

Pension Taxation Issues

1. Introduction

- 1.1.** The overall objectives of our pension policy are to provide a basic standard of living in retirement through direct state supports (the Social Welfare or State pension) and to encourage people to make private pension provision to supplement the State pension with a view to providing for a pension that takes some cognisance of pre-retirement earning levels.

- 1.2.** Over half of people in employment are covered by supplementary or private pension arrangements, including close to 850,000 private and public sector employees in occupational pension schemes. There is also, however, a significant proportion of the workforce that currently make no supplementary pension provision. The pensions industry in Ireland is estimated to employ between ten and fifteen thousand people and has responsibility for private pension fund assets of over €80 billion.

- 1.3.** The State encourages individuals to supplement the State pension with private pension arrangements by offering tax reliefs on private pension provision. These tax relief arrangements have encouraged a significant proportion of the workforce to invest in supplementary pensions for their retirement.

- 1.4.** Pension saving by its nature is a long term investment which is best facilitated by a long term stable pension policy (including tax and other policies). The scale of tax and other reliefs available for pension saving has been subject to significant restrictions in recent years as the State has sought to respond to the fiscal and other problems facing it and to concerns that the benefits derived in certain circumstances from the reliefs provided may be excessive. Private sector sources (xxxxxxxxxxxxxxxxxxxxxxxxxxxx) estimate that contributions to pension plans such as Retirement Annuity Contracts may have fallen by over 12% since the beginning of 2010 while it is estimated that contributions to occupational pension schemes have fallen by about 5% in the same period. Clearly, the economic downturn will have impacted on the confidence and ability of individuals to invest in pension savings. However, it also appears that the restrictions in reliefs, together with the prospect of future curtailments, has also had some impact on the public's confidence in pension investment.

2. Cost of tax relief

2.1. The estimated net cost of tax and various other reliefs on private pension provision can change from year to year, depending on variables such as the levels of individual/employer pension contributions made and the accrued returns on pension fund investment. The latest year for which the most up-to-date estimates are available is 2008 and the net estimated cost for that year amounts to over €2.4 billion.

2.2. The table at Appendix 1 to this paper sets out the detail of the estimated net cost of €2.4 billion for 2008. It represents an update of the table included at paragraph 7.33 of the Green Paper on Pensions published in 2007 which indicated a net cost figure of about €3bn for 2006 and which has attracted much comment since its publication. Less attention was paid to the content of paragraph 7.34 of the Green Paper which cautioned against placing too much reliance on the headline figures. Paragraph 7.34 is repeated at Appendix 2. The debate on the cost of pension tax relief can be misleading and often creates a false impression of the potential for real cost savings or tax yields that may be delivered by way of significant adjustment to some of these reliefs. Among other impacts, of course, would be the significantly reduced level of investment in pensions that would likely take place in the absence of reliefs.

3. Changes in tax reliefs and commitments in the EU/IMF agreement

3.1. The agreement reached with the EU/IMF in 2011 included implicit commitments to deliver full year savings of €940m in tax relief in the broad pension area in the period to 2014.

3.2. Budget and Finance Act 2011 contained measures estimated to deliver about €290m of savings in this area (in full year terms). The measures included:

- Removal of employee PRSI relief and the application of the USC to employee pension contributions.
- Removal of employee PRSI relief and the application of the USC to the public service pension-related deduction.
- Reduction by 50% in employer PRSI relief on employee pension contributions.
- Reduction in the annual earnings limit for determining maximum allowable pension contributions for pension purposes from €150,000 to €115,000 per annum.
- Reduction in the maximum allowable pension fund on retirement to €2.3 million from 7 December 2010

- Increase from 3% to 5% in the annual imputed distribution applying to the value of Approved Retirement Fund (ARF) assets.
- Reduction in the lifetime limit of tax-free retirement lump sums to €200,000 with tax applying to amounts in excess of this amount on a staged basis.

- 3.3.** In addition to these measures, Finance (No 2) Act 2011 introduced the pension fund levy which raised over €460 million. **When taken with the Budget 2011 measures, it means a total policy adjustment of €750 million has been made in 2011.** This is equivalent to 32% of the estimated net cost of pension reliefs in 2008.
- 3.4.** Among the revenue raising measures included in the EU/IMF agreement to deliver €1.5 billion in 2012 is a commitment to further reductions in pension tax reliefs. Specifically, this would involve the first step towards standardising pension tax relief at 20% by reducing relief from 41% to 34% on employee/individual contributions to pension savings and on the public service pension-related deduction. These changes are estimated to deliver savings of €155m in 2012 and €225m in a full year. Similar savings would arise in 2013 and 2014 from the further gradual reduction in relief from 34% to the standard 20% rate.
- 3.5.** However, the Minister for Finance made a commitment to examine the potential for alternative savings to standard rating tax reliefs in this area, in the context of the outcome of the Comprehensive Review of Expenditure. Moreover, there are very significant IT developments, logistical and administrative problems to be overcome for the Revenue Commissioners and others in delivering the tax relief changes in this area and these could not now be dealt with in time for 2012 even if it were decided now to proceed with the move towards the standard rating of tax relief.
- 3.6.** Given the imposition earlier this year of the temporary 0.6% stamp duty levy on pension fund assets to pay for the Jobs Initiative, a move to standard rating of tax relief on contributions, in addition to the levy, could have a significant negative impact on the pensions industry. As the most important fiscal incentive to encouraging pension saving, a reduction of this scale would also represent a major setback to the objective of improving the adequacy and coverage of private pension provision.
- 3.7.** Even if alternatives to standard rating tax reliefs are found elsewhere in the tax system or in expenditure savings, other less fundamental changes in the general pensions tax area could be considered with a view to yielding tax savings in the future or to improving the equity of the existing arrangements. These various potential changes are dealt with hereunder.

3.8. However, further restrictions in certain areas (e.g. the maximum allowable pension fund – SFT) may require a reappraisal of the methodology for delivering on certain objectives. Tax and other changes which affect pension provision can have impacts which often are only fully appreciated in hindsight. Given the scope for possible unintended or unexpected consequences of significant policy change, in particular where the impacts may arise for increasing numbers of individuals, some form of pre-consultative process might be useful. This might involve, for major changes in particular, a consultation process over a specified period with other Departments and interested parties which would allow for the significant (and perhaps unintended) impacts of proposed changes to be recognised and where possible catered for in advance of any subsequent legislative change and for alternative proposals to be considered. This approach to major change might also help manage concerns about the stability and sustainability of pension policy over the long term. In this regard, it is noted that the Minister for Social Protection has been reported to have recently announced the establishment of a Commission on Pensions for this purpose.

4. Consideration of scope for further changes in reliefs and thresholds.

4.1. Employer PRSI relief on employee pension contributions: Employers are required to pay PRSI contributions for all employees aged 16 and over. The rate of employer PRSI contribution is 10.75% on employee weekly earnings of over €356 (c.€18,500 per annum).

4.2. Where an employee makes contributions to a pension scheme, the employer's PRSI is calculated on the employee's earnings net of those contributions under the existing "net pay" arrangements (under which employee pension contributions are deducted from gross pay before the application of income tax) The employer therefore makes a PRSI saving on the pension contributions made by the employee and the relief only arises because of the way tax relief on pension contributions is delivered.

4.3. Budget and Finance Act 2011 reduced the rate of employer PRSI relief on employee pension contributions by 50%. The removal of the remaining relief would yield about €90 million in a full year. This measure would, however, increase payroll costs for employers currently benefiting from the relief

4.4. Annual earnings limit and related issues: The annual earnings cap for tax-relieved pension contributions stands at €115,000 and acts, in conjunction with age-related percentage limits of annual earnings, to put a ceiling on the annual amount of tax relievable pension contributions an individual taxpayer can make in any year. The details of the age-related limits are set out at Appendix 3. The age-related limits increase with age going from 15% of earnings for individuals under 30 to 40% of earnings for those aged 60 and over.

- 4.5.** The annual earnings cap stood at €275,239 for the 2008 tax year, it was reduced to €150,000 in 2009 and to its current level of €115,000 for 2011 in Budget and Finance Act 2011. The reduced level of the annual earnings cap and its interaction with the age-related percentage limits impacts, in particular, on higher earners and a further reduction in the level of the cap would further improve the equity of the existing tax relief arrangements. A reduction from €115,000 to €100,000, for example, would yield about €30 million in a full year.
- 4.6.** The annual earnings cap and age-related percentage limits apply to all contributions (by employee and/or employer) made to personal pension plan arrangements such as Retirement Annuity Contracts (RACs)¹ and employer sponsored Personal Retirement Savings Accounts (PRSAs) but do not apply to employer contributions to occupational pension schemes. Reductions in the earnings cap can therefore be circumvented where employer contributions to such schemes can be used to “top-up” employee contributions by those in a position to do so.
- 4.7.** The rationale for the differing treatments of employer contributions is that contribution-based controls have historically applied in the case of RACs and PRSAs, while controls based on benefit limits apply in the case of occupational pension schemes. The main control that applies to such schemes is that the maximum retirement benefit that can be funded for a scheme member cannot exceed two-thirds of the individual’s final remuneration. In order to reduce the level of abuse of arrangements using employer contributions (primarily in the context of proprietary directors and favoured highly paid executives), Finance Act 2006 introduced a separate maximum life-time pension tax-relieved fund limit (the Standard Fund Threshold). The SFT stands at €2.3 million (reduced from over €5.4 million in Budget/Finance Act 2011) and has general application.
- 4.8.** One of the main arguments advanced against including employer contributions to occupational pension schemes within the annual earnings cap and age-related limits is that it would effectively remove the ability of certain individuals (primarily proprietary directors of companies) to fund for maximum retirement benefits over relatively short periods as allowed by pension tax rules². It is

¹RACs have been used mostly by the self-employed, so that employer contributions would not normally arise.

² Under current rules the maximum pension that an individual can receive at normal retirement age is a pension of two thirds of final remuneration. The rules envisage this accruing over a period of 40 years service with the same employer at the rate of 1/60th of final remuneration for each year of service. This is known as the “strict 1/60th basis”. However it is possible to qualify for this maximum benefit over a shorter period under what is known as the “uplifted scale”. Under this approach an individual can, starting not less than 10 years from normal retirement age, fund for the maximum pension of 2/3rds of final remuneration. In the same way, the maximum lump sum that can be taken on retirement at normal retirement age through commutation of pension is an amount equal to one and a half times final remuneration, accrued at the rate of 3/80ths of final remuneration for each year of service over 40 years. Under the “uplifted scale” this maximum lump sum can be attained where the employee has 20 years service with the current employer at retirement.

argued that such individuals leave the funding of their pensions until late in their careers, concentrating earlier on investing in and the building up their companies. However, these individuals are also in a position to tailor their remuneration package and the level of employer contributions to maximise pension benefits under the existing regime. In addition, the Revenue Commissioners are increasingly coming across instances where professionals are “employing” close family members and making significant pension contributions as employer on their behalf with the aim of circumventing the restrictions on the annual earnings limit and the impact of the lower standard fund threshold that applies to their personal pension provision.

- 4.9.** There is a case, in equity, for incorporating employer contributions to occupational pension schemes within the annual earnings cap and age-related percentage limits which apply to employee and individual contributions to pension saving, generally, or to apply separate limits to employer contributions. However, aside from the immediate logistical and implementation issues, there are a number of matters in this area which would need to be considered in more detail. Firstly, the Revenue Commissioners’ approval of retirement benefit schemes requires an employer contribution to the scheme which must be meaningful in terms of the benefits to be delivered under the scheme. Placing a limit on employer contributions could have implications for deficit reduction of schemes and could have implications for pensions legislation in that schemes are required to reach a minimum level of funding. A limit could also affect proper funding of very ordinary employee schemes that rely heavily on employer contributions.
- 4.10. Standard Fund Threshold issues:** Budget and Finance Act 2006 introduced a maximum allowable pension fund on retirement for tax purposes. An initial **Standard Fund Threshold (SFT)** limit of €5 million was placed on the total capital value of pension benefits that an individual can draw upon in their lifetime from tax-relieved pension arrangements. A higher limit (known as the Personal Fund Threshold –PFT) was introduced at the time for those individuals whose pension fund values exceeded the SFT on the date the SFT was introduced (7th December 2005) on the grounds that those individuals had built up those funds in good faith over the years using the tax reliefs available at that time.
- 4.11.** At that time some 115 individuals were granted PFTs following application to the Revenue Commissioners.
- 4.12.** Finance Act 2006 also introduced indexation for both the SFT and PFT from 2007 onwards in line with an earnings factor to be designated by the Minister for Finance each December. As a result, the value of the SFT over the period to
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2008 was increased to over €5.4 million. No indexation of the SFT or PFT was undertaken for 2009, 2010 or 2011.

- 4.13.** On each occasion that an individual becomes entitled to receive a benefit under a pension arrangement, that individual uses up part of their SFT or PFT. Where the capital value of the aggregate of such benefits exceeds the SFT or PFT, a “chargeable excess” arises equal to the amount by which the threshold is exceeded which is subject to an upfront income tax charge at 41%. This charge is without prejudice to any other income tax charge that might arise on the balance of the chargeable excess as and when benefits are actually taken under the scheme. The effective tax rate (leaving aside other charges) that might therefore apply to a chargeable excess could potentially amount to over 65%.
- 4.14.** The 2009 Report of the Commission on Taxation recommended that there should be a correlation between the annual earnings limit for pension contribution purposes and the SFT and that “the reduction in the annual earnings limit [see 4.5 above] suggests that there should be a corresponding reduction in the standard fund threshold”.
- 4.15.** Budget and Finance Act 2011 reduced the SFT to €2.3 million with effect from 7 December 2010, a reduction in line with the scale of the reduction applied since 2009 to the annual earnings limit for pension contributions purposes. In line with the arrangements when the SFT was first introduced, individuals the capital value of whose crystallised pension rights since 7 December 2005 and uncrystallised pension rights as at 7 December 2010 exceeded the reduced SFT, could protect those rights by applying to Revenue for a PFT before 7 June 2011. About 1,200 applications for PFTs have been received and over 660 of those have been approved representing total pension funds valued at about €2.1 billion (an average PFT of about €3.2 million) The legislation allows for late notification of PFTs and due to administrative delays concerning the inclusion of certain entitlements in PFT calculations, several hundred more PFT applications are likely to be made before year end.
- 4.16.** The recent reduction in the SFT has exposed certain fault lines in the efficiency and effectiveness of the operation of the SFT/PFT limits as between the private sector and the public service.
- 4.17.** The limits appear to operate as intended in the private sector to deter the over-funding of retirement benefits through the tax system. Members of Defined Contribution schemes (almost exclusively private sector) can stop contributing to their pension “pots” so as to avoid exceeding the relevant threshold and suffering a penal tax charge on the chargeable excess. Members of Defined Benefit (DB) schemes in the private sector can arrange with the employer sponsor of the pension scheme to stop accruing benefits for the same reason. In such situations, individuals are likely to seek compensating (taxable) remuneration or replacement tax efficient remuneration (such as share options

or share awards) in lieu of future employer contributions towards or future accrual of retirement benefits.

- 4.18.** Pension schemes in the public service are almost exclusively DB and members of such schemes are not permitted to opt out. Furthermore, the Department of Public Expenditure and Reform is opposed to any suggestion of allowing opt-outs. That Department considers that opt-outs are not appropriate because there would be considerable pressure for compensation or exemption from the pension-related deduction. It takes the view that, in the longer run, if significant numbers of staff were to opt out and found, on retirement, that their pension income was insufficient there would inevitably be demands for the Government to make special pension provision. Moreover, compensatory pay enhancements, as may occur in the private sector, would not be countenanced. For higher earners in the public service the capital value of whose retirement benefits may be close to the reduced SFT or who applied for a PFT to protect entitlements valued above the SFT as at 7 December 2010, they will continue to accrue retirement benefits (unless they resign or retire). Such accrued public service pension benefits will turn exclusively into a chargeable excess liable to a penal tax rate due immediately on retirement. Unlike in the private sector, such individuals who wish to continue serving can exercise no control over this accrual.
- 4.19.** The situation can also have significant impacts on individuals who are recent entrants into a public service career having worked in the private sector where they have legitimately built up personal pension savings close to or above the recently reduced SFT. Members of the judiciary and medical consultants come into this latter category. The current arrangements mean that such individuals must be members of a public service pension scheme on joining the service through which they will also accrue benefits over which they will have no control and which will exceed the SFT or their PFT giving rise to a chargeable excess. Simply by continuing to work, this chargeable excess can build up over time resulting in a very significant tax liability, which liability will have to be met at the point of retirement. The tax liability could, for example, result in the appropriation of the entire public service retirement lump sum and part of the public service pension entitlement. It is being claimed that this situation is acting to push individuals in certain professions out of the public service and will act as a barrier to the future recruitment of the “best quality” individuals into the public service from the private sector. The issues involved are being examined.
- 4.20.** These developments point to the fact that the use of the SFT as a means of capping or controlling the value of retirement benefits payable to individuals may only be effective up to a point, particularly in a public service context, after which further reductions in the limit might render the use of the SFT as unwieldy at best.

- 4.21.** The Programme for Government contains a commitment to “cap taxpayer subsidies for all future pension schemes....that deliver income in retirement of more than €60,000”. If the SFT were to be used as the mechanism to deliver this commitment then, depending on the approach taken to valuing retirement benefits, the limit may have to be reduced from €2.3 million to about €1.4 million. Apart from the significantly greater level of administrative complexity involved in dealing, for example, with many thousands more PFT applications (assuming, as before, the provision of protection to benefits above the reduced SFT), the difficulties created by the operation of the SFT in a public service context as outlined above will become significantly more pronounced.
- 4.22.** Another way of interpreting the commitment in the Programme for Government would be to say that pension arrangements should not provide for a pension of greater than €60,000 per annum. This might be achieved more directly and efficiently, particularly in a public service context, by providing for such an annual pension cap in public service pension schemes by way of legislative and other changes. This would primarily be a matter for the Department of Public Expenditure and Reform. That Department has queries about the nature of the €60,000 pension cap and suggests that how it might be implemented would need to be carefully considered. Any possible changes in this area would have to take account of the separate pension savings of individuals joining the public service from the private sector in the context of the broader application of the SFT to cover the maximum allowable pension fund for tax purposes as between the private and public sector. The points made at 3.8 above have some relevance in this general area.
- 4.23.** By way of indication of the numbers of civil and public servants that may be on pensions over €60,000 per annum, responses to Parliamentary Questions put to various Ministers on 4 October 2011 relating to pensions across various specified ranges, suggested that about 1,800 public and civil servants were on pensions of between €50,000 and €70,000 and above. The figures did not include retired officials of local authorities or of certain commercial and non-commercial state bodies the data on which was undertaken to be supplied separately. The figure of 1,800 also includes those currently on pensions of over €50,000 and for these various reasons are therefore not definitive or exhaustive but may give some initial idea of the numbers that may be affected across the public service.
- 4.24. Notional Distributions from Approved Retirement Funds (ARFs):** Budget and Finance Act 2006 introduced an imputed or notional distribution of 3% of the value of the assets of an ARF on 31 December each year, where the notional amount will be taxed at the ARF owner’s marginal income tax rate. The regime applies to ARFs created on or after 6 April 2000 where the ARF owner is aged 60 or over. Funds actually drawn down by ARF owners are credited against the imputed distribution in that year to arrive at a net imputed amount, if any, for the year. The notional distribution arrangements do not apply to Approved

Minimum Retirement Funds (AMRFs), the capital in which is generally not accessible to their owners until age 75 at which point AMRFs become ARFs.

- 4.25.** The notional distribution measure was introduced because the internal review of tax relief for pensions provision undertaken by this Department and the Revenue Commissioners in 2005 (and published in early 2006) found that the ARF option was largely not being used to fund an income stream in retirement but was instead being used to build up funds in a tax-free environment over the long-term and presumably for inheritance planning purposes.
- 4.26.** The measure is designed to encourage draw downs from ARFs so that they are used, as intended, to fund a stream of income for use in retirement in the same way as a retirement annuity, for which ARFs were supposed to operate as a more flexible alternative. The level of the imputed distribution was increased from 3% to 5% in Budget and Finance Act 2011. The measure, in itself, does not give rise to significant tax revenues as it does not apply to actual draw downs which are taxed in the normal way. The change from 3% to 5% is expected to yield €5 million in a full year. For 2009, about €7 million was paid over to the Revenue Commissioners in respect of tax on notional distributions in relation to over 2,600 ARFs.
- 4.27.** In the context of the introduction earlier this year of the 0.6% stamp duty levy on pension fund assets to pay for the Jobs Initiative, there were calls for the levy to be applied to ARF assets. The levy does not apply to ARFs as they are not pension funds as such but, in common with annuity payments, are more akin to pensions in payment the draw downs from which are taxable at marginal income tax rates. On foot of issues raised in the course of the Dail Debate on the levy, the Minister for Finance stated that he intended “to examine as part of my preparations for Budget 2012 in December next how best to increase the percentage notional distribution for higher value ARFs while ensuring that more modest ARFs are protected. It is not true to state that ARFs are only availed of by wealthy people. Many people have ARFs with modest amounts in them and they are modest savers.”
- 4.28.** Data informally obtained from the private sector (xxxxxxx) indicates that the value of assets in ARFs may currently be of the order of €6 billion (which would also include AMRFs which are not separately identifiable in the data). We do not yet have any data on the numbers of ARFs held or on the numbers and values of higher-value ARFs. This matter is being pursued to see if this data can be provided.
- 4.29.** Increasing the percentage notional distribution for ARFs generally, and for those of modest value in particular, beyond the current 5% of the value of ARF assets would increase the risk that such ARF owners’ funds could be depleted before death. While the legislation imposing the notional distribution does not require that the assets be taken out of ARFs, only that tax be paid at the owner’s

marginal income tax rate on 5% of the asset values at year-end (excluding actual withdrawals in the year), it should be expected that individuals, in general, would act rationally as the measure encourages them to and withdraw funds up to the percentage required. Leaving assets subject to the notional distribution in an ARF would mean that the after tax value of those assets would be taxed again in the future. Indeed most Qualifying Fund Managers require ARF owners to withdraw at least 5% of their ARF's asset value each year to avoid the administrative burden of calculating and accounting for tax on a "notional distribution".

- 4.30.** Increasing the percentage notional distribution for higher value ARFs only (say where the value of ARFs owned in aggregate exceed €2 million) may have less impact in terms of the depletion of funds required by such ARF owners to cater for their ongoing needs over the period of their retirement. On the assumption that individuals will withdraw funds up to the level of an increased notional distribution, the owners of such ARFs could, on an ongoing basis, place any excess moneys from actual ARF withdrawals made up to the level of an increased notional distribution (and over the income needed to fund their day to day retirement needs) into other savings products (albeit that such savings may be less tax-efficient than ARFs). The owners of such ARFs would argue, nevertheless, that a significant increase in the notional distribution percentage acts against the basic concept of the ARF as a stream of income to fund the potential entirety of their retirement and that, no less than for ARFs of modest value, a significant increase in the notional distribution could lead to the depletion of those funds before the death of the ARF owner. This matter continues to be examined.
- 4.31.** If the main concern, however, surrounds the use of ARFs for the purpose of inheritance planning, then the appropriate response may lie in the tax treatment of such transfers. The current position is that the inheritance of ARF assets by the spouse/civil partner of an ARF-owner is subject neither to income tax nor CAT. The inheritance of ARF assets by a child of the ARF owner under the age of 21 is not subject to income tax but may be liable to CAT subject to exemption thresholds. The transfer of ARF assets on death of the ARF owner to a child of the owner aged over 21 would be subject to income tax at the standard 20% rate on the value of the distribution but not subject to CAT. The scope for making changes to this treatment can be considered in the context of the broader changes to CAT and Inheritance tax which have commenced.
- 4.32. Extension of the ARF notional distribution arrangements to Personal Retirement Savings Accounts (PRSAs):** Concerns have been expressed in the past that migration from pension arrangements such as occupational pension schemes and RACs to PRSAs are being recommended by pension providers, originally as a means of accessing the ARF option and more recently as an alternative to an ARF – the latter to avoid the tax on imputed or notional distributions from ARFs. The attraction of a PRSA as compared to an ARF may

of their pension fund for a tax-free lump sum. This option is not available to members of public sector schemes. Depending on the impact of the tax charge on retirement lump sums, the option to commute part of a pension fund may no longer be exercised by private sector pension scheme members or may be exercised in a manner that reduces the value of the lump sum taken to minimise or avoid any immediate tax charge.

5. Pre-retirement access to pension funds (including early encashment of AVCs)

- 5.1.** Tax policy issues to do with pre-retirement access to pension funds are only one element of the broader pension policy issues to be considered. These broader policy issues have already been considered at senior Government level where no change in the current arrangements has so far been advocated.
- 5.2.** Revenue approval of occupational pension schemes is given on the basis, essentially, that retirement benefits may generally only be paid at the point of retirement (usually from age 60) or where the “ill health” provisions apply or on death. Similar rules apply in the case of personal pensions such as RACs and PRSAs.
- 5.3.** There are a number of reasons why, under existing policies, early withdrawals of pension savings are not permitted, the principal one being that schemes (and the associated tax relief on contributions) are designed to encourage savings over the long term that will be “locked away” until retirement in order to help provide for an adequate income throughout old age. Otherwise, there would be little reason to treat pension savings more favourably from a tax point of view than other general savings. Emerging demographic indicators point to increasing numbers of people living longer and healthier lives with more of their lives spent in retirement than previously.
- 5.4.** In the current economic environment, the idea of allowing individuals pre-retirement access to their pension savings if this would prevent them from having their home repossessed or to pay down other household debts is, on the face of it, very attractive. Among the main difficulties with the various proposals for a general scheme of early access to pension funds, is that there is no evidence that those individuals likely to be most significantly affected by mortgage or other debts would have access to sufficient pension savings to make a meaningful difference to their immediate financial situation. There is the real risk that individuals would still have mortgage or debt difficulties and the added difficulty of depleted pension savings.
- 5.5.** Furthermore, it is assumed that the majority of those with significant mortgage difficulties or other outstanding debts are people who bought property at or near the height of the boom and are likely to be aged in their 20’s, 30s or early 40s. If it is further assumed that this group are more likely to be low to middle income

earners, and possibly in the case of a couple that one or both may be unemployed, the individuals in this position are unlikely to have significant pension savings, if indeed many in these age groups have any pension savings.

- 5.6. To the extent that such younger people do have pension savings, a reduction in those savings resulting from access now could have significant negative consequences for them in the longer term with the potential for further demands for intervention by the State down the line. Pension savings made early represent the most valuable contributions as they are the ones invested longest and therefore have the longest period to grow. For younger people in the early years of pension saving, withdrawal of funds now would simply crystallise losses made over recent years with many likely to get less than what they put in. As such, early withdrawal would mean very poor value for money.
- 5.7. At the request of the Economic Management Council (EMC) an ad-hoc group was established to consider the idea of allowing people to access their pension savings before pension age in order to assist with other debts they may have. The ad-hoc group presented a detailed report to the EMC in September which concluded that there is no evidence that the group most likely to be affected by mortgage and other debts has access to sufficient pension savings to make a difference to their situation.
- 5.8. Furthermore, in terms of pension policy the ad hoc group concluded that allowing access to pension savings before retirement would be a significant change to pensions policy and the basis for pension savings in Ireland and that the principle of pension savings being “locked away” should be maintained. It might be noted in this regard that earlier this year, the UK Government announced its decision not to introduce an early access scheme at this time, following a major consultation.
- 5.9. The EMC did not dispute the findings of the ad-hoc group report but asked that the general question be re-visited by the “Keane Group” on mortgage arrears. The Mortgage Arrears Group considered the ad-hoc group’s paper and did not disagree with it and this issue was not included in the Mortgage Arrears Group Report.
- 5.10. Allowing access now to **Additional Voluntary Contributions (AVCs)** is a variation on the theme of early pension fund access and the same conclusions about such access would, generally, apply as set out above.
- 5.11. The Society of Actuaries recommended last month that the Government “take time” to examine AVC draw downs under which individuals could take out AVC savings to which a concessionary tax rate of 20% would apply (notwithstanding that tax relief for many making such contributions would have been provided at the higher marginal tax rate). It is also worth noting that the Society’s recommendation was made as an alternative to proposed standard

rating of tax reliefs, alternatives to which are already under consideration in the context of the Comprehensive Expenditure Review (see 3.5 above).

5.12. AVCs may be made by employees in addition to any regular or compulsory contributions which they may make to their pension scheme. AVCs are used to improve the benefits of scheme members, over and above those provided by the scheme rules but within Revenue limits. It is necessary for the rules of a pension scheme to make provision for AVCs if scheme members wish to make them. If the scheme rules do not allow for AVCs, the sponsoring employer's consent to change the rules of the scheme is required in order to permit voluntary contributions. Alternatively, a separate scheme can be set up to accommodate AVCs but this, again, would need the co-operation of the employer. Although the law does not require schemes to allow AVCs, the Pensions (Amendment) Act, 2002 requires any employer whose pension arrangements do not include an AVC facility to offer access to at least one Standard PRSA to be used for AVC purposes.

5.13. AVCs can be used, within the limits imposed by the Revenue Commissioners, for example to:-

- Increase basic pension entitlements or provide benefits based on non-pensionable pay.
- Increase retirement lump sums, if possible.
- Provide or increase dependants' provisions on death in retirement.
- In a civil or public service context, to provide for the purchase of notional added years service. (It might be noted that there is no separate funded arrangement for AVCs in respect of such purchases in the civil service).

In common with regular contributions to pension saving, AVCS are locked in and may emerge only as benefits on death, retirement or leaving service.

5.14. Neither this Department nor the Revenue Commissioners have information on the value of pension savings in AVCs or on the numbers and characteristics of those making AVCs. (The Society of Actuaries estimated the value of AVCs at €5 billion but it is not clear what this estimate is based on). It may not be unreasonable to infer that individuals who exercise the choice and have the capacity to make AVCS would be in a relatively favourable financial position compared to those without that capacity. It would seem invidious to allow individuals in that favourable position pre-retirement access to AVCs at a favourable tax rate while denying such access to other individuals in a less favoured position in relation to other pension savings.

5.15. The rationale advanced for allowing access to AVCs seems based around the view that such access would make a generally positive contribution to the economy rather than as a targeted measure aimed at a specific problem (e.g. mortgage debt write-down). In the absence of a targeted approach, there is no

guarantee that the release of the AVC funds would make a positive economic contribution (the money could be spent on foreign holidays).

5.16. From a tax policy perspective allowing early access at an incentivised (reduced) tax rate could give rise to unintended consequences. For example, instead of being spent in the general economy, the withdrawn funds could be recycled to make further pension contributions relieved at the person's marginal rate of income tax. The end effect of this would be to be to super relieve pension contributions by those who are able to afford AVCs. For example, €100 invested in AVCs 4 years ago attracted tax relief of €41 (cost to taxpayer €59). The €100 (not taking account of any tax free investment gains) is then withdrawn and is taxed at the preferential rate of 20% giving tax of €20. The €80 left over is then reinvested in AVCs or other pension products and attracts relief at 41% (cost to taxpayer of €47). The original €100 invested has attracted tax relief of €54 (€74 - €20) or 54%. It would not be possible to counteract or prevent this recycling of AVCs and the incentive available is such that one would suspect that the vast majority of draw-downs would be so recycled. This arbitrage is perhaps the real reason why early access to pension funds is seen as so problematic. Any tax rate on withdrawals that is less than the taxpayer's marginal rate is likely to result in similar behaviour.

5.17. As further regards economic activity, AVCs make up part of the pension fund assets that are subject to the temporary pension fund levy. The purpose of the levy is to pay for the Jobs Initiative which is aimed at helping to boost the economy over the next four years. Facilitating withdrawals of AVCs and of pension savings, generally, would narrow the base to which the levy applies, and which together with recent falls in asset values generally, would impact on the future yield from the levy.

6. The Tax Strategy Group may wish to discuss the issues raised in this paper.

Business Tax Team
October 2011

Appendix 1

Estimate of the cost of tax and PRSI reliefs for private pension provision 2008

	<i>Estimated costs*</i>
	€ million
Employees' Contributions to approved Superannuation Schemes	655
Employers' Contributions to approved Superannuation Schemes	165
Estimated cost of exemption of employers' contributions from employee BIK	595
Exemption of investment income and gains of approved Superannuation Funds	685
Retirement Annuity Contracts (RACs)	355
Personal Retirement Savings Accounts (PRSAs)	75
Estimated cost of tax relief on "tax-free" lump sum payments	140
Estimated cost of PRSI and Health Levy relief on employee and employer contributions	255
Gross cost of tax relief	2,925
Estimated tax yield from payment of pension benefits	490
Net cost of tax relief	2,435

* Figures in the table are rounded to the nearest €5m.

Appendix 2
Extract from Green Paper on Pensions 2007

“7.34 The information imparted by the costing of tax and other reliefs in the pensions area as detailed above is, however, inherently limited. It may suggest a significant notional loss against an equally significant assumed yield in the counterfactual situation of tax reliefs for supplementary pension provision not being available. However, where tax relief arrangements are of such significance, as in this instance, 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. For these reasons, the real informational content of these costings of tax reliefs is limited and should be treated with some caution.”

Appendix 3

Age-related percentage limits of earnings for pension contributions

Table 7.1: Contribution Limits

<i>Age</i>	<i>Limit as % of remuneration</i>
Under 30	15%
30-39	20%
40-49	25%
50-54	30%
55-59	35%
60 or over	40%