in 2019 to just under €13,000 pa), individuals earning up to €25,000 gross may be considered to have a "sufficient proportion" (i.e. at least 50%) of their pre-retirement gross earnings replaced by the State Pension.

  If this is the case, then at least 53%[49] of all (employees and self-employed) *without* private pension cover *may not need* a private pension.

In this case the core of those in the private sector who have a strong need for a private pension (i.e. have income of more than €25,000 pa), amounts to about 1/3rd of the private sector workforce, or about 550,000 individuals:

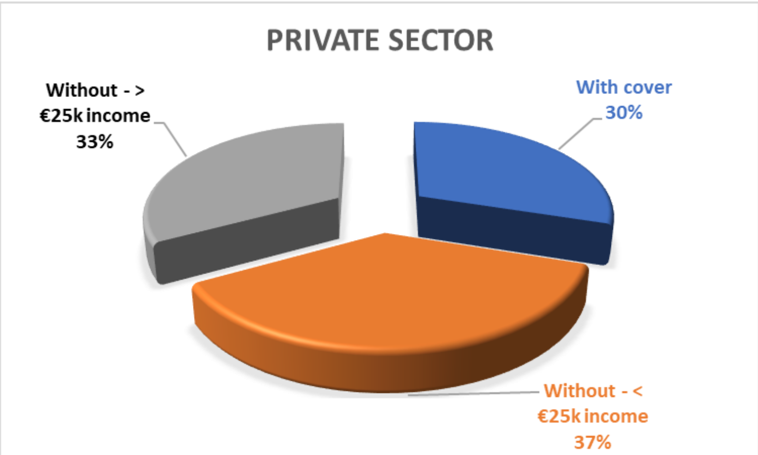


Figure 5:13 Split of private sector with/without pension cover

[46] Average annual earnings for full-time employees in 2017 was €46,402 https://www.cso.ie/en/releasesandpublications/er/elca/earningsandlabourcostsannualdata2017/

[47] CSO Investigation of the earnings distribution based on the participation in a pension scheme Using SILC 2016 Data, Table A1

[48] https://www.welfare.ie/en/pressoffice/pdf/PensionsRoadmap.pdf

[49] CSO Investigation of the earnings distribution based on the participation in a pension scheme Using SILC 2016 Data, Tables A3 & A4

The income distribution of the 33% in the **private sector without private pension cover and who have income of at least €25,000** is concentrated at lower income levels, with a median income of circa €31,000:

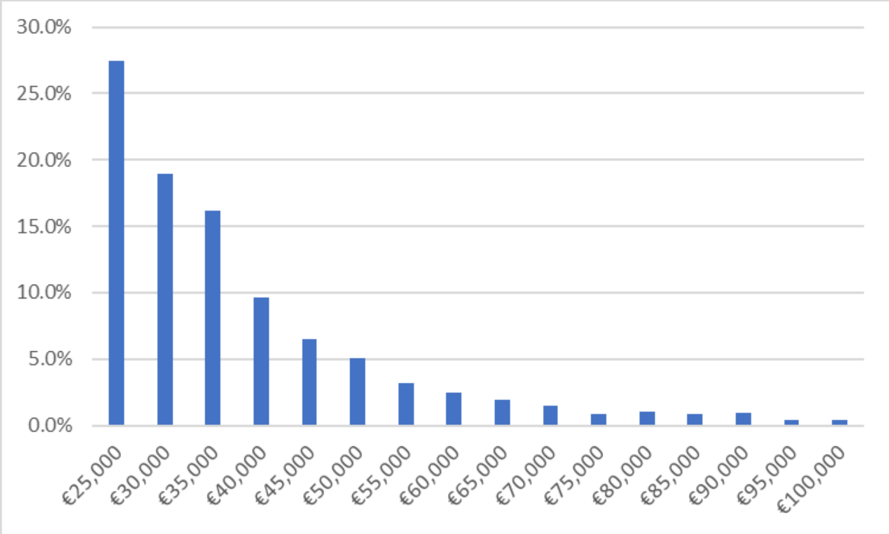


Figure 5:14 Private sector without private pension, income greater than €25,000 pa

5.6 Quality of cover

A different issue is the *quality* of private pension cover, generally regarded as a more significant issue in the private sector than in the public sector. The most noteworthy trend in this regard over the last decade has been the reduction in DB coverage in favour of DC coverage.

The DC proportion of active membership in funded occupational pension schemes has increased from 48% in 2004 to 76% by 2017[50], and is likely to continue increasing as DB active membership runs off through transfers to DC, retirements and scheme wind up.

The estimated average employer contribution rate to a group DC scheme was taken to be 7% p.a. by the DPER in its "Actuarial Review of Pension Provision in the Irish Public Service and a Comparison With the Private Sector"[51], published in March 2017. The average employee DC scheme contribution rate was surveyed to be 5.4% p.a. by the IAPF in its 2014 DC Survey.

The challenge with a DC scheme (or PRSA) is that the benefits at retirement are not known in advance and depend primarily on the amount of money saved, the investment term, the investment returns achieved, the charges incurred, the age at which the person retires and the cost to provide those benefits at retirement.

The quality of coverage issue can be demonstrated by way of an example (all figures have been calculated using the Pensions Authority Pension Calculator and are shown in today's money terms). The salary used in the example is based on the 2017 annual average earnings of €46,402 for a full-time employee, as disclosed by the CSO in its 2017 Earnings and Labour Costs data[52].

Table 20 Estimated income at age 68 based on average DC contribution rates

Age start to save for retirement	Salary	Employer contribution	Employee contribution	Expected private pension at age 68 (State Pension Age)	State Pension	Total Private + State Pension a % of pre-retirement salary
Age 25	€46,402	7%	5.4%	€10,678	€12,695	50%
Age 35	€46,402	7%	5.4%	€7,801	€12,695	44%
Age 45	€46,402	7%	5.4%	€5,170	€12,695	38%

[50] Source: Pensions Authority Annual Reports
[51] https://paycommission.gov.ie/wp-content/uploads/DPER-pensions.pdf, page 4
[52] https://www.cso.ie/en/releasesandpublications/er/elca/earningsandlabourcostsannualdata2017/

The figures shown do not take account of a lump sum that many people will take at retirement, given that some or all of it will be tax-free. Where a lump sum is taken, this will reduce the net income replacement ratio in retirement.

5.7 Other means of providing for retirement

Saving for retirement through a private pension arrangement is only one way to provide for retirement. There are of course other ways that people may provide for their retirement and hence private pension coverage of less than 100% should not be looked on as a 'failure' of the private pension tax incentives:

- Some may depend on their spouse's or partner's private pension in retirement.

  In the CSO QNHS Pensions Module Q4 2015, 9% of female workers expected their spouse's or partner's private pension to be their main expected source of retirement income. The corresponding figure for males was 2%.

- Some in the private sector may save for retirement via other means, such as personal saving from net income, property investment and other tax incentive schemes such as the Employment Incentive and Investment Scheme (EIIS).

  In the CSO QNHS Pensions Module Q4 2015, 16% of the self-employed expected savings or investments, sale of business, farm or other property, to be their main expected source of retirement income.

  The Revenue Commissioners published statistics in September 2018[53] which show that 34% of taxpayer units[54] (193,000) subject to self-assessment in 2016 declared rental income with an average of €21,830 pa.

- Some may plan to downsize and release equity in their home to fund their retirement.
- Some may plan to continue working into later life. Census 2016 reported almost 60,000 people aged 65 years and over were 'at work' (45,000 in 2011). But of course, some of these may be working because of financial necessity (by not having made adequate private pension) rather than as a lifestyle choice.

[53] https://www.revenue.ie/en/corporate/documents/statistics/income-distributors/rental-income-2016.pdf

[54] A married couple subject to joint assessment are one unit

6 Analysis of the taxation of benefits in retirement

Retirement income from a private pension arrangement can be an annuity, a pension from a DB scheme (funded or unfunded), ARF/AMRF withdrawals, and in some cases taxable lump sums payments payable at retirement. Generally, but not exclusively, retirement benefits and will be payable to people over age 65.

Under the EET system, it is expected that tax on taxable retirement benefits will repay a significant portion of the value of the tax relief provided to accumulate the retirement benefits.

6.1 Taxation of retirement income

Private pension retirement income is taxable as income. However, there are two factors which can significantly drive down the effective tax rate payable on private pension retirement income:

- In a highly progressive tax system, where retirees have lower income than when they were working, they will pay a lower effective tax rate in retirement.

  Take, for example, the effective tax rates[55] at different levels of earnings and at 50% of that amount (married couple[56], one income, both under age 65):

  Table 21 Effective Tax Rate on income, under 65

Income	€50,000	€60,000	€70,000	€80,000	€90,000	€100,000
100% income, under 65	21%	25%	28%	31%	34%	35%
50% income, under 65	6%	10%	13%	15%	17%	20%

- The Irish tax system also contains several provisions which discriminate in favour of certain individuals, in view of additional challenges which they face. According to The Tax Strategy Group "*while these measures are deviations from the principle of horizontal equity, under which each person with the same income should have the same tax liability, they have been introduced into the tax code as a result of social policy decisions to provide additional supports to individuals in these specific circumstances*"[57].

  For older people, these additional provisions include:

  - An additional age tax credit of €245 per person for those aged 65 or over; for a married couple the tax credit is €490.
  - Income tax exemption for those aged 65 or over if total income (including the State Pension) is less than €18,000 pa for a single person or €36,000 for a married couple. Marginal relief (40%) applies on the next €18,000 / €36,000. This can reduce the income tax liability in some cases.
  - No USC on the State Pension.
  - USC exemption on income (other than State Pension) of up to €13,000.
  - A reduced rate of USC of 2.0% for those aged 70 and over whose annual income (other than the State Pension) is €60,000 or less.
  - The full Employee Tax Credit (€1,650 max) is provided in respect of the State Pension, even where the retiree's private pension income is less than €8,250.
  - No PRSI on pensions or annuities at any age, or on any income once over age 66.

  This package further reduces the effective tax rate paid on income in retirement.

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[55] Income tax + USC + PRSI (for under 65s).
[56] Any references to married couples also include those in civil partnerships
[57] https://www.finance.gov.ie/wp-content/uploads/2017/07/TSG-17-02-Income-Tax-and-USC-paper-FINAL-JC.pdf page 10

If we take the same example (**married couple, one income**) and assume the 50% income in retirement (i.e. age 65+) is made up of a State Pension (Contributory) (SPC) of €12,695[58] and the balance private pension retirement income (and no other income), the **effective tax rate** on total income[59] in retirement is even lower again:

Table 22 Effective Tax Rate on income, under/over 65[60]

Total Income	€50,000	€60,000	€70,000	€80,000	€90,000	€100,000
Working 100% income, under 65	21%	25%	28%	31%	34%	35%
Working 50% income, under 65	6%	10%	13%	15%	17%	20%
Retired 50% income, over 65	**0%**	**1%**	**1%**	**5%**	**9%**	**12%**

The disparity in effective tax rate between the couple with 50% income under and over 65 is striking, particularly at lower levels of income. It arises from a combination of factors:

- The income tax exemption limit;
- USC not applied to the State Pension; and
- USC exemption where private pension income is less than €13,000; and
- Reduced USC rate for private pension income (applies from age 70 where total private pension income is less than €60,000)

6.1.1 Scenario analysis for over 65s based on current tax rules

We looked in more detail at the tax on private pension income for three retiree scenarios:

Single over 65	Private pension income + the State Pension (Contributory) of €12,695[61].
Married one income over 65	Private pension income + one State Pension (Contributory) of €12,695
Married two incomes over 65	Private pension income+ two State Pension (Contributory), totalling €25,390[62] In this case, the private pension retirement income is assumed to be split 50:50 between the couple

(There are, of course, also other scenarios not considered here, including where the retiree has other income, e.g. work or rental income.)

For each of the three scenarios, we calculated the income tax and USC liability arising and then **expressed that total tax liability as a % of the private pension retirement income only** to arrive at an effective tax rate on private pension income, because:

- The State Pension (Contributory) on its own would not give rise to an income tax liability in any of the scenarios, being under the relevant income tax exemption limit; and
- USC is levied only on private pension income.

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[58] The DEASP Statistical Review 2015 suggested that only 19% of SPC recipients in 2015 received the Qualified Adult increase (means tested). We have therefore taken a typical current scenario of a married couple with one SPC.

[59] i.e. on the sum of the State Pension + private pension income

[60] Total tax (income tax + USC) payable expressed as a % of total income (including the SPC), before and after retirement

[61] Current maximum rate of SPC

[62] Twice the current maximum rate of SPC

We looked at different levels of private pension retirement income, starting from €5,000 pa in €5,000 increments to €60,000.

The resulting effective tax rate (USC[63] + IT) over 65 on the private pension retirement income is:

Table 23 Effective tax rate on private pension retirement income over 65

	Private pension income											
	€5,000	**€10,000**	**€15,000**	**€20,000**	**€25,000**	**€30,000**	**€35,000**	**€40,000**	**€45,000**	**€50,000**	**€55,000**	**€60,000**
Single	0.0%	9.9%	14.1%	16.1%	19.8%	23.5%	26.1%	28.1%	29.7%	30.9%	31.9%	32.7%
Married one income	0.0%	0.0%	0.8%	1.1%	4.0%	10.3%	14.9%	18.2%	20.9%	23.0%	24.7%	26.2%
Married two incomes	0.0%	0.0%	6.6%	9.9%	12.0%	14.1%	15.2%	16.1%	17.3%	19.8%	21.8%	23.5%

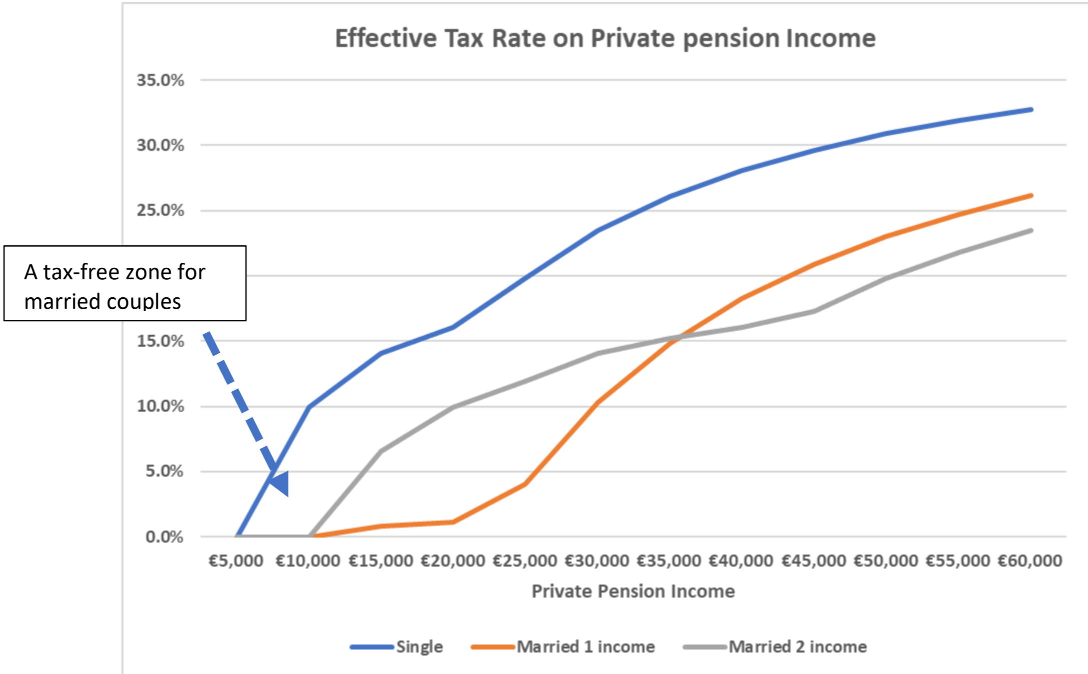


Figure 6:1 Effective tax rate on private pension income at different income levels

As the graph demonstrates, the taxation of private pension income is highly progressive, with those on lower private pension incomes paying either no or very little tax on their private pension income, while those with higher private pension income levels pay much higher effective tax rates.

The table below shows the level of private pension income which is currently tax free and at which an effective tax rate of 15% and 30% applies, for the three stated scenarios:

Table 24 When does private pension income becomes taxable for over 65s?

	Private retirement income is tax free below this level	Effective tax rate of 15% applies to private pension retirement income	Effective tax rate of 30% applies to private pension retirement income
Single	€5,308 pa	€16,930 pa	€46,260 pa
Married one income	€13,000[64]pa	€35,144 pa	€77,360 pa
Married two incomes	€10,610 pa	€33,860 pa	€92,560 pa

[63] For ease of illustration, we have assumed a USC rate of 2%, i.e. the rate that applies to a person aged 70 or over with income of less than €60,000 pa, excluding the State Pension.
[64] USC liability starts at this level; income tax does not start until private pension income exceeds €23,305

One can see from the above table that for married couples with private pension income of less than about €13,000 pa[65] and assuming they have no other taxable income other than the State Pension (Contributory), private pension income is *currently* tax free, or substantially tax free.

A significant number of DC retirees are currently likely to fall into this category, so that most current DC retirees, by number, probably pay little or no tax on their taxable retirement income. For these, the EET system is close to EEE[66].

We can convert the above table of private pension income into an equivalent DC maturity fund (to generate such income) by using current market annuity rates. The results are set out below:

Table 25 DC Fund threshold based on current market annuity rates[67]

	Supplementary retirement income is tax free for maturity funds less than	Effective tax rate of 15% applies to supplementary retirement income	Effective tax rate of 30% applies to supplementary retirement income
Single	€183,000	€584,000	€1,596,000
Married one income	€526,000	€1,422,000	€3,131,000*
Married two incomes	€429,000	€1,370,000	€3,746,000*

** As this is over the Standard Fund Threshold, in practice an effective tax rate of approximately 69% would have been reached at an earlier fund level.*

The taxation of taxable retirement benefits is therefore highly progressive, and significantly favours those middle earners (particularly married couples) who obtained higher rate relief on their pension contributions but who fund relatively low levels of DC private pension income and hence pay no or very low tax on it in retirement when over 65).

6.1.2 Scenario analysis if the over 65s tax concessions did not apply

If the 'Age Package' of tax benefits provided to the over 65s did *not* apply, it would push up the effective rate of tax on private pension income at lower levels:

Table 26 Effective tax rate on private pension income (if no Age Package)

	Private pension income											
	€5,000	**€10,000**	**€15,000**	**€20,000**	**€25,000**	**€30,000**	**€35,000**	**€40,000**	**€45,000**	**€50,000**	**€55,000**	**€60,000**
Single	4.8%	12.4%	15.7%	17.3%	20.8%	24.3%	27.1%	29.3%	31.0%	32.4%	33.5%	34.5%
Married one income	17.3%	18.6%	20.5%	21.0%	25.8%	28.9%	31.2%	32.9%	34.2%	35.3%	36.1%	36.8%
Married two incomes	0.0%	4.8%	9.9%	12.4%	13.9%	15.7%	16.6%	17.4%	18.8%	21.4%	23.5%	25.3%

[65] Currently no USC applies if income (other than the State Pension) is less than €13,000.
[66] However, as personal contributions are not deductible for USC and PRSI purposes, it can be argued that contributions are not fully tax deductible.
[67] Assuming male retiree age 66, pension increasing at CPI max 5% pa, spouse age 63, 50% spouse's pension (for married people), nil commission. Annuity rate effective 6 October 2018

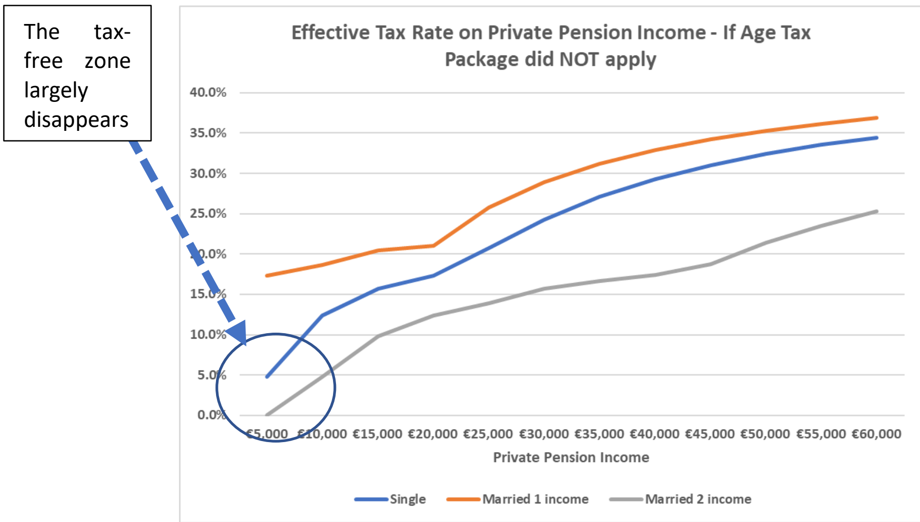


Figure 6:2 Effective tax rate on private pension income (no Age Package)

The revised table of private retirement income threshold levels would also change.

Table 27 When would private pension income become taxable for over 65s (if no Age package)

	Private pension income tax free below this level	Effective tax rate of 15% applies to private pension income of	Effective tax rate of 30% applies to private pension income of
Single	€3,810	€13,630	€41,830
Married one income	€12,060	€31,150	€63,000
Married two incomes	€7,610	€27,250	€79,220

The equivalent DC funds required (required to provide such income), assuming current market annuity rates are:

Table 28 DC Fund thresholds based on current market annuity rates (if no Age package)

	Private pension income is tax free below this fund level	Effective tax rate of 15% applies to private pension income part of fund	Effective tax rate of 30% applies to private pension income part of fund
Single	€131,000	€470,000	€1,443,000
Married one income	€488,000	€1,261,000	€2,550,000*
Married two incomes	€308,000	€1,103,000	€3,206,000*

** As this is over the Standard Fund Threshold, in practice an effective tax rate of approximately 69% would have been reached at an earlier fund level.*

Therefore, the tax concessions provided to the over 65s have a significant impact on lowering (or even eliminating) the tax payable on private pension income.

6.2 Distribution of private pension income by gross income

There does not appear to be any available official source to show the distribution of private pension income by level of income. This would help to estimate the distribution of retirees by the likely effective tax rate they pay on such income.

Drawing on other information sources it is possible to get an indication of what this distribution might look like.

Figures from the Department of Public Expenditure and Reform (DPER) Actuarial Review of Public Service Occupational Pensions, dated 30th November 2017, shows circa 155,000 public service pensioners[68] with an average pension of €19,908 pa.

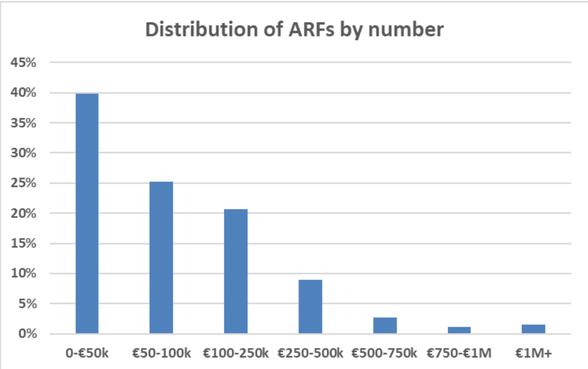
[68] This includes some widow/widowers and children pensioners

However:

- Some 44% of public service retirees were aged under 65 and so would not benefit from the over-65s tax concessions outlined earlier;
- Public sector retirees who entered public service before 6th April 1995 (likely to be the majority of *current* public service pensioners) are less likely to have a State Pension (Contributory) and so have more tax bands, allowances, and income tax exemption limit available to offset against their tax liability on their public service pension.

There is no available data on funded DB pensions and annuity amounts.

Several Qualifying Fund Managers ("QFMs") kindly shared data with us on the current distribution of their ARFs by value and number. The data covers over €5bn of ARF funds for some 36,000 ARF holders.



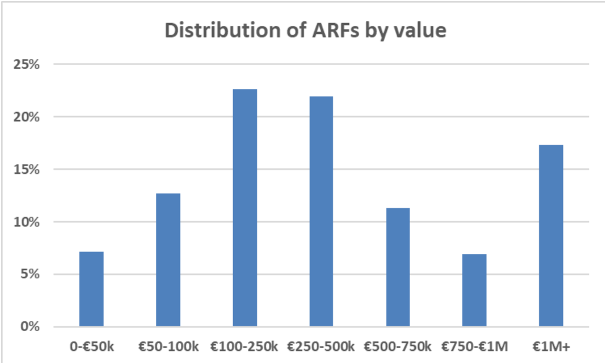


Figure 6:3 Distribution of ARFs by number and value

The current median ARF value is circa €70,000 and the average value is €142,000. The distribution stats from the sample are:

ARF size	% number	% Value
0-€50k	40%	7%
€50-100k	25%	13%
€100-250k	21%	23%
€250-500k	9%	22%
€500-750k	3%	11%
€750-€1M	1%	7%
€1M+	2%	17%

The distribution is skewed, with a large number having a relatively small ARF value and a small number having a relatively large ARF value:

- some 65% of ARF holders have an ARF less than €100k, but in value terms these retirees only account for 20% of all ARF values.
- some 14% of ARF holders have an ARF greater than €250,000, but in value terms these retirees account for 58% of all ARF values.

The skewed ARF distribution probably reflects two different groups with different pre-retirement funding patterns:

- Former employee members of DC schemes and PRSAs, with lower maturity funds, and
- Former proprietary directors, self-employed (RACs and PRSAs), and higher earning employees in sectors like financial services, with higher maturity funds[69].

For those over age 65, we estimated the distribution of taxable annual ARF withdrawals[70] as follows:

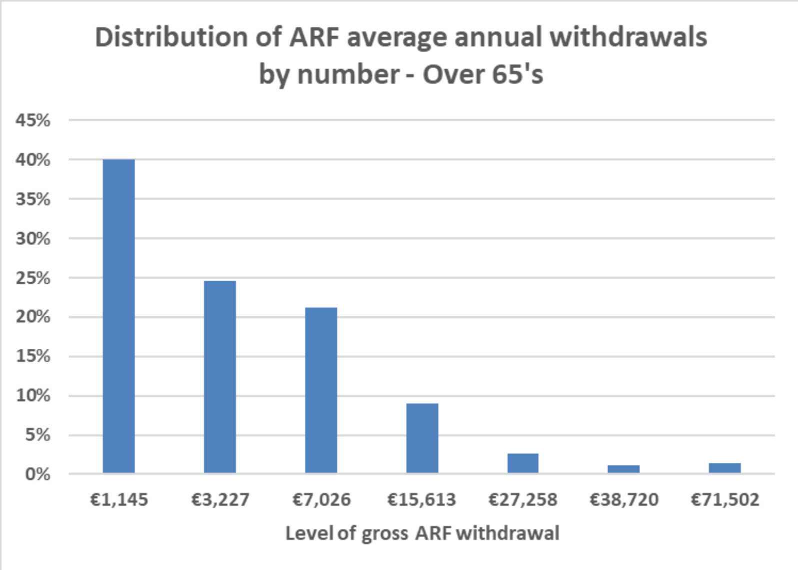


Figure 6:4 Distribution of ARF average annual withdrawals, over 65s

The distribution suggests that 86% of ARF holders over age 65 in our sample have an annual gross ARF withdrawal less than €7,000 pa.

However, because of the skewed ARF size distribution, we split the ARF retirees over 65 into two groups, those with an ARF size less than €250k and those with an ARF size greater than €250k, and on this basis:

- ARF size under €250k, 86% of all cases: average annual ARF income: €3,190 pa
- ARF size greater than €250k, 14% of all cases: average annual ARF income: €25,140pa

Given the level of income tax exemption limit and State Pension (Contributory) it is likely that most of those with ARFs under €250k pay little or no tax on their ARF income (unless they have other income in addition to the State Pension), whereas most of those with ARFs greater than €250k are much less likely to benefit from the income tax exemption limit and hence pay tax on some or all of their ARF income:

	Single Person	Married one State Pension	Married two State Pensions
Income tax exemption limit	€18,000	€36,000	€36,000
State Pension (Contributory)	€12,695	€12,695	€25,390
Available exemption limit for private retirement income	€5,305	€23,305	€10,610

[69] Some of the non-proprietary director/self-employed higher value ARFs may have derived from transfer values taken from DB schemes into Personal Retirement Bonds which were then matured into a lump sum and ARFs.
[70] We assumed an average withdrawal rate of 4.5% pa; the standard withdrawal rate for under 70's is 4% pa currently, while the withdrawal rate for over 70's is 5% (ignoring very large ARFs).

However, there are several qualifications to the above figures:

- The data relates to a survey of some QFMs, not the entire ARF market.
- The data may contain some small level of double counting (hence slightly reducing average ARF size and income withdrawal) where a retiree may have more than one ARF with different QFMs, or where ARFs may have been split in the past under Pension and/or Property Adjustment Orders.
- The data may contain some ARFs derived only from AVCs (e.g. public service retirees and private sector DB scheme retirees) and hence the average ARF size and taxable withdrawal of these ARFs may not be representative of those whose total retirement fund is in an ARF.
- The chart above ignores AMRFs and possible AMRF withdrawals; where an individual holds an ARF and an AMRF and takes a withdrawal from both, the total taxable withdrawal will be higher. However, for those who hold an AMRF only, a withdrawal would likely fall wholly within the income tax exemption limit for the over-65s if the only other income they have is the State Pension (Contributory).
- The chart does not allow for a compulsory 6% pa withdrawal applying to ARFs and vested PRSAs held by an individual whose total value is more than €2m.
- Some ARF holders may withdraw at a rate higher than the average 4.5% pa assumed above.

6.3 Taxation of lump sums

The analysis so far has focussed on those who take a regular taxable income in retirement from their private pension arrangement, usually after taking a tax-free (or tax-efficient) lump sum.

At the point of retirement, part of the benefits which would otherwise have become taxable income in retirement, can be exchanged for a tax-free lump sum (lifetime limit of €200,000) at retirement, with higher lump sums (the next €300,000) taxed only at standard rate (no PRSI or USC is payable).

There are many members of DC schemes who can take all of their fund at retirement as a lump sum (likely to be tax-free in most cases) with no ongoing taxable income; this can happen in a variety of circumstances including where the fund at maturity is within the maximum lump sum allowed (typically 150% of final remuneration), i.e. the notional pension is fully commuted for a lump sum.

There are also circumstances in which a taxable lump sum may be paid out at retirement from a private pension arrangement, with the lump sum taxed as income of the individual in that year. For example, where the residual fund is less than €20,000 after taking a tax-free lump sum, the balance can be taken as a taxable lump sum. Another example is where a 25% lump sum has been taken and the AMRF/pension requirement has been met, the balance can be taken as a taxable lump sum.

However, it is likely that individuals will only take this option (rather than gradual withdrawals within their income tax limits) if they are likely to pay no or low rates of tax on the lump sum. Therefore, while these 'taxable' lump sums occur it is likely that no or low tax is actually paid on the lump sum.

6.4 Other benefit taxation considerations

6.4.1 ARF/AMRF income

In the case of annuities and DB pensions, the private retirement income will remain fixed or increase over time.

However, in the case of ARF & AMRF withdrawals, the annual income provided may fall in monetary terms over time. With a drawdown rate of 4%-5% pa[71] and with most ARF holders adopting a low to medium risk investment approach[72], it's highly likely that most ARFs will not achieve a return to match the drawdown rate + ongoing charges.

[71] The deemed distribution is higher if the ARF is worth more than €2m

[72] The Society of Actuaries '*A Review of Retirement Income choices available from Irish approved Defined Contribution pension arrangements in 2015*' report referred to 2013 data covering €2.6bn of ARF/AMRF funds which indicated that 47% of such funds were invested at that time in risk level of 1 to 3 (from a scale of 1 to 7).

Therefore, if the *monetary* level of ARF withdrawal falls, the effective tax rate on ARF withdrawals may also fall. This means that, even if some ARF/AMRF withdrawals currently incur tax, as the monetary level of withdrawals fall, the withdrawals may move into the 'tax free' zone.

In the case of AMRFs, retirees are not obliged to take any withdrawal until age 75; optional withdrawals apply during this time. Therefore, some retirees with AMRFs may well not take any taxable withdrawal until 75.

In addition, because ARF holder can decide the level of income withdrawal each year (over and above the required level to avoid an imputed distribution) they can potentially 'play' the tax system by withdrawing more in years in which they have available income tax exemption limit and/or other tax deductions such as medical expenses, etc.

In this regard, the mismatch between the income tax exemption limit age (65) and the State Pension Age (up to 68) can allow a window of opportunity to accelerate withdrawals before the State Pension Age to use up the exemption limit.

6.4.2 Income tax exemption limit

The income tax exemption limit plays a crucial role in lowering or eliminating income tax on lower levels of private pension income. However, the current limits (€18,000 for a single person and €36,000 for a married couple) have not been increased since the limits were reduced in 2011 to their current levels.

Each increase in the State Pension, without a corresponding reduction in the exemption limit, gradually reduces the benefit of the exemption limit to retirees with private pension income, particularly for single persons and married couples with two State Pensions.

6.4.3 Overseas transfers

The potential for the Irish Exchequer to recover tax on future retirement income arising from private pension arrangements can be frustrated where accumulated benefits are transferred to another jurisdiction before maturity, particularly where the individual becomes resident in that other jurisdiction.

PRSA holders and holders of preserved benefits in occupational pension schemes are entitled to take a transfer value to an overseas arrangement in certain circumstances under the Occupational Pensions Schemes and Personal Retirement Savings Accounts (Overseas Transfer Payments) Regulations, 2003 (SI 716 of 2013). There is no requirement in the Regulations to be resident in the jurisdiction to which the transfer value may be paid, although Revenue have imposed a 'bona fide' requirement for the transfer.

In the case of a transfer from an occupational pension scheme, the transfer is made gross. In the case of transfers from a PRSA, technically the legislation imposes a PAYE tax charge, as gross transfers from PRSAs are only allowed to Irish approved arrangements; however, this tax charge on overseas transfers, but not to domestic 'internal' transfers, may be discriminatory under EU law.

Where a transfer is made to an overseas arrangement and the individual subsequently becomes non-resident in this State, the retirement income arising from the overseas arrangement may then no longer be taxed in this State.

6.4.4 PAYE exclusion orders

Pension/annuity income: Where an individual in receipt of a pension or annuity from a private sector arrangement in the State (i.e. not a public service pension) becomes non-resident and resident in another jurisdiction with which Ireland has a Double Taxation Agreement (DTA), they can apply for a PAYE Exclusion Order to have the pension/annuity payments made gross to them in their new country of residence, where it will then be taxed locally. In this circumstance the Irish Exchequer loses tax on the taxable pension/annuity.

ARF/AMRF withdrawals: A PAYE Exclusion Order cannot be made in respect of ARF withdrawals; ARF withdrawals are always subject to Irish PAYE. However, in some circumstances the non-resident may be able to reclaim (under a Double Taxation Agreement) some of the Irish PAYE deducted from their ARF withdrawals.

6.4.5 Chargeable excess tax

The effective tax rate calculations shown so far are not complete at higher levels of supplementary retirement income because of the likelihood of a double taxation charge of approximately 69% applying to part of the benefits taken over the Standard Fund Threshold limit.

7 The cost of private pension tax relief

Comment on private pension tax incentives currently tends to focus on two aspects;

- The cost, usually quoted in the region of €2.5bn pa, allied to a general belief that a relatively small number in the private sector benefit most from the relief, i.e. that those who need it least benefit most; and
- The inequity inherent in marginal rate tax relief on personal contributions. We have already covered this issue in section 4.4.

In this section we look at the former issue, i.e. the cost of the reliefs and who benefits most.

7.1 Components of the cost

There are several components to the cost of private pension tax reliefs:

- Income tax relief on employee and personal contributions up to certain limits;
- BIK exemption for explicit employer contributions to occupational pension schemes;
- Income tax/Corporation Tax relief on employer contributions as a business expense;
- Exemption of investment returns from Irish income, capital gains tax, and collective investment funds exit tax; and
- Exemption of retirement lump sums under €500k from marginal rate income tax & USC (tax free up to €200k and next €300k taxed at standard rate income tax).

7.2 Estimated cost of private pension tax relief

The IDPRTG Consultation document states: *'According to the report on Tax Expenditures for the Tax Strategy Group, the cost of tax relief on private pensions is estimated to have been €2.4 billion in 2014.'*

This estimate was based on 2013/2014 data. Using more recent Revenue Commissioners data on tax expenditures for 2015 gives a more up to date estimate as follows:

Table 29 Cost (€m) of Private Pension Tax Reliefs 2007 to 2015

	2007	2008	2009	2010	2011	2012	2013	2014	2015
Employee contributions to OPS	€543.3	€655.0	€729.0	€598.5	€584.0	€560.0	€552.0	€548.8	€580.6
Employer contributions	€120.0	€165.0	€153.0	€141.0	€142.0	€137.4	€132.0	€138.0	€147.0
Employer contribution BIK exemption	€510.0	€595.0	€558.0	€515.0	€532.0	€515.7	€497.0	€520.0	€559.0
	€1,173.3	€1,415.0	€1,440.0	€1,254.5	€1,258.0	€1,213.1	€1,181.0	€1,206.8	€1,286.6
PRSAs	€61.1	€73.8	€77.0	€73.0	€72.3	€68.9			
RACs	€407.9	€352.8	€237.2	€180.1	€164.3	€168.0			
PRSAs and RACs							€211.0	€210.0	€215.0
	€469.0	€426.6	€314.2	€253.1	€236.6	€236.9	€211.0	€210.0	€215.0
Tax relief on contributions	€1,642.3	€1,841.6	€1,754.2	€1,507.6	€1,494.6	€1,450.0	€1,392.0	€1,416.8	€1,501.6
Exempt investment returns	€1,200.0	€685.0	€780.0	€835.0	€805.0	€765.0	€865.0	€865.0	€865.0
Tax free lump sums	€130.0	€140.0	€140.0	€136.0	€136.0	€135.0	€134.0	€134.0	€134.0
Total	**€2,972.3**	**€2,666.6**	**€2,674.2**	**€2,478.6**	**€2,435.6**	**€2,350.0**	**€2,391.0**	**€2,415.8**	**€2,500.6**

Source: Revenue Commissioners Cost of Tax Expenditures (Credits, Allowances and Reliefs)[73]

The split of the total estimated EET cost for 2015 is:

[73] https://www.revenue.ie/en/corporate/information-about-revenue/statistics/tax-expenditures/costs-expenditures.aspx

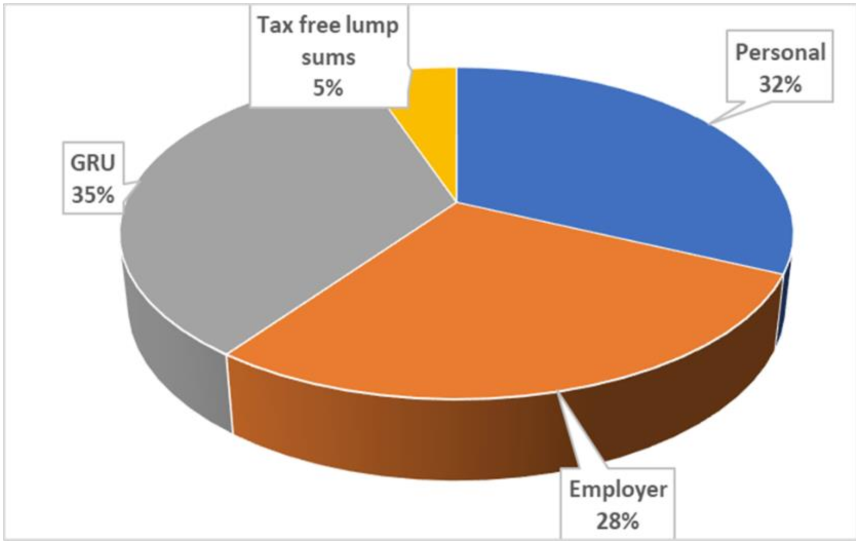


Figure 7:1 Estimated split of total EET cost

The table and associated chart are qualified in a number of respects:

- The Revenue Commissioners have said: *'Estimates of the cost for private pension provision are based on the available aggregate data for contributions to pension schemes from employers and employees.'*
- The Revenue Commissioners have confirmed to us that in respect of the cost of tax relief on employees' contributions to occupational pension schemes this cost has been: *'computed from P35 returns, the total of the employer's contributions are multiped by the estimated average appropriate tax rate, which is close to the higher rate of 40%*; *unless an employer is filing a P35 for an employee it is not captured here.'*
- The cost figure for exemption of investment return is an estimate devised by Revenue which dates to 2013 and is referred to by Revenue as '*particularly tentative and subject to a considerable margin of error'.* Revenue stated to us: '*Department of Finance (DOF) provide us with data on the estimated value of pension fund assets under management in Ireland, as well as the long-run rate of return. We then apply a tax rate to this gain to estimate the tax cost*'. It also is unclear whether the costs include the cost of exemption of returns from AMRFs and ARFs.
- The cost shown for exemption of investment income and capital gains from tax for 2014 and 2015 assumes the latest 2013 estimate of the cost. This may be inaccurate.
- The cost of exempting lump sums from tax for 2015 been taken at its 2014 cost, the latest published by Revenue.
- The cost of the employer contribution BIK exemption relates only to *explicit* employer contributions to funded schemes. No cost has been allocated in respect of the notional employer contribution cost of public service pension benefits.
- There is an element of double counting in including both the cost of employer contribution tax relief as a business expense and the cost of exempting employer scheme contributions from an employee BIK charge: if the BIK exemption did not apply, the contributions would be tax deductible anyway for the employer if paid as remuneration to employees. However, there is a separate cost to tax deduction of employer contributions to funded DB schemes in respect of deferred and pensioner members, where a BIK exemption does not arise, but it has not been possible to isolate this.
- The costs are gross of tax recovery on taxable retirement benefits. No separate data is available on the tax revenue received arising from taxable benefits arising from private pension arrangement, e.g. Schedule E and USC taxes on pensions, annuities and ARF/AMRF withdrawals.
- The cost is also based on a 'no change in behaviour' assumption which is questionable.

The figures should therefore be considered with some caution.

7.3 Estimated cost of relief on explicit employee and employer contributions

Taking account of the qualifications, the analysis does allow us to draw some conclusions:

- The cost (€m) of tax relief on PRSA and RAC contributions has fallen considerably since 2007 and has not recovered to any great extent:

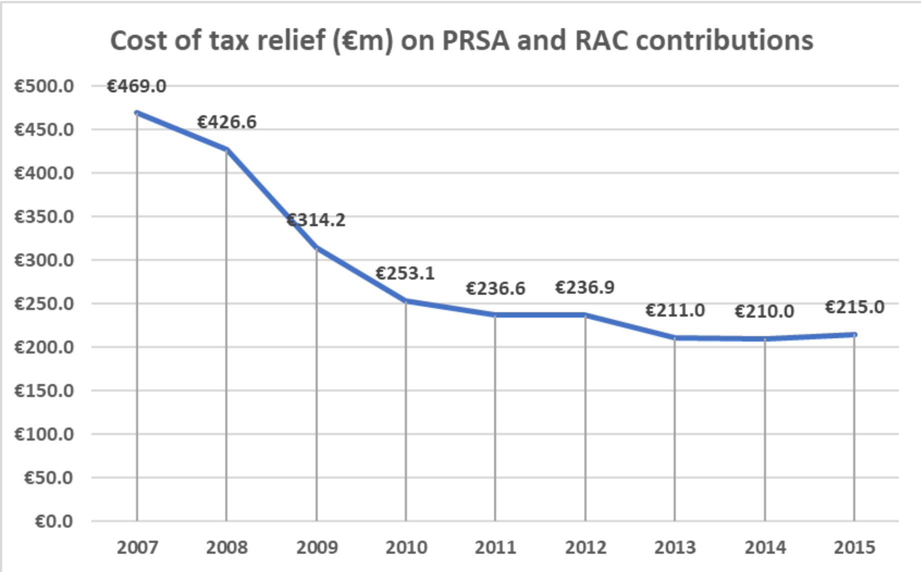


Figure 7:2 Cost of tax relief (€m) on PRSA and RAC contributions

- The cost (€m) of tax relief on employee contributions to occupational pension schemes rose to a high of €729m in 2009, then fell to a low of €552m in 2013 with a small increase in 2015 but has generally 'flat lined' since about 2010:

Figure 7:3 Cost of tax relief (€m) on employee OPS contributions (Public and Private Sector)

- The cost (€m) of income tax relief on employer contributions to funded arrangements (i.e. the cost of the BIK exemption + cost of employer tax relief) has remained relatively steady, rising to a high of €760m in 2009, falling to €629m in 2013 and reaching €706m in 2015. However, this may reflect some employers making large contributions to underfunded DB schemes, rather than maintaining/increasing DC contributions.

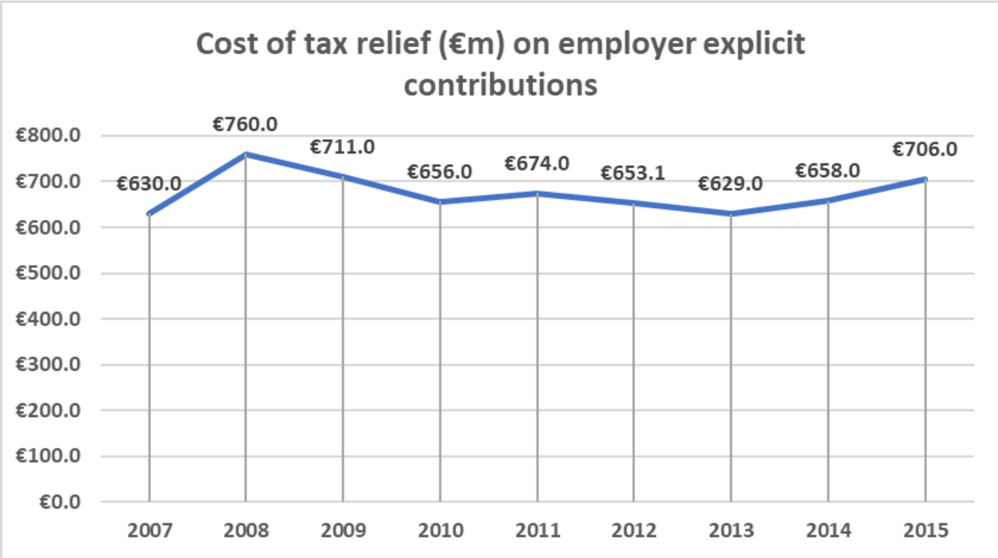


Figure 7:4 Cost of tax relief (€m) on employer explicit contributions

- Overall, the cost (€m) of tax relief on all explicit pension contributions and PRSAs/RAC has fallen relative to 2008:

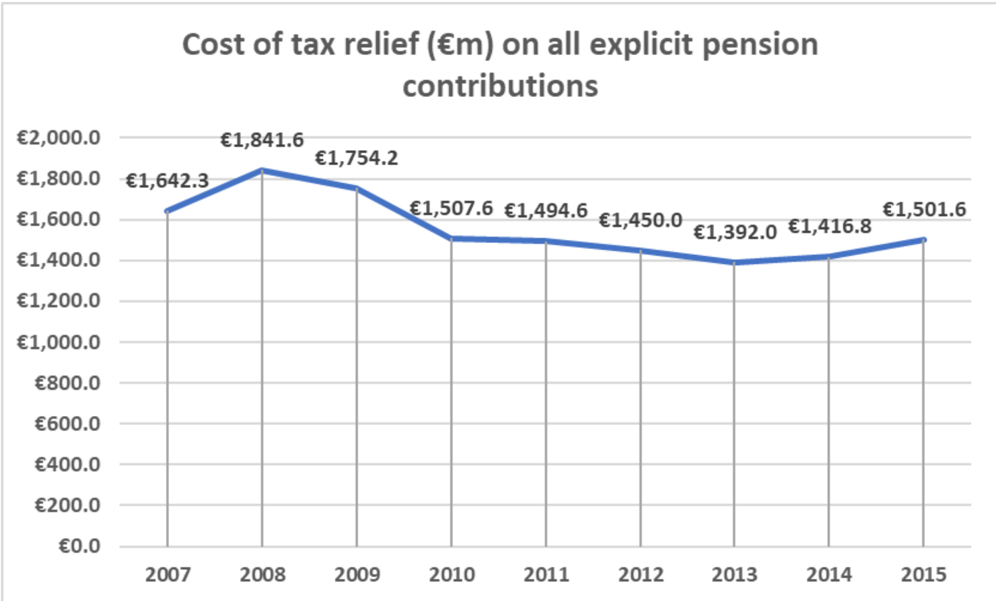


Figure 7:5 Cost of tax relief (€m) on all explicit pension contributions

The gross[74] cost of tax relief on explicit pension contributions (employer and employee combined) ranked as the fourth most expensive reliefs/credit for income tax in 2015. This cost and the cost of other reliefs are shown in the following table:

Table 30 Cost of reliefs by size

	COST € M	NUMBER OF CLAIMANTS	AVERAGE COST PER PERSON €
Employee (PAYE) credit	€3,004.1	1,660,600	€1,809
Married tax credit	€2,467.4	843,000	€2,927
Single tax credit	€1,899.8	1,307,100	€1,453
Income tax relief on pension contributions[75]	€1,354.6	715,100	€1,894
Exemption of Irish Government Securities where owner not ordinarily resident in Ireland	€607.60	Not provided	n/a
Exemption from tax: Child benefit	€454.30	556,700	€816
Medical Expense Insurance	€325.2	1,111,300	€293
Health expenses	€310.3	889,400	€349
Home loan interest relief	€232.4	442,500	€525
Widowed Person/surviving spouse	€186.1	87,800	€2,120

7.4 Numbers benefitting from private pension tax relief on explicit contributions

The numbers benefitting from tax relief in respect of explicit pension contributions in each year were:

Table 31 Numbers claiming relief on pension contributions and average cost

Numbers claiming relief	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**
Employee contributions	693,100	792,600	713,600	625,100	635,900	606,200	592,700	602,100	618,900
Employer contribution BIK exemption	363,100	362,700	342,200	302,900	310,400	311,600	313,100	314,000	342,100
PRSAs	46,600	53,900	56,200	52,300	53,800	48,200			
RACs	121,300	116,000	101,300	82,200	78,700	69,100			
PRSAs & RACs							99,800	93,700	96,200
PRSAs and Racs	167,900	169,900	157,500	134,500	132,500	117,300	99,800	93,700	96,200
Number of individual claimants	**861,000**	**962,500**	**871,100**	**759,600**	**768,400**	**723,500**	**692,500**	**695,800**	**715,100**
Average cost									
Employee contributions	€784	€826	€1,022	€957	€918	€924	€931	€911	€938
Employer contribution BIK exemption	€1,405	€1,640	€1,631	€1,700	€1,714	€1,655	€1,587	€1,656	€1,634
PRSAs	€1,311	€1,369	€1,370	€1,396	€1,344	€1,429			
RACs	€3,363	€3,041	€2,342	€2,191	€2,088	€2,431			
PRSAs & RACs							€2,114	€2,241	€2,235

Source: Revenue Commissioners Cost of Tax Expenditures (Credits, Allowances and Reliefs)

[74] i.e. before any tax recovered on taxable retirement benefits

[75] Excludes cost of tax relief for employers on employer contributions, as we believe including it would be largely doubling counting.

The data shows a significant reduction in the number of RAC claimants of tax relief, from 121,300 in 2007 to 69,100 in 2012 (the last year in which separate data was published for RAC and PRSA contributions), a fall of 43%.

The numbers claiming relief on PRSA contributions was, by contrast, relatively stable over the same period. This suggests a significant and maybe permanent reduction in the number of self-employed claiming pension tax relief following the 2008 crash.

The number of individuals claiming tax relief on personal contributions displays largely the same trend as the overall cost of tax relief on such contributions:

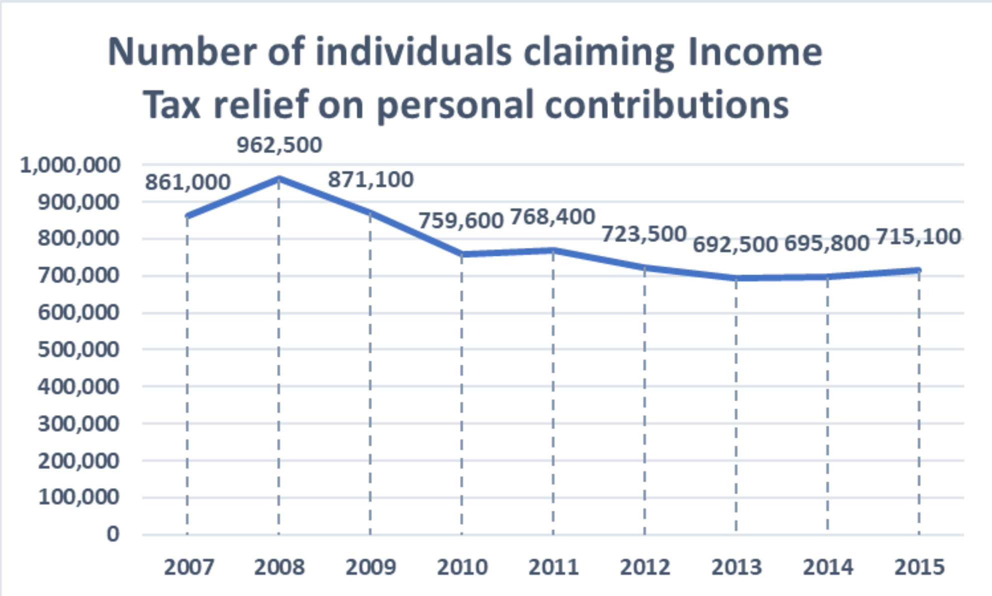


Figure 7:6 Number of individuals claiming income tax relief on personal contributions

Source: Revenue Commissioners Costs of tax expenditures (credits, allowances and reliefs) 31st July 2018

If we assume all public service workers (including the commercial semi state) pay compulsory superannuation contributions, and that all paying PRSA and RAC are in the private sector, we can estimate the split between the total number of individuals claiming income tax relief on **personal contributions** between the private and public sector:

Table 32 Numbers claiming tax relief on personal contributions by sector

		2008	2009	2010	2011	2012	2013	2014	2015
Public service claimants		427,300	409,700	404,100	391,600	381,800	376,500	374,000	379,700
Private sector claimants		535,200	461,400	355,500	376,800	341,700	316,000	321,800	335,400
Total		**962,500**	**871,100**	**759,600**	**768,400**	**723,500**	**692,500**	**695,800**	**715,100**
% private sector		56%	53%	47%	49%	47%	46%	46%	47%

We calculated the number of private sector claimants by deducting the estimated number working in the public sector at that time (CSO EHQ10 series) from the total number of tax relief claimants as per the Revenue Tax Expenditure Report for the relevant years.

Since 2010, more than 50% of individuals claiming tax relief on personal pension contributions worked in the public service.

In relation to those who benefit from **employer contributions** (explicit and implicit), again we can split the number between those in the private sector (excluding commercial semi state) who benefit from an explicit contribution and all who work in the public sector who benefit from an implicit employer (explicit in the case of commercial semi state) contribution:

Table 33 Numbers benefitting from tax relief on employer contrbutions by sector

	2008	2009	2010	2011	2012	2013	2014	2015
Private sector - employer contributions	316,700	298,000	258,700	267,800	271,000	273,900	274,700	301,700
Public sector - implicit employer contributions	427,300	409,700	404,100	391,600	381,800	376,500	374,000	379,700
Total	**744,000**	**707,700**	**662,800**	**659,400**	**652,800**	**650,400**	**648,700**	**681,400**
% private sector	43%	42%	39%	41%	42%	42%	42%	44%

We estimated the number of private sector employees who benefitted from an employer contribution by taking the total number shown in the Revenue Tax Expenditure Report for the relevant years as benefitting from the employer contribution BIK exemption and deducting from that number the estimated number working in the commercial semi state at that time (CSO EHQ10 series) all of whom we assumed to be members of funded schemes.

From 2008 to 2015, more than 50% of individuals who benefited from employer contributions (explicit or implicit) worked in the public service.

7.5 The public sector

The estimate of €2.5bn pa current cost of pension tax relief is not the complete picture as it does not include a corresponding (to the private sector) cost of exempting a notional employer contribution for the cost of providing public service pension benefits.

It can be argued that as there is no advance funding for public service pensions, there is no employer contribution and the cost is eventually disclosed and taxed when benefits are paid out; therefore, there is no need to include the cost of exempting public service employees from a notional employer contribution. In private sector funded schemes, the employer pays the contributions, but the scheme pays out the benefits, not the employer. Two different systems.

However, in discussing the issue of private pension tax relief, figures and discussion focuses largely on cost of *private sector* pension tax relief, without any reference to the cost of paying out public service benefits. Indeed, the IDPRTG Pensions Consultation Paper makes no reference at all to public sector pensions.

In the Revenue Commissioners data, the cost of tax relief on employee contributions for public service employees is included (although no split is provided between the public and private sector); however, the cost of the employer contribution BIK exemption relates only to contributions to funded schemes and does not therefore include a cost for BIK exemption in respect of a notional employer contribution for members of public sector unfunded schemes.

The ESRI research document 'The Tax Treatment of Pension Contributions in Ireland', May 2018[76] tackled this issue and estimated the split of the 2017 cost of tax relief on pension contributions as follows:

Table 34 Estimated 2017 cost €m of tax relief on pension contributions

CONTRIBUTIONS	PRIVATE SECTOR	PUBLIC SECTOR
Employee / Personal contributions	€580	€334
Employer	€541	€778
TOTAL	**€1,121**	**€1,112**

Source: ESRI The Tax Treatment of Pension Contributions in Ireland, May 2018, Tables 1 and 2

The Report stated: *'The cost of tax relief on public sector pensions, given the addition of these implicit employer contributions by the government, accounts for more than half of the total cost of tax relief on pension contributions.'*

[76] The Tax Treatment of Pension Contributions in Ireland (Doorley, Callan, Regan, Walsh)

However, we understand that the €778m cost of employer contributions in the public sector is based on an imputed notional public sector employer contribution rate of 15.5%[77] of earnings, which is lower than:

- the 20% notional employer cost used in the Report of the Public Service Benchmarking Body 2007[78] ("*The Body was advised that a 'central' rate of just over 20% would be appropriate as the employer cost of public service pensions and would reflect the post 2004 situation quite accurately, while being a little conservative in respect of pre-2004 employees*"); and

- the 29%[79] notional employer cost for pre-2013 cohort set out in the Actuarial Review of Pension Provision In the Irish Public Service and a Comparison with the Private Sector, March 2017, in which the paper said "*An average notional employer contribution rate of 29% of pensionable salary was calculated for pre-2013 entrants in public service posts with broadly similar benefit structures and salary progression*".

Taking account of these different estimated rates, the cost of relief on these imputed public service employer contributions could lie somewhere between €778m and €1,456m, in addition to the €2.5bn cost of tax relief on explicit contributions.

If we use a 20% imputed notional public sector employer contribution rate, based on the ESRI estimates above for 2017 the split of the cost of tax relief on pension contributions changes from 50%:50% to 46%:54% private sector: public sector. This increases further to 38%:62% private: public sector split if a 29%[80] imputed notional public sector employer contribution rate is used.

This is demonstrated in the following graph:

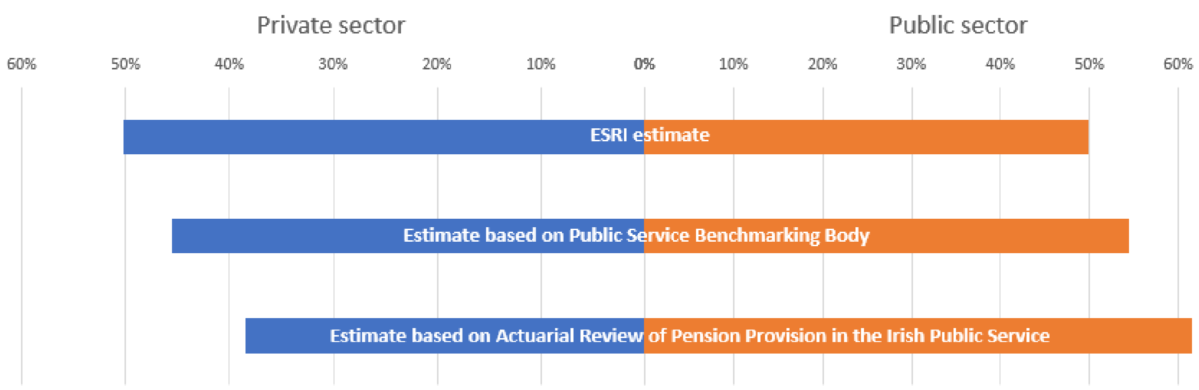


Figure 7:7 Split between cost of tax relief on contributions (private/public sector) based on different estimates

The above figures are gross of tax recoveries on taxable retirement benefits.

In cash flow terms, the State spends on private pensions in two main ways:

- Tax expenditures on private pension tax reliefs, as already outlined. The latest estimate for 2015 is €2.5bn, subject to the many qualifications mentioned earlier.

- Public sector superannuation benefits, less gross superannuation and Pension Related Deduction contributions received. The latest published estimate for 2018 for this net cost is €1.9bn.[81]

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[77] Gross of PRD. The ESRI report said "*We exclude PRD from the analysis because PRD is not, in fact, a contribution which increases an individual's pension entitlement*"
[78] http://benchmarking.gov.ie/documents/benchmarking%2007.pdf
[79] Gross of PRD.
[80] Gross of PRD
[81] Source: Department of Public Expenditure and Reform 'Public Service Occupational Pensions in Ireland - Cash Flow Analysis', July 2018, Chart 6.1

The split of the total estimated current €4.4bn gross cost to the State of private pensions between public and private sectors is:

- Private sector: €2.17bn[82]
- Public sector: €2.23bn[83]

The above figures are gross of tax recoveries on taxable retirement benefits.

While the split of the State's expenditure is currently broadly 50%:50% private sector: public sector, the public sector portion may increase faster than the private sector cost in the short run due to projected ageing and retirement within the public service.

For example, the Department of Public Expenditure and Reform *'*Public Service Occupational Pensions in Ireland - Cash Flow Analysis'*,* July 2018, Chart 6.1, projects that the current €1.9bn expenditure on superannuation benefits (net of employee superannuation contributions) will increase by €900m to €2.8bn in real terms by 2020 and by a further €1bn to €3.8bn by 2025.

7.6 Who benefits most?

The OECD Review of the Irish Pension System 2013 stated: '*Tax deductions give the greatest incentive to save for retirement to those with the highest level of income, while those most in need get the lowest incentive.'*

The ESRI '*The Tax treatment of Pension Contributions in Ireland*' paper, May 2018 stated:

'*higher earners benefit more from tax relief on pension contributions than lower earners. The top four deciles of the income distribution gain between 3-4.5% of disposal income due to tax relief on pension contributions'*.

'most of the gains from tax relief on contributions are concentrated in the upper half of the income distribution'.

We summarise here various statistics/estimates (latest available) on the differences between those with and without private pension coverage:

	Those with active private pension cover	Those without active private pension cover
Private pension coverage	**Public sector (incl semi State)**: 100% DB **Private sector**: 30%, split[84] circa 5% DB and 25% DC	**Public sector (incl semi State)**: 0% **Private sector**: 70%
Numbers *(Source: CSO Statbank EHQ10 & QNHS)*	**Public sector (incl semi State):** 396,000 **Private sector**: 63,000 DB and 330,000 DC.	**Public sector (incl semi State):** Nil **Private sector**: 1,171,000
Gross income distribution (2016) [85]	**Public + Private sector** (full-time)	**Private sector only** (full-time)
Lower quartile	€41,065	€21,850
Median	€54,586	€28,540
Upper quartile	€72,170	€39,122

[82] i.e. €2.5bn estimate for 2016 less €334m estimated cost of tax relief on public service employee contributions
[83] i.e. €1.9bn superannuation benefit payments plus €334m cost of tax relief on employee contributions
[84] Using the 2017 Pensions Authority Annual Report split of DB: DC active members, after excluding an estimated 41,500 DB active members assumed to be all commercial semi state.
[85] Source: CSO Investigation of the earnings distribution based on the participation in a pension scheme (2016 data), Table 4.

	Those with active private pension cover	Those without active private pension cover
	28% had gross earnings of less than €40,000[86] (approx. ave earnings) 82% had gross earnings of less than €80,000 (approx. 2 x ave earnings) 9% had gross earnings of more than €100,000.	82% had gross earnings of less than €40,000 (approx. ave earnings) 97% had gross earnings of less than €80,000 (approx. 2 x ave earnings) 1% had gross earnings of more than €100,000.
Profile of pension contributors by marginal tax rate[87]	Standard rate: 29.4% Higher rate: 70.6%	
Average pension contributions levels *(Source: DPER Actuarial Review Of Pension Provision in the Irish Public Service and a Comparison with the Private Sector, March 2017)*	**Public Sector (incl semi State):** *Employee*: 5% (average, varies by grade and entry date) + PRD/ASC, between 3.33% -10.5% (varies by pre and post 2013 entrants) on excess of earnings over circa €32,000 pa *Employer implicit*: Pre 1st January 2013-entrants: average 29% pa (261,000 current employees, gross of PRD) *For some grades, e.g. Hospital Consultant, the cost of accrual (46%) is higher than the average (29%) due to their faster than average salary progression. For other grades, the average cost is higher due to faster accrual, eg Garda 53%, High Court Judge 71%.* Post 1st January 2013 entrants: average 9% pa (37,000 current employees). *(Some grades, e.g. Gardai, High Court Judge, the fast accrual terms lead to higher implicit employer contributions e.g. Gardai 14%, High Court Judge 39%)* **Private Sector** Average employer DB: 22% pa Average employer DC: 7% pa Average employee DC: 5.4% pa	

[86] €46,402 for full-time employees in 2017 and €36,920 including full-time and part-time workers.
[87] Source: '*Supporting Pension Contributions Through the Tax System: Outcomes, Cost and Examining Reform*' (Collins and Hughes) (2017), Table 5

The ESRI The Tax Treatment of Pension Contributions in Ireland, May 2018 report estimates the distribution of the benefit of pension tax relief for 2017 (private and public sectors combined) in terms of income deciles as follows:

Figure 1 The difference in household disposable income by decile due to tax relief on pension contributions

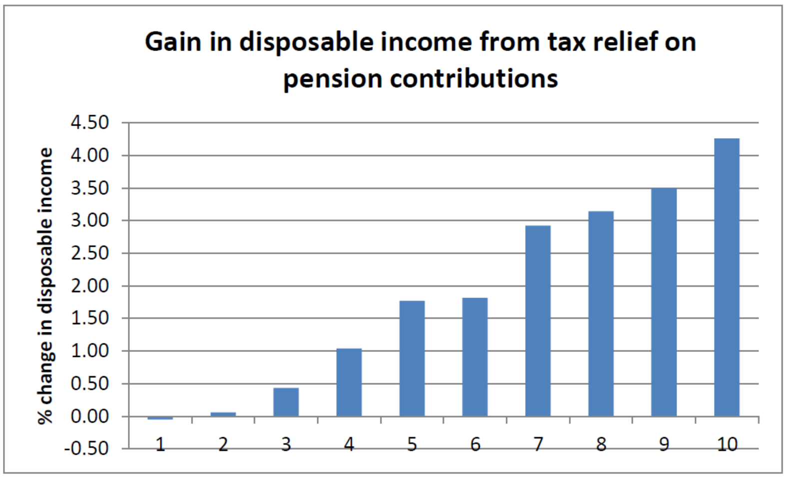

Figure 7:8 ESRI estimate of the distribution of the benefit of pension tax relief by income decile

The above table is an amalgam of private and public sector and includes personal contributions as well as an imputed employer contribution for employees in the public sector of 8% and in the public sector of 15.5%.

In relation to the question, "*who benefits most from private pension tax relief on contributions*" we can say:

- Everyone with taxable income who is in a pension arrangement benefits to a greater or lesser extent, either through tax relief on their personal contributions (if they pay such contributions and are liable to income tax) and/or the benefit of an employer contribution (explicit or implicit).
- The largest volume of pension contribution tax relief cost is likely to be absorbed by public service employees, because:
    - These public service employees recruited prior to 1st January 2013 (261,000[88]) benefit from an implicit employer contribution rate of 29% pa (gross of PRD) on average, compared to 22% pa for those in private sector DB schemes (estimated to be 63,000 people, excluding members of semi-State organisations) and just 7% pa for those in private sector DC schemes (330,000 people).

      Public sector employees also benefit from tax relief on their PRD contributions of up to 10.5% (which is not included in the cost of private pension tax reliefs) for those earning more than about €32,500 pa.
    - Public service employees are paid more on average than private sector workers. A 2017 report by Davy[89] found that the average public service employee earns 40% more than the average private sector worker.
    - 53% of individuals who claimed tax relief on personal pension contributions in 2015 worked in the public service.
    - 56% of individuals who benefited from employer pension contributions (explicit or implicit) in 2015 worked in the public service.

[88] Source: DPER Actuarial Review of Public Service Occupational Pensions in Ireland as required by EU Regulation 549 / 2013, November 2017, Table 5.3
[89] https://www.davy.ie/research/public/printPdf.htm?id=publicsectorpay20170327_24032017.htm

- In the private sector, employees in DB schemes (63,000) benefit more than private sector employees in DC schemes (330,000), because they benefit from an average employer contribution rate of 22% pa (plus occasional capital injections for funding purposes) as compared with 7% pa for DC.
- Deferred members of defined benefit schemes (circa 415,000[90] in private sector + unknown number in the public service) benefit from revaluation increases funded by explicit or implicit employer contributions.
- Higher rate taxpayers benefit more than standard rate taxpayers, because a higher proportion claim pension tax relief and because relief is granted at the higher marginal rate.

  However, single persons become higher rate taxpayers on gross income of more than €34,550, while for married couple the figure can be as low as €43,550. So, it is not appropriate in our view, to conflate 'higher rate' taxpayers with 'high earners'.

  While it can be emotive to suggest that 'higher rate' taxpayers benefit most from pension tax relief, in fact this group is mainly composed of middle-income earners, e.g. the median gross income of full-time employees included in a private pension is about €54,000 (or just 1.4 x average earnings), and 75% have gross income less than €72,000.

  Only an estimated 9% of those workers with private pensions had gross income in 2016 of more than €100,000, a 'high earner' benchmark sometimes used[91].

  The National Recovery Plan 2011-2014 in relation to the (then) proposal to standard rate tax relief on personal contributions stated: "*It is not the case that only those on higher incomes benefit from pension relief. The bulk of employee/individual pension contributions attract tax relief at the marginal or 41% tax rate. This is reflected in the fact that individuals on gross earnings of not much over the average industrial wage and contributing to a pension arrangement benefit from tax relief at 41%.*"
- If it is accepted that the private pension need is correlated with income, i.e. the more you earn, the more private pension you need to replace in retirement, then it is to be expected that the quantum of pension tax relief obtained (through personal contributions or benefitting from explicit or implicit employer contributions) will be similarly be scaled up by income.

  The following chart shows the 'pension need' (in terms of the quantum of gross income to be replaced) to replace 50% of pre-retirement income, inclusive of the maximum rate of State Pension (Contributory), at different levels of gross pre-retirement income, for a single person and married couple (two incomes):

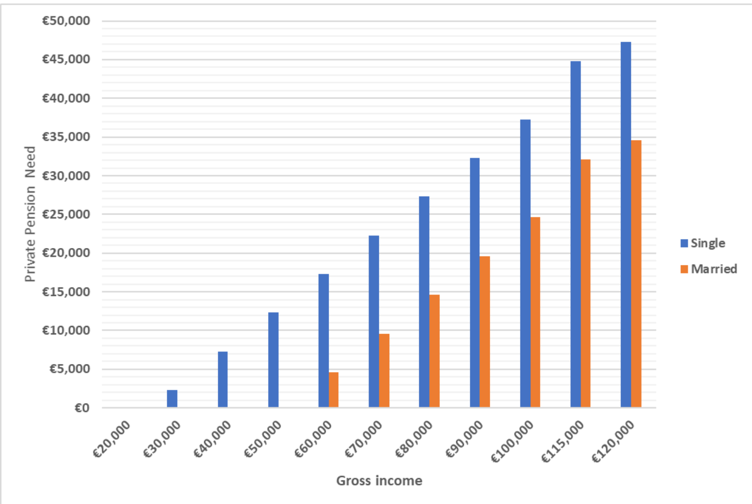

Figure 7:9 Private pension "need" by gross income

90 Source: https://www.pensionsauthority.ie/en/News_Press/News_Press_Archive/Defined_benefit_schemes-_Review_of_2016_statistics.pdf

91 A 3% USC surcharge is applied to the non-PAYE income of the self-employed in excess of €100,000.

Therefore, the higher a person's income above the State Pension (Contributory), the higher their private pension need. This means that pension contribution levels (personal and employer) will be highly correlated with income and hence more likely to be claimed in the main by higher rate taxpayers. This is not surprising.

The chart above is not entirely dissimilar in trend to the distribution of the cost of pension tax relief by disposable income deciles shown in Table 6 of Collins and Hughes (2017) paper[92] based on 2014 data:

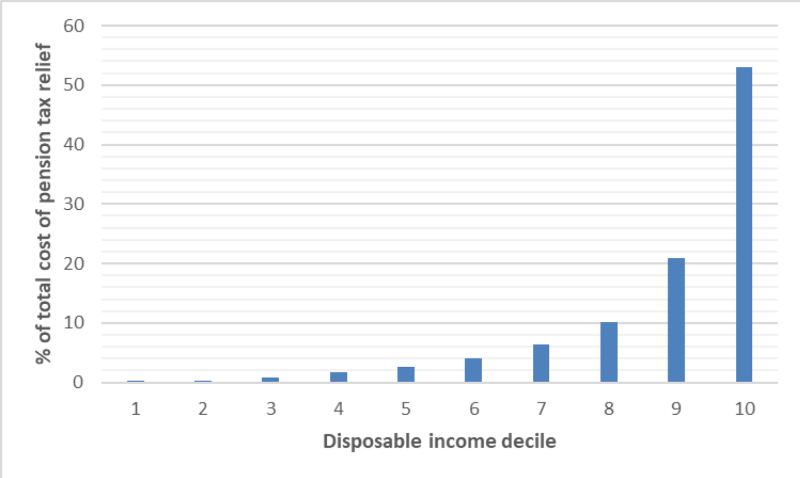

Figure 7:10 Distribution of cost of Pension Tax Relief by Income Deciles (2014), Table 6 of Collins and Hughes (2017) paper

The 9th and 10th deciles above refer to average earnings of €53,293 and €84,571 respectively and are an amalgam of private and public sector employees.

[92] 'Supporting Pension Contributions through the Tax System: Outcomes, Costs and Examining Reform'

8 Conclusions

8.1 Reduce/reform private pension tax relief?

The main arguments in favour of reducing or reforming private pension tax relief were listed in the introduction and our findings are:

Marginal rate income tax relief on personal contributions is inequitable.	Yes, it is inequitable that a higher rate taxpayer can get more tax relief for the same gross pension contribution than a standard rate or non-taxpayer. However: • The difference in relief is less (about 14% instead of the perceived 20% difference) when adjusted to the pension contribution which can be funded from the *same* level of gross remuneration. (see 4.4) • 71% of those with private pension cover are higher rate taxpayers. (see 7.6). So, the majority who claim relief on personal contributions do benefit from higher rate relief. • it is just one of many inequities in the private pension tax relief system; the difference in the tax treatment of employer and employee contributions gives rise to greater inequity than the issue of marginal rate relief on personal contributions. (see 4.4) • higher rate tax applies to income as low as €34,500 p.a. for a single person and €43,550 p.a. for a married couple. Higher rate taxpayers are not all high earners.
A relatively small number of higher earners benefit disproportionately from the relief.	We found that the benefit of private pension tax relief is spread over a large number of people, most of whom could be fairly described as middle-income earners, and that significant measures have been introduced to limit the benefit of pension tax relief to high earners and those accumulating high levels of benefits: • Some 715,100 people benefitted in 2015 from private pension tax reliefs on individual contributions, of which over 50% worked in the public sector. See 'Numbers claiming pension tax relief' (see 7.4) • Some 681,400 people benefitted in 2015 from employer pension contributions (either explicit or implicit), of which over 50% worked in the public sector. (see 7.4) • The median gross income in 2016 for full-time employees *with* private pension cover was €54,586, with 75% having a gross income of less than €72,170. (see 5.5) • The median gross income in 2016 for full-time self-employed *with* private pension cover was €36,467, with 75% having a gross income of less than €63,000. (See 5.5) • Only 9% of workers with private pension coverage had gross income in2016 in excess of €100,000 (See 5.5). • if it is agreed that the private pension need is earnings-related, it is to be expected that higher earners will need to contribute more and hence benefit from more tax relief on pension contributions.

	• Several effective measures have been taken to restrict the benefit of pension tax relief for high earners and those who accumulate higher benefits, primarily the reduction in the Standard Fund Threshold limit to €2m in 2014 (from a previous high of €5.4m). (See 4.2) • The Standard Fund Threshold limit forces many high earners to cease pension funding well before they reach the Threshold, as investment growth or future benefit accrual can carry the value of their benefits over the limit. (See 4.2)
The cost of the relief at €2.5bn pa is one of the highest tax expenditures by the Government and represents poor value for money.	The cost of the relief in one of the major tax expenditures but: • the published cost is gross of tax on retirement benefits, both current and prospective. • The published cost assumes no change in behaviour which hardly seems likely. E.g. if the Government stopped private pension tax relief in the morning it would not save €2.5bn pa. Its own staff would almost certainly look for compensating pay rises or reduced superannuation contribution rates if tax relief on personal contributions was abolished. • the published cost is based on several assumptions and some figures are historic, in particular, the cost figure for exemption of investment has been referred to by Revenue as '*particularly tentative and subject to a considerable margin of error'*. • the cost of the relief has fallen since a high near €3bn figure in 2007 and has been relatively stable over the last 5 years or so. (See 7.2) • the cost of relief on contributions is spread over a large number of people. For example, in 2015, 715,100 people benefited from an average tax saving of €1,894 each in respect of personal contributions. (See 7.3) • it is estimated that somewhere between 50% - 62% of the cost of tax relief on contributions relates to public sector employees. (See 7.5) • public sector employees recruited before January 2013 (261,000) benefit from private pension tax relief more than any other group because they benefit from an implicit average employer contribution rate of 29% pa (gross of PRD), compared to 22% pa for those in private sector DB schemes (63,000 people) and just 7% pa for those in private sector DC schemes (330,000 people). They also earn more on average than private sector workers. (See 7.6)

The relief has failed to produce significant private pension coverage in the private sector and the quality of the coverage is on average poor.	To the extent that, in spite of the availability of "*generous tax reliefs*"[93], private sector private pension coverage is currently only 30%, with provision predominantly DC at a likely inadequate contribution rate, it could be said that private pension tax relief is failing in its primary objective of increasing private pension coverage in the private sector.
	
	However:
	
	• Not everyone in the private sector may need a private pension. The Roadmap says *"Private savings arrangements .. generally aim to secure a payment level in retirement that, when combined with the State pension, replaces a sufficient proportion (e.g. 50% – 60%) of an individual's pre-retirement earnings so as to enable the individual concerned to maintain a reasonable standard of living after retirement".* The State Pension is €12,695 p.a. at November 2018.
	  o Full time employees in the private sector *without* private pensions have a median gross income of €28,540, with 75% having a gross income of less than €39,122. (See 5.5)
	  o Full-time self-employed in the private sector *without* private pensions have a median gross income of just €19,179, with 75% having a gross income of less than €30,779. (See 5.5)
	  o Some in the private sector have or use other means to provide for retirement, such as after-tax savings or rental property investment. For example, over 1/3rd of self-assessed taxpayers have an average rental income of circa €22,000 pa. (5.7)
	
	• Our 30% estimate of private pension coverage in the private sector for 2017 excludes those working in the private sector who hold preserved benefits but no longer accruing additional benefits.
	
	• If we excluded the 450,000 in the private sector proposed to be excluded from the Automatic Enrolment scheme, our 2017 estimated 30% private pension coverage rate in the private sector would increase to circa 41%. (see 5.3)
	
	• If we excluded all those in workforce without private pension cover who have gross earning of less than €25,000 (circa 2 x State Pension), our estimated 30% private pension coverage rate in the private sector would increase to circa 47%. (See 5.3)
	
	• Economic factors following the crash in 2008 may have caused some individuals to cease private pension funding on affordability grounds. It may also have contributed to a growth in the number of smaller employers not offering a pension scheme.
	
	• The QNHS Penson Module Q4 2015 stated in relation to those in the private sector without a private pension at that time: '*Affordability was the main reason given by both full-time (36%) and part-time (44%) workers for not having a pension.'* (See 5.4.)

[93] Pensions Roadmap, page 6

	• The Pension Levy applied to private pension funds between 2011 and 2015 (which amounted to €2.4bn) may have discouraged some from continuing to make private pension contributions (or to start at all) in fear of confiscation of their funds by the Government.
There is a substantial deadweight cost of the relief.	The inference is that if private pension tax relief was not available (or reduced/limited in some way), that higher earners would continue to save for their retirement at a similar level without the tax relief. While there are numerous papers that look at the effectiveness of increasing subsidies as a tool to encourage increased pension saving (which generally conclude that they are not as effective as automatic enrolment), there is much less analysis of the reaction by individuals if existing longstanding subsidies/reliefs are reduced/removed under the Irish EET system. However: • 75% of full-time employees *with* private pension cover had gross income less than €72,170. These could hardly be described as 'high earners' and it would be questionable if this 75% would continue their retirement saving at the same level through some other non-pension vehicle if pension tax relief was abolished. (5.5) • Only 9% of full-time employees *with* private pension cover had gross income greater than €100,000. (5.5) • High wealth individuals (HWIs) make little use of pension tax relief, because they are limited by the Standard Fund Threshold limit and because they frequently have low earnings liable to income tax by using other means (e.g. capital allowances and loss relief) to reduce their taxable earnings [94]. *"Looking at taxable income, 140 HWIs (42%) had taxable income of less than €125,000. Of these, 83 (25%) had taxable income of less than the average industrial wage."*[95] The Green Paper on Pensions discussed the removal of pension reliefs and concluded: *"the removal of the reliefs would represent a fundamental adjustment to the current balance of the tax system and would have very significant implications in terms, among other things, of the economic and behavioural impacts which would ensue. These impacts would be difficult to model in advance"*[96]

[94] Comptroller and Auditor General Management of high wealth individuals' tax liabilities, 2017. https://www.audit.gov.ie/en/Find-Report/Publications/2018/2017-Annual-Report-Chapter-18-Management-of-high-wealth-individuals%E2%80%99-tax-liabilities.pdf
[95] Comptroller and Auditor General Management of high wealth individuals' tax liabilities, 2017, 18.18
[96] http://www.welfare.ie/en/downloads/greenpaperchapter7.pdf

8.2 Maintain the status quo on private pension tax relief?

The main argument in favour of maintaining the status quo on private pension tax relief listed in the introduction and our findings were:

The relief encourages private pension provision which is good for Society.	According to TILDA, the level of retirement income is positively associated with quality of life in retirement *"actual income in retirement, rather than retirement income replacement rates, that seems to affect quality of life of Irish retirees".* Where quality of life is sustained into retirement, this is good for society and the State's finances. (See 3.3)
Pension tax relief granted is substantially a deferral of tax, **as tax is paid in retirement on taxable retirement benefits.**	We find that the link in the EET system between EE and T is very weak because of a combination of factors but, despite that, it is progressive: • A significant number will benefit from pension tax relief but pay little or no tax on their taxable retirement benefits because of a combination of low funding and the package of tax concessions provided to the over 65s. (See 6.1) • Those who accrue higher levels of benefits will pay more tax on them in retirement than those who accumulate lower levels of benefits. (See 6.1.) However, many of these are likely to pay a lower effective tax rate on their private pension income in retirement than the effective rate of relief claimed. • There are other leakages of tax, which reduce the T of EET, such as the provision of a tax-free lump sum (or a lump sum partially tax-free and partly taxed at standard rate) and overseas transfers. (See 6.4.)
Middle income earners benefit most from private pension tax relief and reducing tax relief now on personal contributions would impact most on this group, including many in the public sector.	We find that there is evidence to support this view: • Some 715,100 people benefitted in 2015 from private pension tax reliefs on individual contributions. Over 50% of these worked in the public sector. (see 7.4) • Some 681,400 people benefitted in 2015 from employer pension contributions (either explicit or implicit). Over 50% of these worked in the public sector. (see 7.4) • The median gross income in 2016 of full-time employees *with* private pension cover was €54,586, with 75% having a gross income of less than €72,170. (See 5.5.) • The median gross income in 2016 of full-time self-employed *with* private pension cover was €36,467, with 75% having a gross income of less than €63,000. (See 5.5.).
There has already been a substantial number of measures introduced since 2009, cutting back the scope for private pension tax relief, particularly for higher earners and those accumulating higher benefits.	Since 2009, a substantial number of measures have been introduced to limit the ultimate level of pension tax relief, particularly for high earners and those who fund high levels of benefits. (See 4.2)

9 Reform

The current private pension system has resulted in pension coverage of 100% in the public sector and just 30% (our estimate) in the private sector. There is a desire to improve coverage by ensuring sustainability for those in DB pension arrangements and encouraging others to start saving for their retirement or to save more (if they are already in a DC or personal arrangement).

In this section, we look at possible options to reform the private pension tax relief system to:

- reduce or eliminate inequities;
- improve the connection between EE and T, in the EET model; and
- control or reduce the costs to the Exchequer.

We are not advocating any of the options referred to below and indeed, some may have significant negative potential financial consequences for some individuals and could lead to undesirable changes in behaviour in relation to private pension provision.

9.1 Options for reform

9.1.1 Public Sector

The public sector pension bill is a significant cost to the Exchequer, with a current net cash flow cost of €1.9 bn per year, increasing to an estimated €2.8bn in just 2 years and increasing by a further €1bn by 2025.

While some steps have already been taken to put this on a more sustainable footing (a Career Average Revalued Earnings (CARE) model was introduced for new joiners to the public service from January 2013) and a permanent Additional Superannuation Contribution will be introduced in January 2019 for higher earners, there are further opportunities to improve the sustainability of the public sector arrangements.

Considerations for reform could include:

- The 2017 Actuarial Review of Public Service Occupational Pensions in Ireland as required by EU Regulation 549 / 2013 noted if pension increases were awarded in line with Consumer Price Inflation (CPI) instead of pay parity[97], this would result in a cost saving of €17.3bn to the economy over the next (approximately) 70 years, or approximately €250m per annum.
- reducing fast accrual for some grades; a slower pace of accrual for these grades would lower costs;
- reducing (or eliminating) the granting of credited years' service, such a Professional Added Years, for some technical grades;
- valuing public service pensions at a realistic more open market rate for the purposes of the Threshold limit, to take into account the value of post retirement increases and survivor's pensions; and
- adopting a more 'commercial' basis for paying chargeable excess tax arising on public service benefits, rather than the current interest free loan over 20 years with a write off on death within this period.

[97] Par parity increases were only introduced in 1969.

9.1.2 Private Sector

Considerations for reform include:

- Change the current Revenue maximum 2/3rds x final remuneration funding potential to 2/3rds inclusive of the State Pension (Contributory), as applies to all public sector recruited since 6th April 1995.
- Under the current regime, an occupational pension scheme can provide a pension of 2/3rds x final remuneration for an employee with just 10 years' service. If this period was to be lengthened to (for example) 20 years' service, this would also reduce the maximum tax-deductible funding opportunity in any one year.
- Extend the current 20-year service requirement to qualify for a 150% x final remuneration lump sum to, say, 40 years to align with the public service gratuity.
- Impose a maximum 25% lump sum option across all DC arrangements (subject to the current normal €200,000 tax free lump sum limit), so that at least 75% of all DC funds would be taxable.
- Limit employer contribution BIK exemption (including implicit employer contributions in the public sector) to the current age-related percentage and €115k earnings limit which applies to tax relief on personal contributions.[98] This would in effect introduce annual cash limits on employer BIK exempted contributions (explicit and implicit). However, this would in substantially block past service funding potential and also hasten the demise of funded DB schemes where employer special contributions to fund deficits could easily exceed the limit suggested above in individual cases.

9.1.3 Both Private and Public Sector

Considerations for reform include:

- Reduce tax relief (as opposed to a tax credit) on personal contributions for all taxpayers to a fixed rate, say 25% (the effective tax relief rate set out in the Automatic Enrolment Strawman).

  We envisage issues with adopting this approach, including:

  - Unless employer contributions (explicit and in the case of the public service, implicit) are imputed to the employee for income tax purposes at marginal rate and then treated as a personal contribution and tax relieved at the new fixed rate, say 25%, as a personal contribution, it would *increase* the existing level of inequity as between the tax treatment of employer and personal contributions.

    If employer contributions are not imputed and treated for tax purposes as a personal contribution, moving to a fixed 25% tax relief rate only on personal contribution could be largely side stepped in the private sector by the swapping of employee contributions for increased employer contributions (financed by employees taking a corresponding reduction in gross remuneration)

    This reaction would ***increase*** the cost of pension tax relief in larger group DC schemes, as effective relief would then more commonly become 52% (because of the BIK exemption relating to employer contributions) compared to the current 40% for employee contributions for higher rate taxpayers.

  - Moving to a fixed 25% tax relief[99] on personal contributions for higher and standard rate taxpayers would swap the current inequity which favours higher rate taxpayer with a new inequity favouring standard rate taxpayers.

[98] Ignoring personal contributions so that two separate limits would apply to personal contributions and to employer contributions.
[99] as opposed to a tax credit paid directly to the scheme/arrangement

For example, Appendix 3 shows the comparison of the gross pension contributions which can be paid currently from €1,000 of gross income and the value of marginal rate tax relief which can be claimed, i.e. €320 by the higher rate taxpayer and €178 by the standard rate payer.

But if the tax relief were to be given at a fixed rate of 25% of the gross pension contribution:

- the higher rate taxpayer would get €160 in tax relief, but the standard rate payer would get €238. (See Appendix 4.) The inequity would therefore swing around; standard rate taxpayers would get higher tax relief than higher rate taxpayers, because they can afford to pay a higher gross contribution from the same level of income.
- The affordable gross pension contribution for a higher rate taxpayer from gross remuneration of €1,000 would fall from its current €800 level to €640, while increasing for the standard rate taxpayer from €891 to €950.

There are two ways in which this in equity could potentially be fixed:

- We estimate 35% fixed relief for higher rate taxpayers and 25% fixed for standard rate would almost equalise the value of tax relief provided per €1,000 of gross income. (See Appendix 5), i.e.

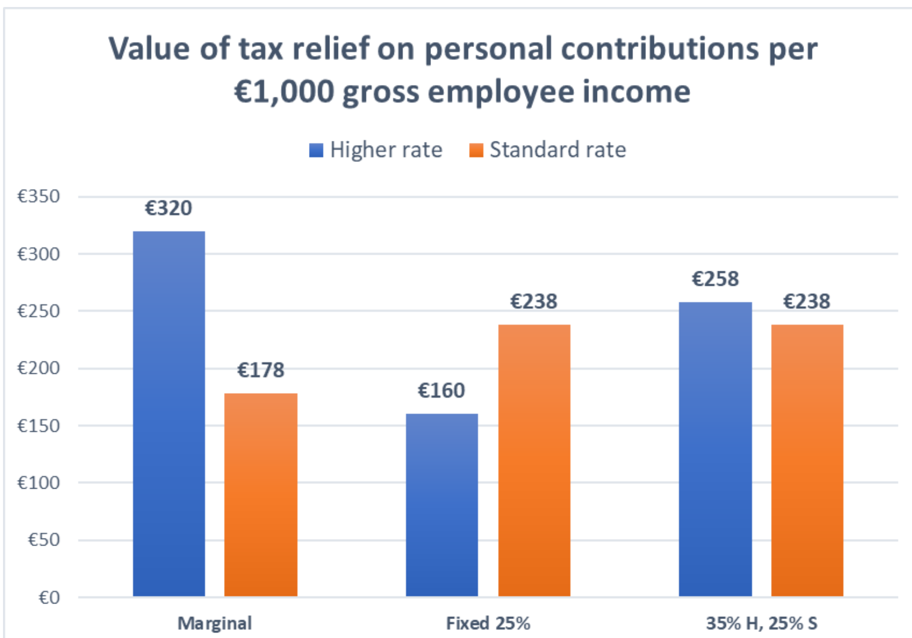

Figure 9:1 Value of tax relief on personal contributions

- If personal contributions are made from net income, with the 25% relief added to the fund, in a manner similar to that envisaged for the Auto Enrolment Scheme.

  However, this approach would present many difficulties:

  - It could not be applied to the public service (as there is no fund);
  - It could not be applied to funded DB schemes (as there is no segregation of the fund between individual members);

        - It would require a complete change in the tax relief system for personal contributions to funded DC arrangements for schemes, providers and Revenue.

    - If tax relief on personal contributions is reduced for higher rate taxpayers, the estimated 70% higher rate taxpayers paying pension contributions may react by reducing their contributions so that their net take-home pay is not affected (affordability). If this happens, this may mean that many will save less for their retirement. This goes against Government's stated objective to *"encourage personal long-term saving and asset accumulation for retirement purposes".*

      Some higher rate taxpayers (e.g. AVCs and unincorporated self-employed) may react by stopping discretionary personal contributions due to a perception that they will only benefit from, say 25%, on contributions but emerging benefits will be taxed in retirement at higher rate income tax (40%) + USC, even if in reality this perception for many will be invalid as the tax rate paid on taxable retirement benefits will for most be less than the 25% relief rate, and in addition at least 25% of emerging benefits may be tax free.

      By encouraging employees to reduce or stop their contributions, this could also drag down matching employer contributions in private sector DC schemes, leading to a compounding effect.

    - In the case of public service superannuation and PRD/ASC contributions, it could lead to a demand from public service employees for a corresponding pay rise to compensate for those impacted by the change or a demand for reduced contribution rates. It might well be seen by public service employee unions as a reintroduction of FEMPI measures.

      There is precedent for this; in April 1995 when a compulsory 5% superannuation contribution was introduced for new entrants, the pay scale for new entrants was increased to 100/95 of the that applying to the pre-April 1995 entrants, thereby in effect fully compensating new entrants for the 5% contribution.

    - The cost saving achieved by reducing tax relief on contributions may be less than the headline rate of €1bn as set out in the ESRI report.

      For example, Revenue reported in its Ready Reckoner (Pre Budget 2019)[100] an estimated a saving of €319m if income tax relief on personal contributions was restricted to 20%.

    - It would, in effect, reintroduce a tax on employer contributions to an employee's PRSA, for higher rate taxpayers. Currently such contributions are treated as a BIK, but the employee can claim income tax relief at marginal rate on them as if they were personal contributions, within the limits which apply to tax relief on all personal contributions. For a higher rate taxpayer this usually means that the personal tax relief claimed equates to and wipes out the BIK associated with the employer contribution[101].

      But if pension tax relief on personal contributions is reduced to 25%, but the BIK remains taxable at a higher rate (40%), the employee paying higher rate income tax could have an income tax liability of 15% of the employer contribution. This would reduce the attractiveness of employer contributions to PRSAs as opposed to an employer contribution to an occupational pension scheme (which is exempt from a BIK charge). It would introduce another anomaly into the taxation of private pension arrangements.

- Apply tax relief to a % of contributions (explicit and implicit employer and employee/personal). If, for example, 75% of any pension contributions were subject to relief, this could reflect the likely 25% of retirement benefits which may end up being taken as a tax-free lump sum.

[100] https://www.revenue.ie/en/corporate/documents/statistics/ready-reckoner.pdf , page 11

[101] *Assuming the combined employer and employee contribution is within the age related and €115,000 net relevant earnings limits*

To do this in an equitable and fair manner, it would have to apply to both private sector (actual personal and explicit employer contribution) and the public sector (actual personal and imputed implicit employer contribution). For DB schemes and public sector schemes, this may lead to other inequities, as the employer contribution rate is an average across all ages and both genders (i.e. it is not specific to an individual).

- Reduce the net relevant earnings limit (currently €115,000) for personal contributions[102]. The estimated tax savings which might ensue (on a no change in behaviour basis).

  The Revenue Ready Budget reckoner for 2019 outlines the change in tax cost if the €115k limit is decreased at various rates of tax relief:

Changes to Income Tax Relief on Pensions
Cost of decreasing/increasing the ceiling for occupational pension schemes, RACs and PRSAs and / or reducing the marginal effective rate applicable to these reliefs.

€ Million

		Rate					
		40%	39%	34%	33%	30%	20%
	€200,000	-13	3	84	100	149	312
	€150,000	-8	8	88	105	153	314
	€120,000	-2	15	94	110	158	318
	€115,000	0*	16	96	111	159	319
	€110,000	8	24	103	118	165	323
	€105,000	17	32	110	126	172	327
	€100,000	26	41	118	133	179	332
Ceiling	€95,000	36	51	126	142	186	337
	€90,000	47	62	136	150	195	342
	€85,000	59	74	145	160	203	348
	€80,000	72	86	156	170	213	355
	€75,000	85	99	168	182	223	361
	€70,000	100	114	181	194	235	369
	€65,000	116	129	195	208	247	377
	€60,000	134	147	210	222	260	384

*Current rate and ceiling.

  However, such a reduction without imputing employer scheme contributions as a BIK (as happens for employer contributions to PRSAs) would proportionately impact more on the unincorporated self-employed who do not benefit from employer contributions and on private sector employees in DC schemes who pay circa 50% of the total contributions.

- Increase the imputed distribution rate for ARFs from say age 80 onwards to 6% pa, to reflect reducing life expectancy.

- Disallow the benefit of the age income tax exemption limit to private pension income, possibly by imposing a minimum 'withholding tax' on all private pension income payments. This withholding tax could be offset against an income tax liability on other income but would not be refundable.

- Align the income tax exemption age with the State Pension Age.

[102] And imputed employer PRSA contributions.

9.2 Automatic Enrolment Scheme (AES)

The Government has set out its plans for an Automatic Enrolment scheme. This should help to increase pensions coverage going forward as it may better address the needs of those who are currently without any supplementary retirement savings.

The current AES strawman targets employees in the age rage 23-60 with a salary of €20,000 - €75,000[103]. The proposed Exchequer subvention to this in the AES is €1 for each €3 of employee contribution, i.e. in effect 25% tax relief.

For those on the standard rate of tax, it would *increase* the cost of pension tax relief currently provided to standard rate taxpayers most of whom will pay no or very little tax on their private pension benefits in retirement. So, for standard rate taxpayers, it would likely *increase* the gap between the rate of pension tax relief obtained and the rate of tax, if any, they will pay on supplementary retirement income in retirement.

For those on the higher rate of tax, i.e. anyone earning more than €34,550 pa (single) or €43,550 pa (married, one income) it would significantly *increase* the net cost of personal contributions: under the current regime they can benefit from tax relief of 40%, but under the new regime they could only benefit from 25% tax relief. As outlined above, people may react by reducing or stopping their pension savings.

9.3 Introduce more flexibility into the system

The objective (we understand) of the AES is to complement existing private pension provision and not replace it. The AES is targeted at those who are not already in private pension arrangements.

The CSO QNHS Pension Provision Module of Q4 2015 shows the some of the lowest private pension coverage in the following areas of employment:

Sector	**Pensions Coverage Q4 2015**	**Average annual earnings (2015)**
Accommodation and food service activities	13.1%	€16,605
Wholesale and retail trade; repair of motor vehicles and motorcycles	26.5%	€28,006
Agriculture, forestry and fishing	28.5%	Not provided
Administrative and support service activities	24.9%	€26,928

As these sectors are lower paid than other sectors, they would benefit from AES tax credit paid to their account of 25% when compared to traditional pension tax relief as a deduction against income. By contrast, higher earning sectors in the private sector show much higher private pension coverage (albeit that this coverage has reduced over the last decade):

Sector	**Pensions Coverage**	**Average annual earnings (2015)**
Information and communications	58.9%	€55,966
Financial, insurance and real estate activities	75.2%	€52,877
Professional, scientific and technical activities	49.5%	€41,954

[103] Employers will not be required to contribute in respect of earning in excess of an upper earnings limit, currently proposed to be €75,000

It is clear that there is a strong correlation between private pension coverage and earnings, so that those covered by existing private pension arrangements are predominantly higher rate taxpayers. For these, marginal rate pension tax relief on personal contributions is a better incentive than 25% tax relief. Therefore, the existing private pension arrangements and the proposed AES are likely to be targeted at two different constituencies.

Maintaining marginal rate tax relief on personal contributions to other pension arrangements might initially seem to jar with a fixed 25% tax credit under AES. However, by adopting two different types of tax incentives for the two systems, i.e. existing private pension arrangements and the AES, is likely to give the best outcome in terms of maintaining and increasing private pension provision.

The Government could therefore consider introducing flexibility and choice into the system rather than trying to design a “one size fits all” system. There is precedent for this in other jurisdictions. For example, in the UK, they have successfully increased pensions coverage by offering a range of options:

- Option 1: Contributions made to a pension scheme are tax-exempt up to certain limits (the “Net Pay” approach). This approach is similar to our current pensions tax-relief regime.
- Option 2: An individual can avail of a 25% top-up on contributions (subject to limits), regardless of their tax position (“Relief at Source” approach). This is similar to the proposed AES regime.
- Option 3: Individual Savings Account (ISA). After-tax savings (subject to a limit) are invested in an ISA. Any gains are free from tax while the tax rules on withdrawal depend on the type of ISA. This option is available in addition to options 1 or 2. We do not have an equivalent ISA-type option in Ireland.

By providing flexibility and choice, this might encourage people to save for their retirement (by, for example, asking people to choose how they will save for retirement and not focus on whether to save or not) and can also help large numbers of existing savers from being financially disadvantaged as a result of other policy initiatives (i.e. promoting “simplicity” under the AES approach where everyone gets relief at an effective rate of 25%). More flexibility does however have to be balanced against more complexity. One way to address this could be ensure that no one is worse off if they choose AES. For example, a higher rate taxpayer who is saving through the AES might be able to claim the additional relief through his/her year-end tax return. We understand this approach has been adopted in the UK.

9.4 Special considerations for the self-employed

According to the Automatic Enrolment Strawman Proposal, the self-employed make up c. 16% of the working population (c. 338,000 workers) and figures indicate that only 30% (c.100,000) of self-employed people have private pension coverage.

Unlike employed people, those who are unincorporated self-employed have much fewer supports to help them save for retirement:

- They do not benefit from employer contributions, the most tax efficient contributions.
- Personal contributions are limited based on the age-related restrictions and the net relevant earnings limit of €115,000. In effect this introduces an annual cash limit on contributions in addition to the lifetime Standard Fund Threshold.
- Personal contributions do not benefit from USC and PRSI relief in the way that employer contributions do.
- They can only backdate pension saving tax-efficiently for one year; employer schemes can fund extensive past service liabilities (within Revenue limits)
- The AES does not address their needs, other than proposing to allow the self-employed access to the AES on an opt-in basis.

There is no doubt that the unincorporated self-employed get the worst deal of all those who benefit from private pension tax relief, for the reasons outlined above.

Given the special challenges faced by the unincorporated self-employed and given that, in particular, their earnings may fluctuate from year to year, a pension savings model (such as the AES) which assumes regular funding may not be appropriate.

The following may therefore be worth considering, specifically for the unincorporated self-employed:

- Allow unincorporated self-employed people to back-fund for retirement contributions for up to, say, 6 years.

  (Under the current regime, a company can back fund for a proprietary director's service, while an unincorporated self-employed person can only back fund for one year. Previously, self-employed people could backdate a contribution up to 6 years.)

- Allow unincorporated self-employed pension contributions to be deductible for USC and PRSI purposes to recognise that self-employed people do not benefit from an employer contribution[104] under AES.

[104] Proposed to be 6% of earnings up to a limit in the AES Strawman

10 Appendices

Comparison of gross income needed to fund a €1,000 gross pension contribution

		Higher Rate taxpayer		Standard rate taxpayer
Gross income		**€1,250**		**€1,123**
Used as follows				
USC	8%	€100	4.75%	€53
Employee PRSI	4%	€50	4%	€45
Income tax	40%	€500	20%	€225
Gross pension contribution		€1,000		€1,000
Total outlay before pension tax relief		€1,650		€1,323
Deduct tax relief on €1,000 pension contribution	40%	-€400	20%	-€200
Total outlay after pension tax relief		**€1,250**		**€1,123**
Pension tax relief as a % of gross income		32.0%		17.8%

Comparison of pension contribution which can be afforded from €902 gross income

		Higher Rate taxpayer		**Standard rate taxpayer**
Gross income		**€902**		€902
Used as follows				
USC	8%	€72	4.75%	€43
Employee PRSI	4%	€36	4%	€36
Income tax	40%	€361	20%	€180
Gross pension contribution		€722		€803
Total outlay before pension tax relief		€1,191		€1,063
Deduct tax relief at marginal rate on €1,000 pension contribution	40%	-€289	20%	-€161
Total outlay after pension tax relief		**€902**		**€902**
Pension tax relief as a % of gross income		32.0%		17.8%

Comparison of pension contribution which can be afforded from €1,000 gross income

		Higher Rate taxpayer		Standard rate taxpayer
Gross income		**€1,000**		**€1,000**
Used as follows				
USC	8%	€80	4.75%	€48
Employee PRSI	4%	€40	4%	€40
Income tax	40%	€400	20%	€200
Gross pension contribution		€800		€891
Total outlay before pension tax relief		€1,320		€1,178
Deduct tax relief at marginal rate on respective pension contribution	40%	-€320	20%	-€178
Total outlay after pension tax relief		**€1,000**		**€1,000**
Pension tax relief as a % of gross income		32.0%		17.8%

Comparison of pension contribution which can be afforded from €1,000 gross income, with fixed 25% tax relief for higher and standard rate taxpayers

		Higher Rate taxpayer		Standard rate taxpayer
Gross income		**€1,000**		**€1,000**
Used as follows				
USC	8%	€80	4.75%	€48
Employee PRSI	4%	€40	4%	€40
Income tax	40%	€400	20%	€200
Gross pension contribution		€640		€950
Total outlay before pension tax relief		€1,160		€1,238
Deduct pension tax relief on €1,000 pension contribution	25%	-€160	25%	-€238
Total outlay after pension tax relief		**€1,000**		**€1,000**
Pension tax relief as a % of gross income		16.0%		23.8%

Comparison of pension contribution which can be afforded from €1,000 gross income, with 35% relief for higher rate taxpayer and 25% for standard rate

		Higher Rate taxpayer		Standard rate taxpayer
Gross income		**€1,000**		**€1,000**
Used as follows				
USC	8%	€80	4.75%	€48
Employee PRSI	4%	€40	4%	€40
Income tax	40%	€400	20%	€200
Gross pension contribution		€738		€950
Total outlay before pension tax relief		€1,258		€1,238
Deduct pension tax relief on €1,000 pension contribution	35%	-€258	25%	-€238
Total outlay after pension tax relief		**€1,000**		**€1,000**
Pension tax relief as a % of gross income		25.8%		23.8%