Society of Actuaries in Ireland

Position Paper on the Taxation of Private Pension Provision

Paper issued in November 2011

Supplementary Note issued in November 2017

Supplementary note to the "Position Paper on Taxation of Private Pension Provision

1. Introduction

1.1 The Society of Actuaries in Ireland ("Society") has received some comments from a member on its "Position Paper on Taxation of Private Pension Provision", which was issued in November 2011. The Society has reviewed the work done in preparation of the paper and has decided to issue this supplementary note to clarify two aspects of the paper. The paper should be read in conjunction with this supplementary note.

2. Background to the position paper

2.1 It is useful first to understand the background to the position paper.

2.2 The paper was published in November 2011 to contribute to debate on the question of whether tax relief on pension contributions should be changed. This was being considered by Government at that time as part of the National Recovery Plan 2011-2014[1].

2.3 The Society's paper illustrated possible consequences for individuals if the proposed reductions in tax relief on contributions were implemented. The paper also drew attention to the potential for adverse behavioural consequences and recommended that the "clock should be stopped" on further pension tax change at that time, to allow time for more comprehensive analysis with a view to arriving at a pensions framework that would be sustainable over the long-term and that would encourage people to made adequate provision for retirement.

3. The treatment of tax exemption on investment returns

3.1 One of the comments received is that net effective rates of tax relief set out in the paper did not properly represent the "true" rates of tax relief as they did not allow for the tax exemption that applies to the accrued income and gains of pension funds[2].

3.2 Section 6.5 of the National Recovery Plan set out the three ways in which tax incentives were provided in respect of pension saving:

i. Tax relief on employee/self-employed/individual contributions to pension savings;

ii. Exempting employer contributions from being treated as Benefit–in–Kind (BIK) in the hands of employees; and

iii. Exempting from tax the accrued income and gains of pension funds.

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[1] http://www.budget.gov.ie/The%20National%20Recovery%20Plan%202011-2014.pdf

[2] Pension funds roll up gross of tax to provide a higher pension which (subject to some exemptions) is taxed in the hands of pensioners as the pension is paid.

3.3 The National Recovery Plan noted that abolishing one or more of these exemptions would lead to behavioural changes in relation to pension saving, which would impact on the amount of tax revenue obtained.

3.4 The requirement under the National Recovery Plan was to raise an additional €700m per annum from private sector pension savings. The actions set down to achieve this were as follows:

i. Removal of PRSI and Health Levy relief on pension contributions in 2011;

ii. Reduction in the annual earnings cap for employee/personal pension contributions of almost 25% in 2011;

iii. Phased reduction in tax relief on contributions from marginal to standard rate of income tax over the period 2012 – 2014.

3.5 The objective of the Society's paper was to demonstrate the <u>consequences for individuals</u> of reducing the rate of tax relief granted on contributions – from the paper:

> "The primary purpose of this paper is to examine the effect of reducing the tax relief on pension contributions made by individuals.
>
> Individuals currently receive tax relief at their marginal income tax rate on pension contributions. The National Recovery Plan 2011-2014 proposes to change the tax relief from the individual's marginal tax rate to the standard tax rate of 20% by 2014.
>
> We set out information in this paper on the probable consequences of these changes."

3.6 The Society agrees that tax exemption on investment returns is an important and valuable element in the overall tax incentivisation of pension savings and that if one wants to quantify the total tax incentives provided to pension savers, the tax exemption on investment returns should be taken into account. However, the very broad question of whether the whole system of tax incentives for pension savings should be changed (e.g. by changing the basis of taxation of investment returns and benefits) was not under consideration and so we confined our analysis to considering the consequences for individuals of reducing the tax relief on contributions.

3.8 To ensure that the calculation of the net effective rate of tax relief on contributions reflected the current and proposed Irish tax regime, we assumed that the exemption from tax on investment returns would continue, and this is made clear in the summary of assumptions at the end of the paper, where tax on fund growth is stated to be 0%. **Hence, all references in the paper to "the value of tax relief" were intended to mean "the value of tax relief on contributions" and likewise all references to "the effective rate of relief" were intended to mean "the effective rate of relief on contributions".**

3.9 The paper drew attention to the fact that:

i. Whereas contributors to pension plans receive tax relief on those contributions at a "headline" rate of the marginal rate of income tax, this is offset to some extent by the fact that they pay tax on pensions at a future date (those pensions being secured from a fund that accumulates gross of tax);

ii. For higher rate tax payers, the attractiveness of saving for retirement would be greatly diminished if contributions attract tax relief at the standard rate, but benefits are taxed at a much higher rate;

iii. In fact, if probable behavioural changes[3] are taken into account, the consequences for the individual extend beyond the loss of tax relief on contributions highlighted in the tables in the paper. We comment further on this in the "General Comments" at the end of this note.

3.10 *Alternative approach:* The OECD Pensions Outlook 2016 calculates the "tax advantage of pensions" as "the difference in the present value of the total tax paid on contributions, return on investments and withdrawals between a benchmark savings vehicle and a private pension plan"… "expressed as a percentage of pre-tax contributions". We agree that this is an appropriate approach to assessing the overall tax treatment of pensions saving. We also acknowledge that this broader approach can usefully contribute to informed decision-making on changes to individual elements of the pensions taxation framework. If this broader approach had been adopted for the purposes of the Society's paper, and if the probable behavioural changes[3] had been quantified, this would have shown that reducing the tax relief on contributions could have had even more adverse consequences for individuals than indicated by the tables in the paper. As mentioned, we return to the subject of behavioural changes in the "General Comments" at the end of this note.

4. Methodology for the determination of the net effective rate of tax relief on contributions

4.1 The second aspect of the paper that has been questioned is the use of a discount rate of 3% per annum in conjunction with assumed investment growth of 5% per annum.

4.2 Page 5 of the paper describes the "net effective rate of tax relief [on contributions]" as "the present value of net reliefs (i.e. offsetting the stream of projected future tax revenues against the stream of projected future reliefs and taking the present value of the projected net relief/revenue in each future year) as a percentage of projected contributions".

4.3 The use of the term "present value" suggests that future cashflows were discounted to the start date at the discount rate of 3% p.a. quoted in the Appendix. This is misleading as the approach used to calculate the net effective rate of tax relief on contributions (for a male aged 40 retiring at age 65) was a simplified one which can be described as follows:

i. Contributions (assuming 3% p.a. increases in line with salary) were rolled up to age 65 at 5% per annum compound.

ii. The accumulated fund, less the maximum tax-free cash which was assumed to be taken, was converted to a pension using an annuity rate of 5%.

[3] Behavioural changes could include decisions to cease saving in pension plans, resulting in the loss of tax relief on contributions, gross roll-up of investment returns and in some cases other benefits, such as matching employer contributions.

iii. This pension was deflated to 2011 terms by dividing by 1.03^{25}. This was to facilitate the calculation of tax and Universal Social Charge (USC) on the pension, using 2011 tax and USC rates, allowances and tax bands.

iv. The amount of tax relief on the contribution paid in 2011 was calculated using the existing and proposed regimes.

v. The net effective rate of tax relief on contributions was calculated by summing the tax relief (in 2011 terms) over the 25 year term to retirement, deducting the tax and USC paid (in 2011 terms) over the 20 years of retirement, and dividing the result by the sum of the contributions (in 2011 terms) paid over the 25 years.

4.4 The Society now considers that it would have been more appropriate to have used an approach where future contributions, the tax relief granted on them and the tax and USC payable on the pension were discounted to 2011 at an appropriate discount rate.

4.5 The results of alternative calculations on this approach, using a discount rate equal to the expected rate of fund growth of 5% (or 2% in excess of salary inflation), are set out below, together with the corresponding figures from the paper*:

From Tables 2 and 3 in paper		
Salary	Net effective rate of tax relief on contributions assuming relief at marginal rate	Net effective rate of tax relief on contributions assuming relief at 20%
20,000	20%*	20%*
30,000	17%	17%
40,000	34%	13%
50,000	32%	11%
75,000	27%	6%
100,000	23%	2%
150,000	10%	-11%
200,000	2%	-19%

Allowing for 2% p.a. real discount pre-retirement		
Salary	Net effective rate of tax relief on contributions assuming relief at marginal rate	Net effective rate of tax relief on contributions assuming relief at 20%
20,000	20%	20%
30,000	18%	18%
40,000	36%	15%
50,000	34%	13%
75,000	30%	9%
100,000	27%	6%
150,000	17%	-4%
200,000	11%	-10%

**In reviewing the report, it was noted that allowance had been made for a USC liability on the pension in this example, but the amount of the pension fell below the level at which USC was applied at the time.*

4.6 It can be seen that for salaries up to €100,000, which would include the bulk of the target population, the results are not materially different. The difference increases at higher salaries, but the conclusions set out in pages 6 and 7 of the paper are still supported by the figures calculated on this basis, i.e.

- *The effective rate of relief is lower than the headline rate at all salary levels [at which] individuals are expected to pay tax on some of their pension in retirement.*
- *For persons paying higher-rate income tax, the effective rate of relief falls as salaries increase.*
- *The effective rate of relief is most advantageous for those earning between approximately €33,000 and €50,000, i.e. those earning just above the standard rate cut-off.*
- *[The] attractiveness of making pension contributions will greatly reduce for individuals [if tax relief is restricted to 20%], particularly members who are likely to pay tax at the higher rate in retirement.*

As noted above, references to "the effective rate of relief" are intended to mean "the effective rate of tax relief on contributions".

4.7 As part of the review of the paper, sensitivity tests have been carried out to check if the conclusions would have been different if different assumptions had been adopted. These calculations indicate that the conclusions outlined above would still have been broadly appropriate under alternative assumptions.

4.8 All of the figures set out in this note are based on the circumstances which applied in 2011 and would be different if they were calculated as at November 2017, due to changes in tax and USC rates, allowances and bands, and the level of State Pension. If the figures were to be updated to 2017, it would also be appropriate to review the assumptions adopted for future rates of investment return and inflation, and to allow for updated mortality assumptions.

5. General Comments

5.1 As noted, the 2011 Society paper considered a specific proposed change to the system of pension tax incentives.

5.2 In considering any change, whether that be the specific change in the 2011 National Recovery Plan or any other change, policymakers may have regard to the total value of tax incentives and the Society agrees that the value of tax exemption on investment returns forms part of that value.

5.3 The Society's view, however, is that it would be inappropriate for policymakers to make decisions based solely on the value (or cost to the State) of the incentives and that a key factor also to be considered would be the potential loss to individuals (effectively an impact analysis).

5.4 If tax relief on contributions is reduced, the loss to the individual could comprise not only the direct loss from whatever reduction is applied, but also additional loss due to behavioural changes.

5.5 Depending on the behavioural change, these additional losses could be substantial.

- It is the Society's view, for example, that had the change from marginal to standard rate of tax relief on contributions been introduced in 2011, a substantial number of people could have stopped saving for retirement, thus losing out to an even greater extent.
- Also, if they reduced their aggregate level of saving, they would have lower pensions in retirement, which in some cases could lead to greater demands on State resources in the medium- to long-term.

5.6 The Society's paper did not seek to quantify the additional losses that individuals could have experienced due to behavioural responses, which would have been a complicated exercise to carry out. The paper did, however, highlight the behavioural considerations and indeed the National Recovery Plan itself also acknowledged that behavioural considerations applied.

5.7 The Society's general view is that changes should not be implemented without consideration of the direct and potential indirect additional behavioural losses that could occur, including quantification of such losses as far as possible, e.g. through scenario analysis. Such quantification, for a given scenario, should also take account of the value of tax exemption on investment return as otherwise the potential loss for the individual could be understated.

5.8 The considerations involved are complex, in particular as regards the intended and potential unintended consequences for individuals. The Society's paper in 2011 called for *"a deferral of further changes, and in particular changes on tax relief on contributions, pending a comprehensive and holistic analysis of the various changes currently under consideration"*. We are satisfied this was the correct call to make, given the potentially profound impact of the change being proposed at the time and the complexity of the issue.

November 2017

THE SOCIETY OF ACTUARIES IN IRELAND

Position Paper on the Taxation of Private Pension Provision

November 2011

<u>Position Paper on the Taxation of Private Pension Provision</u>

1 Purpose

The primary purpose of this paper is to examine the effect of reducing the tax relief on pension contributions made by individuals.

Individuals currently receive tax relief at their marginal income tax rate on pension contributions. The National Recovery Plan 2011-2014 proposes to change the tax relief from the individual's marginal tax rate to the standard tax rate of 20% by 2014.

We set out information in this paper on the probable consequences of these changes.

We also set out information on the effects of changes that have already been made to the pensions tax system.

We conclude that the changes that have already been made have had substantial impacts. In light of this, we call for deferral of further changes, and in particular changes to tax relief on contributions, pending a comprehensive and holistic analysis of the various changes currently under consideration. We believe that this is critically important in order to arrive at a pensions framework that will be sustainable over the long-term and that will encourage people to make adequate provision for their retirement.

2 Contents

To ensure a holistic view of the topic, the paper includes the following sections:

- Background: National Recovery Plan & pensions
- The current pensions environment
  - *Three pillars of pensions*
  - *Tax regime*
  - *Recent changes to tax reliefs*
  - *Impacts of recent changes*
  - *"True" effective rate of relief*
- Impact of proposed changes to tax relief on pension contributions
- Alternatives
- Conclusion

3 Queries

Please direct any queries on this paper to Ms. Yvonne Lynch, Director of Professional Affairs, at the contact details at the end of the paper.

4 Background: National Recovery Plan & pensions

The National Recovery Plan 2011-2014 set out a number of measures for pensions which are aimed at targeting savings of €940 million in a full year. The Government indicated that it is willing to engage with the pensions industry to examine alternatives to deliver this outcome.

A number of measures have already been implemented in 2011 which have achieved savings of €293 million, ahead of the target for 2011 of €260 million. Further savings of well over €100 million have been achieved due to a fall-off in contributions. These combined savings will recur in 2012, which means that the measures already implemented will deliver a significant part of the €485 million target for 2012.

According to the National Recovery Plan, the remaining yearly savings are due to be achieved by reducing the maximum relief available on employees' pension contributions from the marginal rate of income tax to the standard rate on a phased basis, i.e. (for higher rate tax payers) from 41% to 34% in 2012, from 34% to 27% in 2013 and from 27% to 20% in 2014.

However, as noted above, the savings achieved to date are ahead of target, and we suggest that this allows some time to review alternatives before proceeding with further reductions in tax relief.

Before considering the change from the marginal rate to the standard rate, it is important to review the role of tax relief on contributions within the pension environment. We turn to this topic in the next section.

5 The current pensions environment

Three pillars of pensions

A pension system can be defined by three pillars, as follows:

- Pillar 1 – public pension financed by government on a pay as you go basis and typically a flat subsistence amount
- Pillar 2 – private occupational pensions involving employers and employees which are normally pre-funded and earnings-related
- Pillar 3 - voluntary retirement savings.

The Melbourne Mercer Global Pension Index report for 2011[4] concluded that the best pensions systems adopt multi-pillar approaches to spread the long-term risks and costs of retirement provision between governments, employers and individuals.

In Ireland, the government meets Pillar 1 by providing a State Pension to individuals and the maximum pension is currently €11,976 per annum. Pillar 2 is provided by the private sector, with many employers setting up pension schemes for their employees. These are generally funded by a combination of employer and employee contributions. Pillar 3 is typically met by additional voluntary contributions from employees and the self-employed.

It is worth noting that only 50% of the working population in Ireland are members of a pension arrangement and that only about 40% of those in the private sector have a pension arrangement.

Tax relief favours retirement saving and encourages individuals and their employers to make provision for retirement. This effectively underpins Pillars 2 and 3. Pillar 1 cannot be expected to provide adequate retirement benefits for all and hence encouraging Pillars 2 and 3 is critical to help individuals maintain their living standards in retirement. This point is of particular relevance to the significant number of people in relatively low quality defined contribution schemes who are highly reliant on additional personal saving through AVCs if they wish to generate adequate pension benefits at retirement.

Tax regime

In common with many other OECD countries, the Irish tax regime is referred to as EET:

- Contributions are ”Exempt” from tax
- Investment return is “Exempt” from tax
- Pension income is “Taxed”.

[4] See http://www.mercer.com/articles/1359260.

The only deviation is that retirees can take part of their benefits at retirement in the form of a tax free lump sum up to certain limits (normally 1.5 times salary) with an overall monetary cap of €200,000.

It is widely accepted that tax reliefs to encourage supplementary pension provision are not a ‘cost’ in the true sense of the word in that they represent tax deferred rather than tax foregone.

Recent changes to tax reliefs

There have been a number of changes to the tax environment for pensions over the last few years to restrict the reliefs available to high earners. Further measures were taken in 2011 as part of the National Recovery Plan and are set out below.

- Maximum value of a pension reduced to €2.3 million (previously €5.4 million), which equates to a pension of €115,000 p.a.
- Tax free lump sum capped at €200,000 (previously €1.3 million)
- Earnings limit for individual contributions eligible for tax relief reduced to €115,000 (€150,000 in 2010 and previously €275,000)
- Individual contributions do not attract relief from PRSI and health contribution (now part of universal social charge)
- Employer PRSI relief on employee contributions halved.

In addition, a pension levy equal to 0.6% of pension fund assets for each year between 2011 and 2014 was introduced in June 2011. To date in 2011, this has raised €460m. This is in addition to the savings targeted under the National Recovery Plan, which brings the total savings to date to more than €850 million from pension assets of approximately €76 billion.

Impact of recent changes

The confidence of the various stakeholders (Trustees, employers and members) to deliver retirement benefits in the future has been reduced by the current economic climate. This has been further impacted by the pension levy. While employers may cover the cost of the levy in some cases, in other cases pension scheme members will suffer a reduction in their benefits. This is particularly significant for members close to retirement and pensioners who cannot make alternative provision.

In addition, every contributing member has been impacted by the withdrawal of PRSI and the health contribution relief (now included in the universal social charge) from individual pension contributions. This has resulted in an increased cost to members of making contributions. Table 1 overleaf sets out the impact on an individual’s take-home pay for a range of salaries and assumes a single member is paying 5% of salary to a pension scheme.

Table 1

Salary	Annual Contribution	Standard / Higher rate tax	Relief in 2010	Relief in 2011	Impact on take home pay
€20,000	€1,000	Standard	€280	€200	(€80)
€30,000	€1,500	Standard	€420	€300	(€120)
€40,000	€2,000	Higher	€960	€820	(€140)
€50,000	€2,500	Higher	€1,225	€1,025	(€200)
€75,000	€3,750	Higher	€1,837	€1,537	(€300)
€100,000	€5,000	Higher	€2,300	€2,050	(€250)
€200,000	€10,000	Higher	€4,600	€4,100	(€500)

The other changes made in 2011 (reduction in maximum value of pension, reduced cap on tax free lump sum etc) impacted a relatively small number of people. However, these changes can reasonably be expected to have had a proportionately larger impact on total contributions paid (as evidenced by declines in pension premiums written by insurance companies, for example) and hence on the amount of tax relief granted. This is helping to redistribute the total quantum of tax relief to those on average earnings away from high earners.

"True" rate of tax relief

As mentioned earlier, it is widely accepted that tax reliefs on an individual's pension contributions to encourage supplementary pension provision are not a 'cost' in the true sense of the word in that they represent tax deferred rather than tax foregone. A true assessment of the cost would be the value of these reliefs less the present value of the future additional tax income.

Previous work was carried out on this topic by Milliman in 2008 *(source: IAPF Green Paper response, May 2008)*. This expressed the present value of net reliefs (i.e. offsetting the stream of projected future tax revenues against the stream of projected future reliefs and taking the present value of the projected net relief/revenue in each future year) as a percentage of projected contributions to derive the 'net effective rate of tax relief'. This measure captures the tax revenues which will accrue in the future in return for the reliefs granted and is thus a better measure than the headline rate of relief.

We have updated the calculation of the 'net effective rate of tax relief' following the recent changes to the taxation of pensions outlined earlier (i.e. withdrawal of relief for PRSI and health contribution) and changes to the taxation bands and credits. The results for a 40 year old single individual contributing 5% of salary to a pension with a further 10% being paid by the employer are set out in Table 2 overleaf. The detailed assumptions are set out in the Appendix.

Table 2

Salary	Headline rate of tax relief	Net effective rate of tax relief
€20,000	20%	18%
€30,000	20%	17%
€40,000	41%	34%
€50,000	41%	32%
€75,000	41%	27%
€100,000	41%	23%
€150,000	41%	10%
€200,000	41%	2%

The following observations can be made from Table 2:

- The effective rate of relief is lower than the headline rate at all salary levels as individuals are expected to pay tax on some of their pension in retirement.
- For persons paying higher-rate income tax, the effective rate of relief falls as salaries increase.
- The effective rate of relief is most advantageous for those earning between approximately €33,000 and €50,000, i.e. those earning just above the standard rate cut-off.

It is worth considering the level of pension and lump sum that individuals earning between €33,000 and €50,000 may expect at retirement, for a given contribution rate. Assuming a contribution rate of 15% of salary per annum, a 40 year old single individual may expect to receive on retirement at, say, age 65:

- A pension of 24% of salary at retirement ("final salary"); or
- A lump sum of 1.5 times final salary and a pension of 16% of final salary.

The State pension will be payable at age 68 and will represent in the region of 19% to 28% of the salary at retirement, assuming that the State pension increases in line with inflation in the future. In total, therefore, if no lump sum is taken, the individual may expect to receive a pension, inclusive of the State pension, in the region of 43% to 52% of salary.

6 Impact of proposed changes to tax relief on pension contributions

So, what impact will a reduction in tax relief on member contributions to the standard rate have?

Table 3 below sets out the 'net effective rate of tax relief' if this change is made.

Table 3

Salary	Headline rate of tax relief	Net effective rate of tax relief
€20,000	20%	18%
€30,000	20%	17%
€40,000	20%	13%
€50,000	20%	11%
€75,000	20%	6%
€100,000	20%	2%
€150,000	20%	-11%
€200,000	20%	-19%

The proposed change will have no impact for individuals on the standard rate. However, it is worth noting the following in relation to the potential impact on higher rate tax payers:

- Attractiveness of making pension contributions will greatly reduce for individuals, particularly members who are likely to pay tax at the higher rate in retirement. Unlike benefits from other savings products (where tax applies only to investment returns[5]), benefits from pension products in excess of tax free lump sums at retirement are fully taxable at income tax rates. Therefore, it would not make sense to make a contribution that attracts 20% tax relief, only to be taxed on the corresponding benefit at a much higher rate.
- Individuals are not likely to target a pension fund beyond that which would result in them paying tax in retirement at the standard rate. There could be significant impacts on pension savings in the near-term, and on pensions adequacy in the longer-term, as individuals who already have accumulated funds cease or reduce their contributions.
- Certain high earners will realign remuneration packages so that the company pays higher contributions for them.
- Recent changes to the pensions framework, and the introduction of a levy on pension funds, have dented confidence in saving on a long-term basis under this framework. Confidence will be dented further if tax relief is reduced.

[5] How tax is applied to investment returns varies across different savings products. For example, under life assurance savings policies and mutual fund investments, the investment funds accumulate gross of tax and benefits in excess of contributions paid are taxed on exit, with deemed disposals applying every 8 years on long-term investments.

Overall, one would expect the number of individuals in pension schemes to reduce. If members stop contributing, there will be lower pensions from Pillar 2 and Pillar 3 and hence greater reliance on Pillar 1 to provide adequate income in retirement.

7 Alternatives

If tax relief on pension contributions is to be maintained into the future at an individual's marginal rate, then alternative measures will have to be taken to achieve savings for the National Recovery Plan. These could include some or all of the following:

- On a "once off" basis, allow members to access part or all of their Additional Voluntary Contributions (AVCs) before retirement and pay tax on the value refunded. Currently, members may access their AVCs only at retirement. This could be a temporary initiative to raise tax that could form part of the National Recovery Plan.

  Further thought would need to be given to the details involved. In particular, careful consideration should be given to the tax rate that would apply on early drawdown and also any limits or restrictions on the amount of AVCs that may be accessed. Such limits could be set at a fixed nominal amount or as a percentage of the AVC fund or perhaps as a combination of both these approaches.

- The Programme for Government proposes a maximum pension of €60,000 per annum, which would equate to a maximum value of pension of €1.2 million using the conversion factor of 20 currently used for this purpose (though a conversion factor of closer to 25 is probably more realistic). We note too from recent ministerial statements that this change is under very active consideration.

  This would further reduce the scope for high earners to pay contributions and hence would reduce the cost of tax relief as contributions decline. In fact, a 25 year old on a salary of €41,000 would reach the maximum pension value of €1.2 million at age 65 with contributions of 15% of salary, if the maximum pension value of €1.2 million is not indexed and does not increase in future. At higher salaries, the required contribution rate for the maximum benefit would be lower. Note, however, that we would not advocate omitting index-linking of the maximum pension, as there could be serious consequences for adequacy of private pension provision.

  Further analysis would be required to quantify the financial impact of this change on tax revenue, and on the adequacy of private pensions, now and into the future. Note that the adequacy of pensions could suffer if there is a lack of alignment between the threshold pension and tax relief on contributions – as discussed earlier, it does not make sense to continue paying contributions into a pension fund if the benefits derived from further contributions will ultimately be taxed at a higher rate than the tax relief on the contributions.

  Further analysis would also be required if other reliefs and benefits were to be reduced further - e.g. if the tax free lump sum of €200,000 or the earnings limit of €115,000 was reduced, or if a maximum annual contribution (including employer contribution) per person was introduced. Consequences could include unanticipated behavioural changes resulting from a loss of confidence in the stability of the framework applicable to private pensions provision.

8 Conclusion

The private sector represents a critical component in Ireland's pension system, as the public pillar cannot be expected to provide adequate benefits for all over the longer term.

Therefore, one of the features that will help promote the adequacy of a system is the incentive provided by government to encourage middle income earners to save for their retirement. The best retirement income systems provide tax incentives to encourage middle income earners to make contributions to pension plans.

If these incentives are reduced to such an extent that individuals do not consider it worthwhile committing to long term savings within a pension arrangement, then it is inevitable that the proportion of the working population in pension arrangements will fall from the current level of approximately 50%. This means that over half of the population will be reliant on the State pension (currently €11,976) in retirement.

Clearly, this is contrary to the government's policy of supporting a sustainable pensions system that will provide adequate and reliable pensions for retired and older people and that achieves wide coverage *(source: Pensions Board strategy 2011-2015, published September 2011)*.

A holistic view of the pension system must be taken when making decisions on future pension policy, including the decision on whether to retain tax relief on pension contributions at the individual's marginal income tax rate.

So, in summary:

- We suggest that there should be no further reductions in employee tax relief on contributions, as this would undermine long term pension coverage and adequacy.

- If the Programme for Government proposal to limit maximum lifetime pensions to €60,000pa is enacted, this measure will, in time, result in a material and sustained reduction in the "cost" of pension tax reliefs[6]. If this proposal proceeds, we strongly urge that the cap be linked to earnings inflation; otherwise, there will be very damaging consequences over time in terms of the adequacy of private pensions provision.

- In this context, the short-term National Recovery Plan gap in 2013 and 2014 could be filled by an emergency measure, such as allowing pension scheme members to access, on a "once off" basis, part or all of their AVCs. This, or any other initiative aimed at addressing the gap in the short-term, would need to be fully thought through before being implemented. A short-term initiative such as this would allow time for more fundamental long-term reform of the pensions system to be properly assessed and implemented.

- We propose that, to allow time for alternative measures to be assessed, the "clock should be stopped" on further pension tax change in 2012, given that the National Recovery Plan targets will be substantially met from measures that have already been implemented.

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[6] Note: Work is currently under way to quantify the long term financial impact of this change.

Appendix – Assumptions

The following assumptions were used in the calculations in this paper:

Retirement Age	65
Salary inflation	3% per annum
Fund growth (net of charges)	5% per annum
Discount rate	3% per annum
Inflation	2% per annum
Employee contribution rate	5% of Salary
Employer contribution rate	10% of Salary
Tax on fund growth	0%
Tax free lump sum	1.5 times salary subject to monetary limit of €200,000
Annuity rate at retirement	5%
Standard tax rate	20%
Higher tax rate	41%
2011	
Tax band	€32,800
PRSI/health contribution	8% up to €75,036 and 5% above
2010	
Tax band	€36,400
PRSI/health contribution	N/A
Universal Social Charge	2% up to €10,036, 4% on next €5,980 and 7% on balance
State pension	€11,976 per annum

In addition, as age tax credits are being phased out, we have made no allowance for them in calculating tax on retirement income.

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