THE SOCIETY OF ACTUARIES IN IRELAND

Pre-Budget Submission to the Minister for Finance

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Pre-Budget Submission

Introduction

The Society of Actuaries in Ireland is making this submission in order to highlight possible implications of proposed changes to the tax relief on contributions to pension arrangements – in particular, proposals in the Programme for Government to apply a standardised tax relief rate of 33%.

We urge the Minister to factor into the decision-making process the likely impacts on individuals and the changes in behaviour that may be expected as a result. We are concerned that these changes in behaviours could have far-reaching social implications, particularly for middle income earners, as outlined below.

In addition, we believe that the proposed changes are fundamentally unworkable in practice. They would require a multi-year period of advance preparations. If employer contributions to pension arrangements become liable to benefit-in-kind tax in a standardised tax rate environment, this would be enormously complex to apply equitably in the area of defined benefit provision, including public sector pensions.

Consequences of removing marginal rate tax relief

To assess the overall consequences of removing marginal rate tax relief, it is useful to consider the impacts on different groups of people, as follows:

A. Those paying higher rate tax now but who are likely to pay standard rate tax in retirement

Restricting tax relief will have most effect on employed persons on middle levels of income and may significantly diminish their propensity to make provision for retirement, which could have far-reaching social consequences.

The reduction in tax relief will make pension plans less attractive. Also, mixed messages about the tax benefits of pension plans, under the new framework, may make it more difficult to convince this group that it still makes sense to provide for retirement. While some may maintain the discipline of saving through other products, overall savings will probably fall. The societal consequences in terms of adequacy of income in retirement may put significant pressure on social welfare systems in the medium to long term.

A reduction in tax relief would also increase the financial burden on the very many members of defined benefit schemes who are currently suffering contribution increases and/or benefit reductions to address funding shortfalls, in addition to continued uncertainty of future outcomes.

B. Those on standard rate tax and low-income persons not paying tax

The lowest paid have the potential to benefit most from the proposed changes to tax relief and the redistribution of wealth that could result. However, given other demands on their financial resources, and their capacity, therefore, to put money aside for retirement, it is possible that the proposed changes will in reality have little impact on those on lower incomes, while adversely impacting middle income earners.

Tax credits could deliver benefits but care is needed as there is potential for abuse.

C. Those paying higher rate tax now and likely to pay higher rate tax in retirement

This group get proportionately less from the current tax relief regime than other groups, since ultimately the tax on pension payments broadly offsets the tax relief on contributions (a fact that is overlooked in some public commentary). The availability of a tax free lump sum is advantageous but this is subject to a monetary limit, as is the amount of contribution on which tax relief may be claimed.

If marginal rate relief is removed, many people in this category would be better served by investing in an equivalent non-pension product under which the tax treatment of proceeds is more favourable and savings may be accessed prior to retirement. It is likely, therefore, that significant numbers in this group will stop paying voluntary contributions to pension plans.

Senior employees could perhaps influence employers to pay contributions on their behalf, which would mean that they would still gain tax relief. This could be countered by making employer contributions a benefit-in-kind, but this would have enormous consequences for all pension scheme members, including those from the public sector. Also, calculating the benefit-in-kind under defined benefit schemes would be very complex.

Concerns

Since pension tax relief is used by higher rate tax payers to reduce tax bills, removing marginal rate tax relief on contributions would increase tax receipts in the short-term.

However, tax relief issues in respect of high earners have already been addressed through the more focused approach whereby tax free lump sums and tax deductible contributions are subject to a monetary limit.

Removing marginal rate relief will affect middle-income employees most and will act as a disincentive to making financial provision for retirement. This is contrary to the Government's long-standing policy to encourage private sector pension provision and increase the overall level of pension coverage. It is also contrary to previous initiatives to stimulate private pension provision, such as the introduction of Personal Retirement Savings Accounts. Moreover, people's ability to save is presently more challenged than at any time in the last 20 years. Any further disincentive could have unintended adverse consequences.

We do not expect that the reduction in pension contributions from middle- and high-income earners would be balanced by an increase in contributions from persons paying standard rate or no income tax.

There have been suggestions that a pensions product akin to the Special Savings Incentive Account should be developed. We do not think that such a product would encourage consumers to save in the way that the SSIA did. The SSIA was a relatively short-term, uncomplicated product under which savings were not locked-in for a long period. Moreover, the initiative was significantly boosted by a deadline for contributions. A pension version would not have such a deadline. Also, in a pension version, the total benefit – rather than only the investment returns – would be subject to tax; and the tax would exceed the government contribution for the many tax payers who pay higher rate income tax. Finally, pensions are longer-term than SSIAs and they are more complex from an investment and maturity point of view, so they would not have the same mass market appeal.

Conclusion

We believe that removing marginal rate tax relief will significantly reduce the amounts directed into pension arrangements, with potentially far-reaching social consequences in terms of adequacy of retirement income.

We urge the Government to look at the implications of any proposal on different categories, taking into account whether persons are employed or self-employed and having regard to the tax bands that may be expected to apply before and after retirement.

We note also that the Commission for Taxation report recommends removing the PRSI relief that employers receive on employee contributions. We would encourage the Government to analyse potential behavioural changes that may result if this relief is withdrawn. The PRSI relief incentivises many employers to promote pension provision amongst their employees and to some extent subsidises the cost of establishing and administering voluntary occupational pension schemes.

We understand that, following on from the 2007 Green Paper on Pensions, Government intends to publish a policy paper on pensions which will map out the way forward and determine what pension system will apply in Ireland. The consultation process on the Green Paper gave rise to 384 submissions, indicating the breadth and the complexity of the issues. To make a radical change to one of the fundamental tenets of the current system, i.e. tax relief, in advance of the discussion on any new pension system would be premature and potentially damaging to that discussion and the new system.

If part of the objective of the proposed changes to tax relief on pension contributions is redistribution of wealth, we would argue that there are more effective ways of achieving this. Any reform of the pensions framework needs to done, not a piecemeal basis, but on a holistic basis that has regard also to the role of the State pension, changing demographic patterns, the various measures that can be employed to achieve equity between different categories of tax payers, the challenge of improving security of pension benefits, and other associated issues. In the meantime, we believe that people need to be incentivised to save for retirement, not discouraged from doing so.

We would welcome the opportunity to participate in the debate regarding potential tax relief changes and other changes to the pensions system. We are willing to provide expertise in evaluating the implications.

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