Society of Actuaries in Ireland

Limits on Tax Relieved Pension Funds

13.03.13

- **Background to introduction of limits on retirement limits**
- **Lump sum limit**
- **Fund/benefit Threshold limit**
- **2014?**

Introduction of limits

Where the limits came from

ARF option → Borrow to invest → Review of Tax reliefs → Introduction of limits → ARF imputed distribution

ARF option	Borrow to invest	Review of Tax reliefs	Introduction of limits	ARF imputed distribution
April 1999	2004	2005	7th December 2005	2007

"The ARF option... may be encouraging the build-up of very substantial pension funds with a view to availing of the long-term tax exempt environment of the ARF where there are no distributions from the ARF"

they can influence the level of employer contributions and their remuneration level."

Dept of Finance : Internal Review of Certain Tax Schemes, Feb 2006

Internal Review of Certain Tax Schemes

"The analysis does suggest … that for those who have the capacity to survive in retirement without the need to rely on funds invested in an ARF, our "EET" system of pension taxation is much closer to an "EEE" system where effectively no tax is paid, or if it is, it is at a low rate and far into the future"

€100m! **€100m!**

ARFs

www.taxpolicy.gov.ie

Menu of measures proposed by Review

- Impute employer contributions for tax relief limits
- Cap on maximum size of tax relieved retirement fund
- Cap on 25% tax free lump sum
- Cap maximum final salary
- Extend final salary averaging period to 10 years
- Flat tax charge on the value of ARF
- 3% pa ARF notional distribution
- ARF transfers to adult child taxed as income
- ARF option limit on employer contributions

Dept of Finance : Internal Review of Certain Tax Schemes, Feb 2006

Finance Act 2006

S790AA TCA 1997	Chapter 2C TCA 1997
Tax Free Lump Sum Limit	Limit on Tax Relieved Pension Funds
25% x Standard Fund Threshold	Standard Fund Threshold
€1,250,000	€5,000,000


Tax free
lump sum
limits

‘Relevant pension arrangement’

Approved retirement benefit scheme

RACs & PRSAs

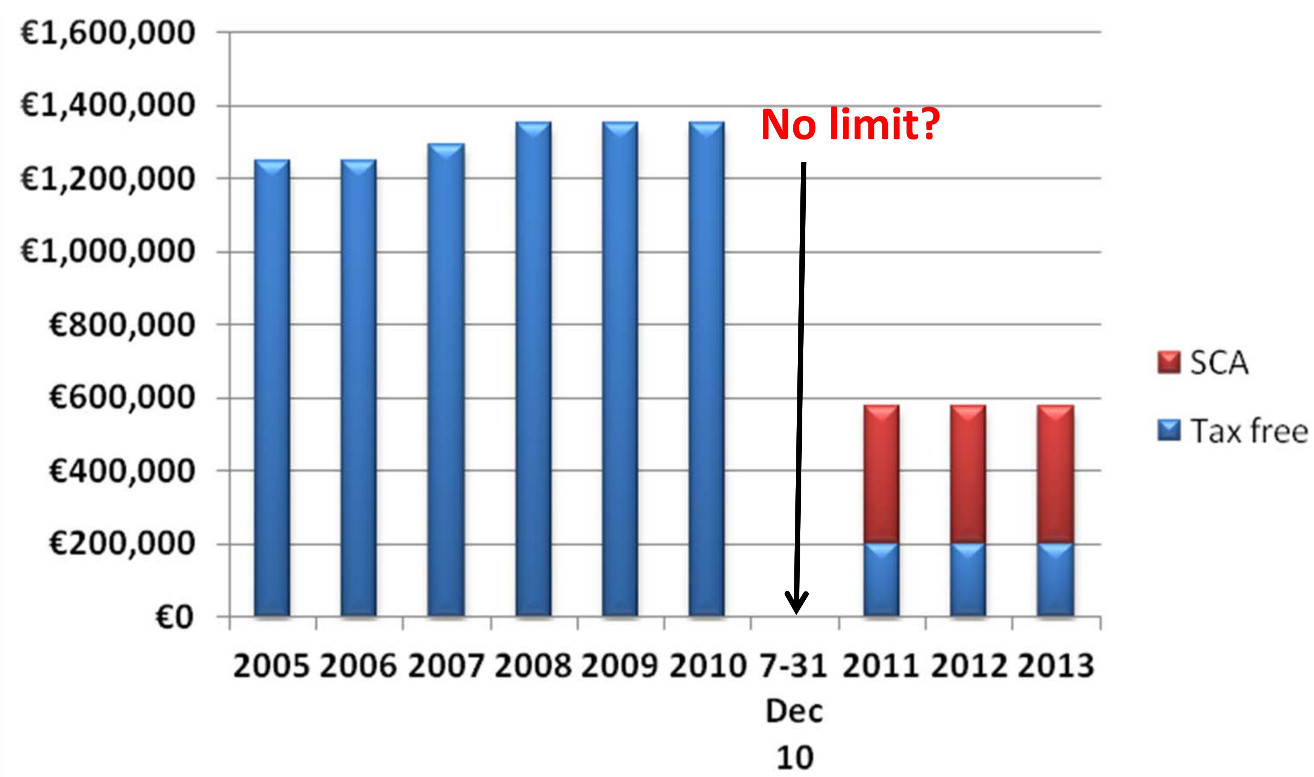
RACs, RAC Trusts, & PRSAs

Public service pension scheme

Statutory scheme

Qualifying overseas pension plan

Tax free lump sum limit



Current lump sum limit

7th December 2005

'excess lump sum'

Tax free amount

Standard chargeable amount (SCA)

Balance

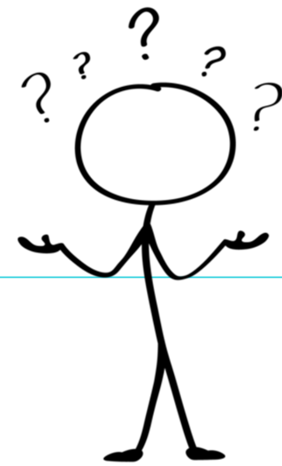
€200,000

25% x SFT - €200k = €375k

Standard rate tax

PAYE & USC

What is a ‘lump sum’



“a lump sum that is paid to an individual under the rules of a relevant pension arrangement by means of commutation of part of a pension or of part of an annuity <u>or otherwise</u>.”

ROCs ?

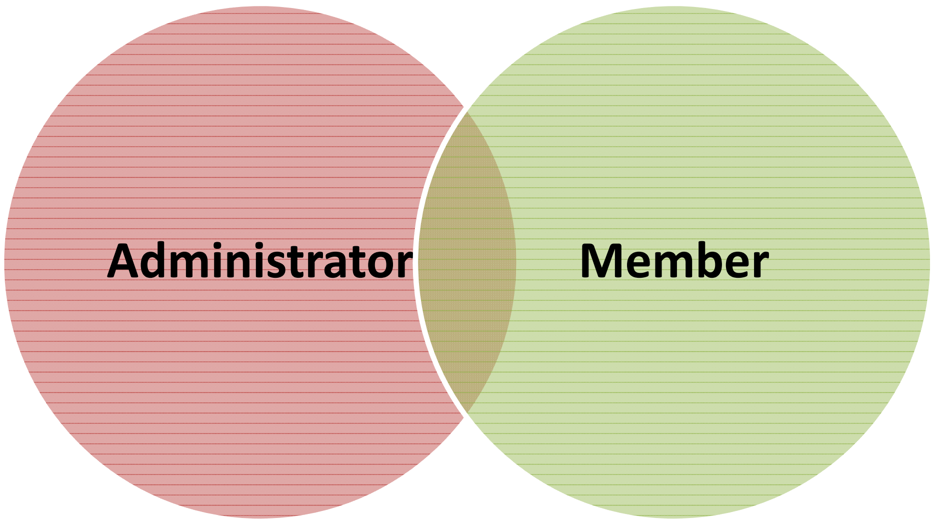
AVC early access?

Taxable lump sums?

Death lump sums excluded

Does not apply to full commutation on exceptional circumstances

Payment of standard rate tax



"... charged to income tax under Case IV of Schedule D"

S790AA(3) TCA 1997

USC? **PRSI Class S?**

Standard rate tax paid by the administrator

"… so much of the tax that is paid by the administrator in whole or in part shall itself be treated as forming part of the excess lump sum
UNLESS

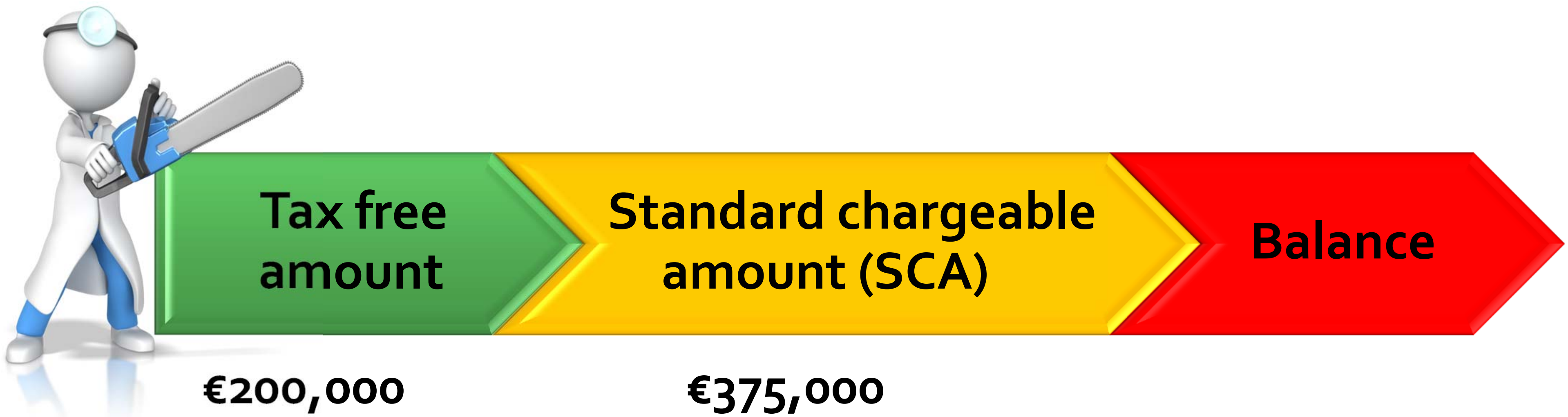
the lump sum paid by the administrator under the relevant pension arrangement are <u>reduced so as to fully reflect the amount of tax so paid</u>

<u>OR</u>

the <u>administrator is reimbursed</u> by the individual in respect of any tax so paid"

S790AA(6) TCA 1997

Pension Adjustment Orders?



S790AA makes no reference to PAOs


Limits on tax
relieved
pension funds

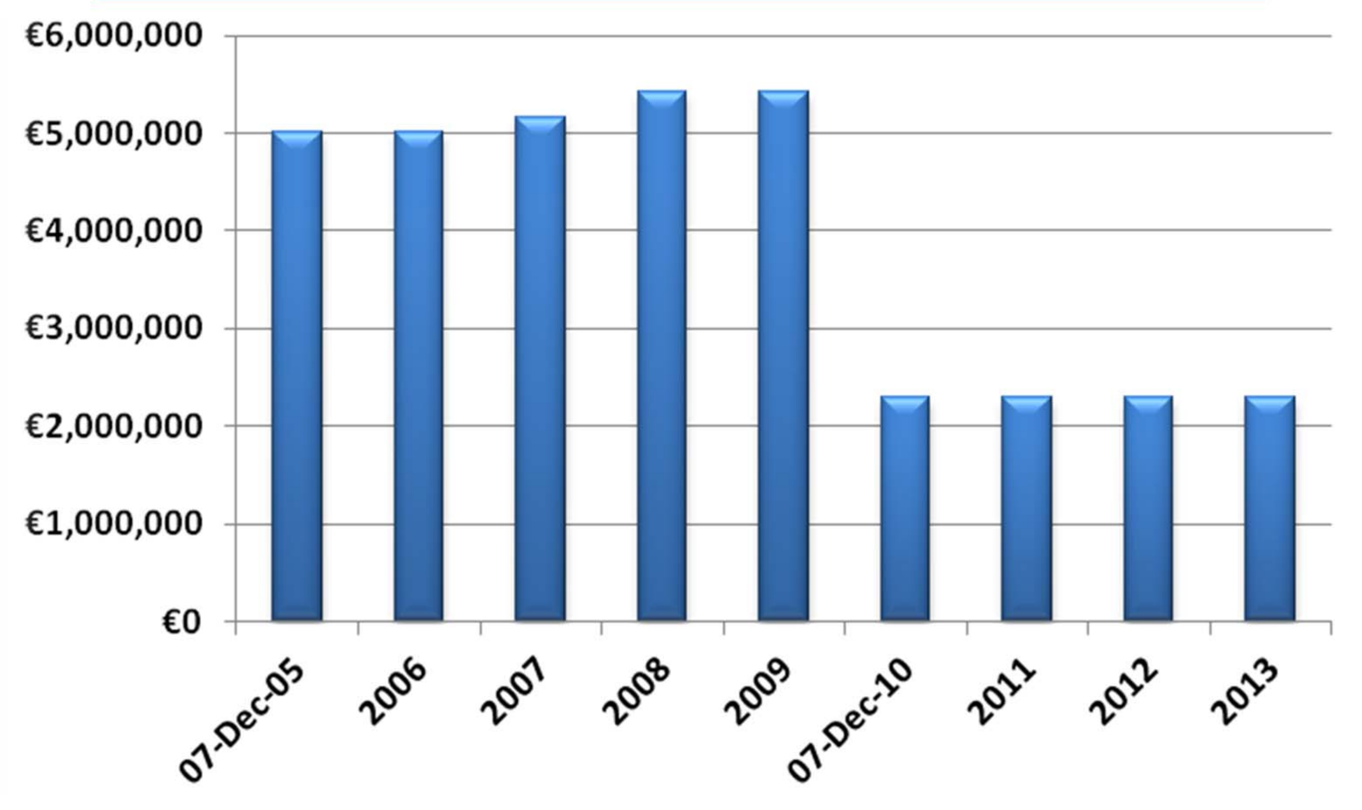
Deterrent

7th December 2005

Income Tax @ 41%

(1 -41%) x (1- IT – USC)

Standard Fund Threshold



PFT 2005

- > €5m
- 1.0836 indexation
- 115 PFTs issued

PFT 2010

- > €2.3m < €5.4m
- No indexation
- 1,200 ‘applications’
- Average : €3.2m

Standard Fund Threshold

- €2.3m
- No indexation

DB PFTs :
accrued or prospective entitlement?

Benefit Crystallisation Event (BCE)

- **Becomes entitled to a**
  - Pension
  - Annuity
  - Lump sum
- **Exercise of ARF option/vested PRSA**
- **Payment of TV under Overseas Transfer Regs**
- **Increase in DB pension in retirement**

BCE amount

DC

- Funds used

DB

- Pension : 20 x pension payable in first 12 months
- Lump sum/gratuity

Relevant Valuation Factor (RVF) 20:1

"The administrato… …ay, wi… …prior agreement of the Revenue Commissione… …valuation factor other than 20:1 where the Reven… …issioners are satisfied that 20:1 is clearly inappror… …e, … the other factor would be appropriate, to u… the circum… …ces"

S787(0)(2)(b) TCA 1997

Bridge pensio…

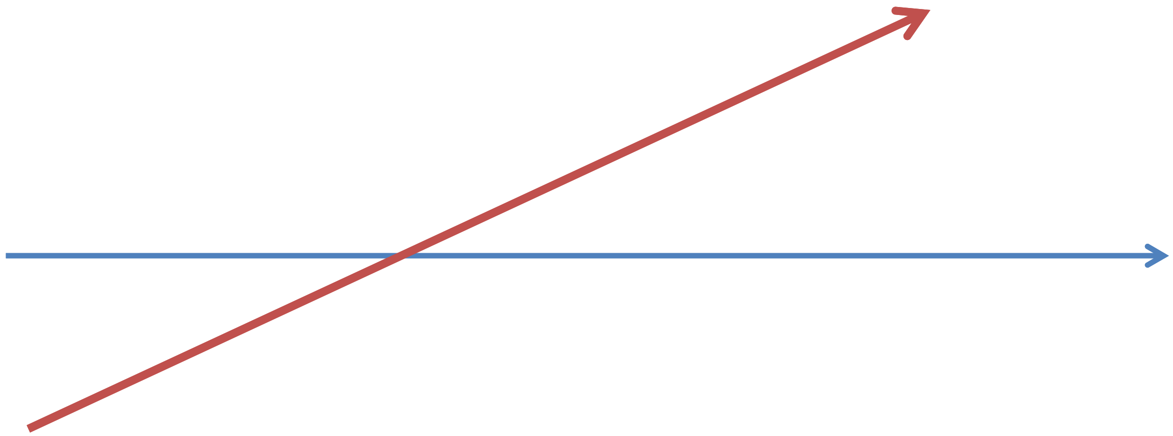
Ill health retirement

7th December 2010 onwards

DB post retirement increases ignored

- Pay parity
- 5% pa
- CPI + 2% pa

DB pensions – pension swapping



20 x Yr 1 Pension

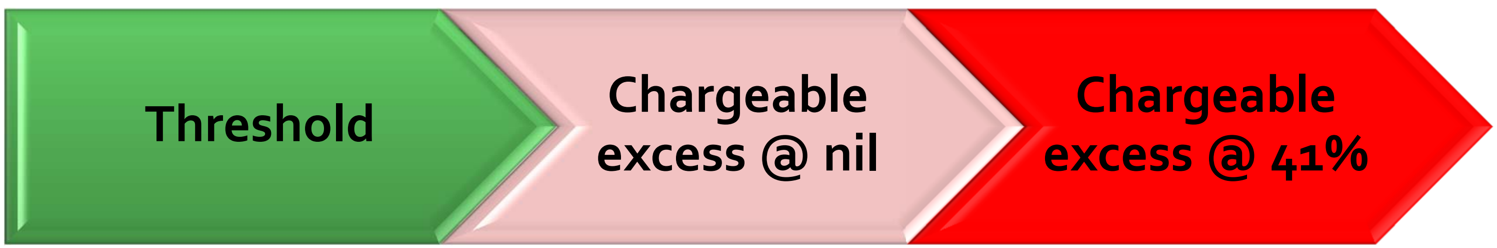
Lump sum tax credit – S787RA

Pension	€125,000
Lump sum	€375,000
BCE amount	€2,875,000
SFT	€2,300,000
Chargeable excess	€575,000
CE Tax	**€235,750**
Less	
Standard rate tax on SCA	-€35,000
CE Tax	**€200,750**

Backdated to 1st Jan 2011

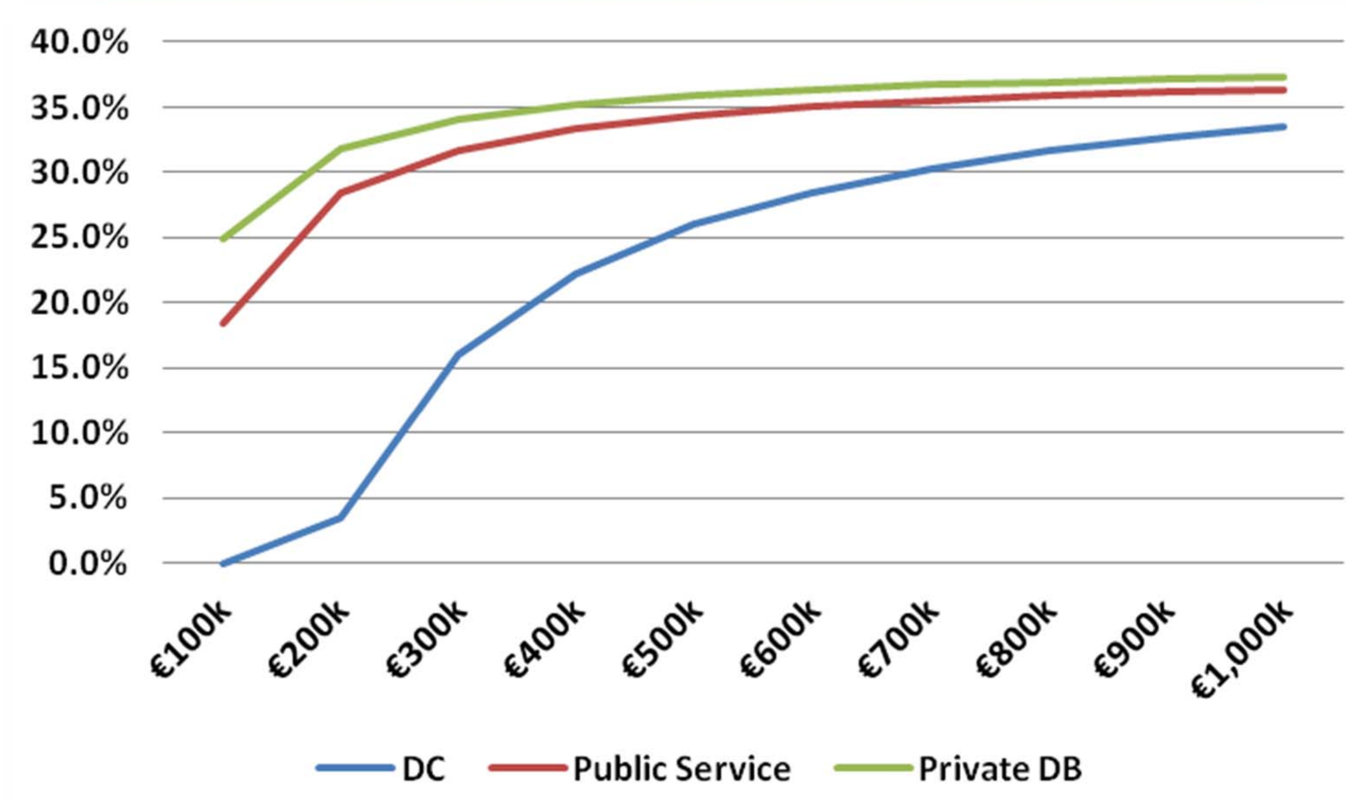
35%

Chargeable Excess Tax



20/41 x SCA

‘Blended’ CE tax rate on excess



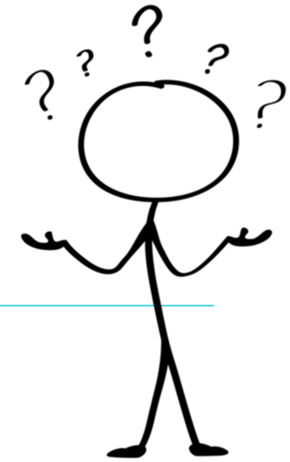
Disaggregation

- **Encashment Option**
  - S787TA
- **Pre retirement access to AVCs**
  - S782A

"… the amount transferred shall not be a benefit crystallisation event"

S782A(6) TCA 1997

Death in service benefits

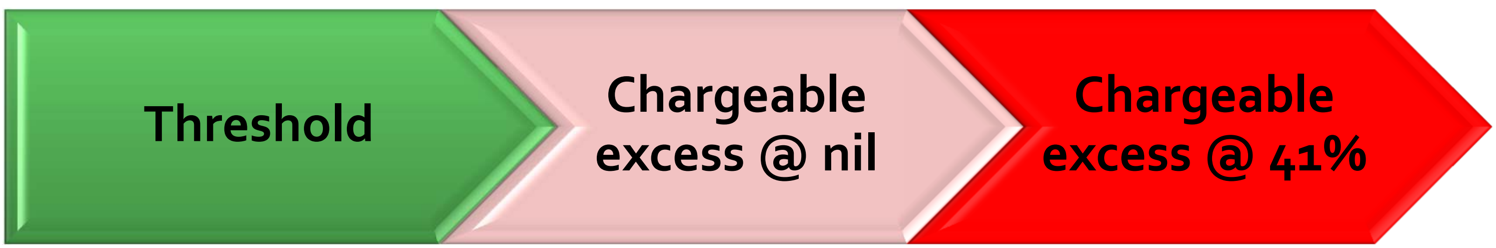


- **No specific exemption**

> ***"Member ...any individual having been admitted to membership under the rules of the arrangement, remains entitled to any benefit under the arrangement."***
>
> ***S787Q(1) TCA 1997***

Pension Adjustment Orders

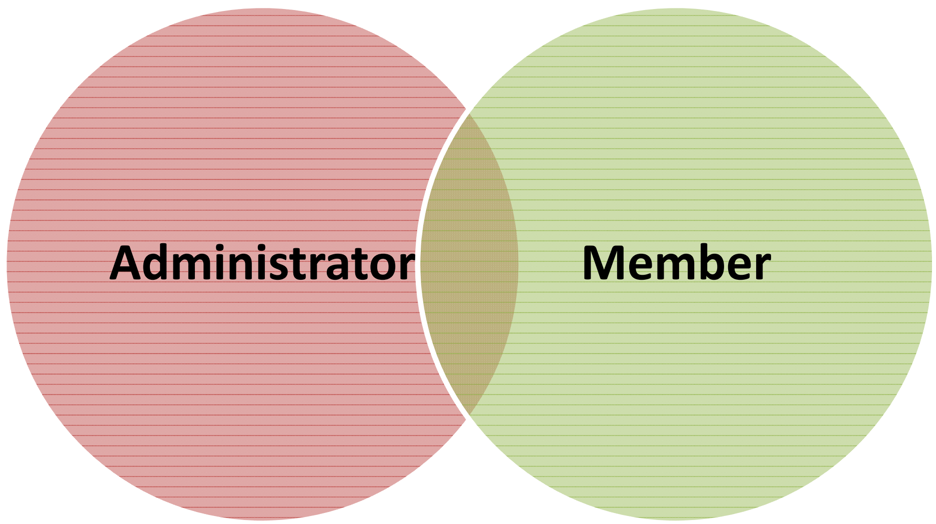
It never happened!



Can end up with the tax liability, but no benefits to pay it from!


Payment &
recovery of
CE tax

Payment of CE Tax



"... chargeable to income tax under Case IV of Schedule D"

S787R(1) TCA 1997

USC? **PRSI Class S?**

CE Tax paid by the administrator

"… so much of the tax that is paid by the administrator shall itself be treated as forming part of the chargeable excess UNLESS

the individual's rights under the relevant pension arrangement are <u>reduced so as to fully reflect the amount of tax so paid</u>

<u>OR</u>

the <u>administrator is reimbursed</u> by the individual in respect of any tax so paid"

S787Q(5) TCA 1997

Scheme rules

"... A retirement benefits scheme shall neither cease to be an approved scheme nor shall the Revenue Commissioners be prevented from approving a retirement benefits scheme ... because of any provision in the rules of the scheme whereby a member's entitlement under the scheme may be commuted, to such extent as may be necessary, for the purpose of discharging a tax liability in connection with that entitlement under the provisions of Chapter 2C."

S772(3F) TCA 1997

Reimbursement of administrator

- Personal 'cheque'
- Gross transfer from ARF or vested PRSA to administrator

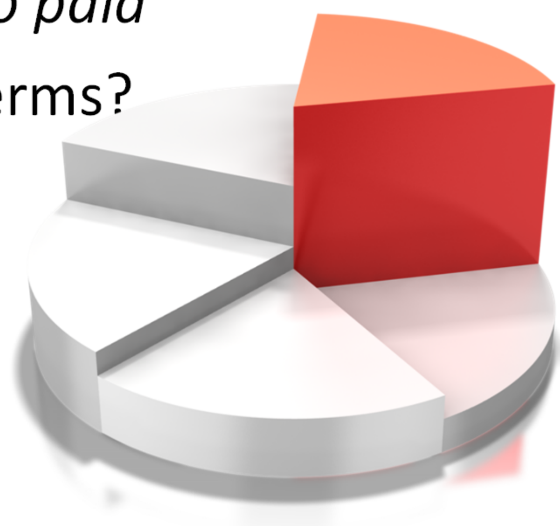
CE tax recovery in public service/statutory schemes

Up to 50% net gratuity	Balance
• Recovery from gratuity • Personal reimbursement	• Reduction in *gross* pension up to 10 years • Personal reimbursement

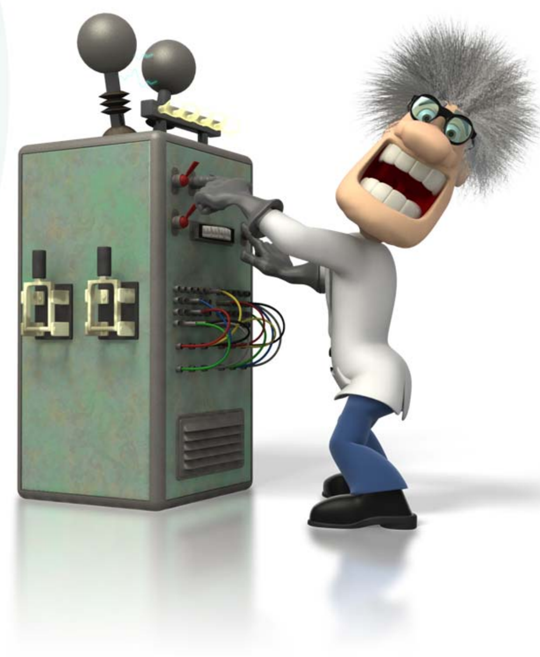
Finance Act 2012

Recovery in funded DB schemes?

- **Lump sum and/or gross pension**
- **Gross pension**
  - *'reduced so as to fully reflect the amount of tax so paid'*
  - Commutation terms?




Funding
beyond the
Threshold?



DC

Alternative Remuneration	Funding chargeable excess beyond nil rate band
(1- IT – PRSI – USC)	(1 - 41%) x (1-IT-USC)
Class A : $^{1}/_{1.1075}$ x (1- IT – PRSI – USC)	(1 - 41%) x (1-IT-USC)
Net roll up	**Gross roll up**

DB funded

Alternative Remuneration	Funding 'chargeable excess' pension
$^{1}/_{1.1075}$ x (1- IT – PRSI – USC)	11.8% x (1- 20%) (lump sum) + 88.2% x (1-IT-USC) (Pension) – - (41% x 20/25 - 11.8% x 20%) x (I-IT-USC)
43.3%	**41.2%**
Risks – DC	**Risks - DB**
Net roll up	**Gross roll up**

2013
2014

Programme for Government

"... We will cap taxpayers' subsidies for all <u>future</u> pension schemes for politicians (and indeed for everybody) that deliver income in retirement of more than €60,000."

Programme for Government

Budget 2013

"... The current arrangements governing the maximum allowable pension fund at retirement for tax purposes of €2.3 million still allow for very generous pensions for higher earners through tax-subsidised sources, particularly by way of Defined Benefit schemes in both the public and private sectors.

Therefore, the necessary arrangements to give effect to the Programme for Government commitment <u>to effectively cap taxpayers' subsidies for pension schemes that deliver income of more than €60,000 pa</u> will be put in place in 2014."

Minister for Finance

Minister for Finance

"… The changes required will likely involve not only a reduction in the current level of the threshold from €2.3 million but other changes to ensure equity as between Defined Contribution and Defined Benefit pension arrangements and between the private and public sectors. "

31st January 2013

Requirements

- €60,000 pa pension link
- Reduction in Threshold
- Equity between DB and DC
- Equity between private and public
- €250m pa tax savings
- Protect accrued entitlements?

Inequities?

DC	DB
20:1 used for DB regardless of gender, age, type of pension	**20:1 for:** • older ages • bridge pensions • ill health pensions
Self employed subject to both annual tax relief limits and lifetime limit	**May be forced to pay from net gratuity**
	Solvency risk
	Mortality risk ... no refund mechanism!

Inequities?

Private sector	Public sector
Lack of private pension coverage : 60%	**Compulsory recovery of CE tax from 50% net gratuity; private sector pay from gross only**
Later access to benefits than public service, e.g. RAC from age 60	**Compulsory accrual of benefit; no alternative remuneration option**
Solvency/wind up risk	
Less/no post retirement increases	
Less favourable accrual terms than public service	

Options

Amend Current Threshold System	Change to Pension limit	Focus on Tax Relief consumed	Tax benefits in retirement
• Age related RVF • Open market terms	• Convert DC to pension • Final salary limit?	• Impute employer contribution • Annual limit • Lifetime limit	• Supertax on retirement income

Society of Actuaries in Ireland

Limits on Tax Relieved Pension Funds

13.03.13