TSG 12/21

Pension Taxation Issues

Summary

1. This paper sets out the changes made in the incentive regime for pension saving over recent years. It also sets out the broad feedback obtained on informal consultations with various stakeholders in the pension sector on potential future changes to the regime and the broad options for such changes. In particular, the paper discusses the extent to which changes in the rate of income tax relief on pension contributions or to the maximum allowable pension fund at retirement for tax purposes (the Standard Fund Threshold – SFT) would meet certain policy objectives.

2. Significant changes have been made to the incentive regime for supplementary pension provision since 2006 and the Minister for Finance indicated in his 2012 Budget speech that further reform would be needed.

3. Consultations with representatives of professional stakeholders in the pensions sector (fund managers, insurance companies and actuaries) have largely focussed on the potential for alternatives to standard rating tax relief on pension contributions to secure Exchequer savings. The preference of these stakeholders is for changes in the maximum allowable pension fund at retirement for tax purposes (the SFT).

4. Consultations with a wider spectrum of stakeholders in the pension sector have elicited broader and more forward-looking views about supplementary pension provision and the incentive regime to encourage it. These stakeholders want long term certainty as to the direction of Government policy in this area.

5. The paper discusses the extent to which reductions in tax relief on pension contributions or the SFT might meet certain policy objectives. The position is summarised hereunder:

   - *Exchequer savings*: Reductions in tax relief are much more certain to deliver significant savings and more quickly than marginal changes in the SFT.

   - *Impact on other costs*: Reductions in tax relief would represent a pay cut for the significant numbers of PAYE members of occupational pension schemes with resulting pressure for compensating pay increases. Reductions in the SFT would not have the same scale of effect but could

have other implications for the international competitive position of Irish companies.

- *Sustainability of the supplementary pension regime*: Even if it were decided not to reduce tax relief in the short term, ongoing issues such as low supplementary pension coverage for middle income earners and auto-enrolment schemes will continue to focus attention on the sustainability of marginal rate tax relief over the longer term.

- *Equity*: Marginal reductions in the SFT would affect higher earners. Reductions in tax relief affect both middle income earners and higher earners. Reductions in tax relief impact on the potential benefits from funded pension schemes but not on the benefits from unfunded (public service) schemes. Reductions in the SFT bring into sharper focus the use of the standard capitalisation factor of 20 in the calculation of the capital value of benefits in DB schemes as compared to the inability of DC schemes with the same level of capital to purchase benefits of equivalent value. Solutions to this latter issue are difficult and would further complicate an already complex SFT regime.

- *Impact on incentive to save over the long term*: A recent report from Deloitte finds that fiscal incentives for retirement savings in the Irish pension system are progressive and compare well internationally but that proposed changes could discourage long-term saving. Reducing the cap on the SFT would be preferable, according to the report, to reducing tax relief to the standard rate. Fewer people would be affected and change would affect mainly high income earners and a reasonable level of fiscal incentive would be maintained for middle income earners. However, the report also indicates that if tax relief were capped at 33% on employee contributions the fiscal incentive to save for a pension would be maintained for individuals commencing to save at 30 and on earnings up to €75,000 (assuming no change in the SFT).

6. The paper also deals briefly with the issue of early access to certain forms of pension savings.

Introduction and background

7. Since 2006, there have arguably been more significant changes made to the tax incentive regime for supplementary pension provision than in the previous 30 years. While these changes have been necessary for various different reasons, the scale of the changes made over such a short period does not sit well with the principle that, as a long term investment, incentives to save for a pension should also reflect a long term, stable policy. The current uncertainty about the future direction of the incentive regime for pension saving has, with other non-tax related developments in recent years, impacted negatively on the confidence of individuals to invest in pensions.

8. Changes made in 2006 were primarily designed to prevent abuse of the tax incentive regime for pension savings and to stop over-funding of pensions by the better-off. Restrictions on tax reliefs for pension savings since 2009 have continued to be targeted at high-earners but from 2011 have also been applied more broadly to secure Exchequer savings as part of our agreement with the EU/IMF on fiscal consolidation.

9. An internal review of tax relief for pensions provision conducted by the Department of Finance in conjunction with the Revenue Commissioners in 2005 as part of a broad review of tax relief schemes found, among other things, that:

- Tax reliefs appeared to be very generous in relation to individuals whose employers are in a position to make substantial tax deductible contributions to their schemes effectively without limit, particularly in circumstances where such individuals can influence the level of employer contributions and their remuneration level.

- The tax-free retirement lump of 25% of the accumulated pension fund was considered too generous in cases where the value of the fund was substantial.

- The ARF option was not being used as intended to fund an income stream in retirement but as a form of wealth and estate planning.

10. On foot of the 2005 review, the following changes were introduced in Budget and Finance Act 2006:

- A maximum allowable pension fund at retirement for tax purposes was introduced (the SFT) which placed a life-time limit on the capital value of the aggregate of pension benefits that could be accumulated from tax-relieved sources. The SFT was set at €5m from 7 December 2005[1].

- The maximum lifetime limit for tax-free retirement lump sums from all pension fund sources was set at 25% of the SFT (€1.25m).

- An imputed or notional distribution of assets from ARFs was introduced increasing to a rate of 3% of the value of assets in ARFs each year which notional distribution was liable to tax at the ARF owner's marginal tax rate (actual distributions are deducted from the notional calculation).

11. Employee and individual contributions to occupational pension schemes and personal pension plans (Retirement Annuity Contracts and Personal Retirement Savings Accounts) are tax relieved at the individual's marginal rate of income tax and employee contributions to occupational pension schemes were also historically exempt from employee PRSI and health levy. Age-related percentage limits apply to determine the maximum annual level of tax-relievable contributions as follows:

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

12. In addition to the age-related limits, tax relievable pension contributions are subject to a maximum annual earnings cap. The earnings cap was first universally applied across all pension savings products in 2002 and at a level of €254,000 per annum. It was increased in line with indexation of the SFT and stood at €275, 239 for 2008. The earnings limit was significantly reduced to €150,000 for 2009 and stayed at that level for 2010.

[1] On the occasions that the SFT was both introduced (7 December 2005) and subsequently reduced (7 December 2010), individuals whose pension funds were valued above the SFT on those dates could apply to protect the funds at that value by applying for a Personal Fund Threshold (PFT). Some 115 PFTs issued after the introduction of the SFT regime and 1,200 were applied for on foot of the reduction in the SFT to €2.3 million on 7 December 2010. For the sake of simplicity, however, this note will only refer to the SFT unless the context requires otherwise.

13. The agreement reached with the EU/IMF in 2011 included implicit commitments to deliver full year savings of over €900m in tax relief in the broad pension area in the period to 2014.

14. Budget and Finance Act 2011 contained measures estimated to deliver about €300m of savings in this area (in full year terms). The measures included:

- From 1 January 2011, employee contributions to occupational pension schemes and other pension arrangements were made subject to employee PRSI (they were previously exempt) and to the new Universal Social Charge.

- The employer PRSI exemption for employee contributions to occupational pension schemes and other pension arrangements was reduced by 50% from 1 January 2011 (the remaining 50% relief was removed by Finance Act 2012 from 1 January 2012).

- The annual earnings limit for determining (with age-related limits) the maximum allowable tax-relieved contributions was reduced from €150,000 to €115,000 for 2011 (representing a reduction of over 58% in the annual earnings cap from its peak in 2008).

- The maximum allowable pension fund on retirement for tax purposes (the SFT) was reduced from its indexed level of over €5.4 million to €2.3 million from 7 December 2010 (equating to the scale of the reduction in the annual earnings limit described above).

- The overall lifetime limit on the amount of tax-free retirement lump sums that an individual can draw down from pension arrangements was reduced to €200,000.

- The annual imputed distribution applying to the value of assets in ARFs was increased from 3% to 5% in respect of asset values at 31 December 2010 and future years (Budget and Finance Act 2012 increased the imputed distribution percentage for ARFs with asset values in excess of €2 million from 5% to 6% and extended the imputed distribution arrangements to "vested" PRSAs – these are PRSAs from which retirement benefits have commenced to be taken.)

15. In addition to the measures detailed above, Finance (No 2) Act 2011 introduced the pension fund levy to pay for the *Jobs Initiative* over 4 years which raised €463 million in 2011. When taken with the Budget and Finance Act 2011 measures, it means a total policy adjustment of over €750 million was made in 2011 in relation to pension saving taxation. The pension fund levy has since raised an additional €477 million in 2012. Furthermore, Budget and Finance Act 2012 removed the remaining 50% employer PRSI relief on employee contributions at an estimated saving of €90m in a full year.

16. In his 2012 Budget speech on 6 December 2011, the Minister for Finance acknowledged the contribution being made by the pensions sector and also stated:

"Although the EU/IMF Programme commits us to move to standard rate relief on pension contributions, I do not propose to do this or make changes to the existing marginal rate relief at this time. However, the incentive regime for supplementary pension provision will have to be reformed to make the system sustainable and more equitable over the long term. My Department and the Revenue Commissioners will work with the various stakeholders in the next year to develop workable solutions."

Consultations with stakeholders in the pensions sector

17. The Department of Finance and the Revenue Commissioners have for some time been engaged in a process with representatives of certain of the professional stakeholders in the pensions sector (fund managers, insurance companies and actuaries) about the potential for securing the savings implicit in the EU/IMF agreement other than by way of a reduction to standard rate tax relief. Xxxxxxxxx xxxxxxxxxxxxxxxxxxxxxxxxxxxxxxxxxxxxxxxxxxxxxxxxxxxxxxxxxxxxxx xxxxxxxxxxxx

18. On foot of the Minister's comments in this year's Budget speech, a broader consultation was undertaken across a spectrum of stakeholders in the pensions sector to establish their views on further changes to the incentive regime for pension saving. A list of the organisations and individuals with whom meetings were held on this issue is attached as an Appendix to this paper.

19. The following points broadly reflect the various views expressed during this consultation process:

- Together with the crisis in financial markets and the general economic downturn, changes to tax reliefs over the past number of years together with increasing costs of administrative compliance in the pensions sector and recent announcements of increased regulatory burdens on certain Defined Benefit (DB) schemes, have added to the major loss of confidence in pension savings and to stagnation in the supplementary pensions market.

- Any announcement of further significant restrictions in the pension incentive regime at this time would represent particularly bad timing in view of the developments referred to above.

- Strong views were expressed that if there are to be further changes that they should be signalled well in advance of implementation and should reflect some clear vision for the stable tax treatment of pension savings over the long term as opposed to a further "raid" to effect short-term Exchequer savings. The latter will only add to current uncertainty.

- There is very considerable scepticism about whether the pension fund levy will end in 2014 and further assurances were sought that the levy would end at that time. The view was expressed that if the levy or a revised version of it remained post-2014 that this would, for example, further hasten the demise of DB schemes.

- Multinational companies, in particular, expressed concern that further reductions in the rate of tax relief on pension contributions and in the SFT will impact (i) on competitiveness (because a reduction in relief represents a pay cut which employers will be under pressure to replace) and (ii) on the mobility of senior management (the loss of talent abroad).

- The view was expressed that a reduction in the rate of relief on pension contributions will impact most negatively on the incentive to save of the unincorporated self-employed or employees with pension plans where the employer makes no contribution. Where employers make matching contributions with employees to pension schemes, a reduced rate of relief (depending on the scale of the reduction) might still represent a valuable incentive to invest in a pension only not as valuable as before.

- Further changes to contribution-based controls should include a mechanism for limiting the scope for employers to contribute to occupational pension schemes.

- If auto-enrolment remains a future option for dealing with the gap in supplementary pension coverage in the private sector, any reduction in the rate of tax relief on pension contributions should only occur simultaneously with the introduction of a scheme of auto-enrolment.

- Future changes to the incentive regime should take account of and avoid exacerbating the perception of a growing rift between unfunded public service pensions and funded pension provision.

The broad options for future change

20. Recent debate around the alternative approaches for any future significant change in the incentive regime for pension saving has focused broadly on the rate of income tax relief on pension contributions (a change which would affect significant numbers of contributors) and/or the level of the maximum allowable pension fund at retirement for tax purposes – the SFT – a change which would affect fewer contributors on higher incomes.

21. Ultimately, the choices to be made may depend on the extent to which changes in one or other (or both) are considered to meet specific policy objectives. Among the objectives against which possible changes should be benchmarked include

- Cost/savings to the Exchequer.
- Impact on other costs.
- Sustainability of the supplementary pension regime over the long term.
- Equity as between higher and lower income earners, funded and unfunded pension schemes, Defined Benefit and Defined Contribution schemes.
- Impact on incentive to save over the long term.

Some commentary follows on the extent to which changes in the SFT or changes in the rate of tax relief on contributions would meet these objectives.

Cost/savings to the Exchequer

22. A *reduction to standard rate tax relief* for all employee and individual contributions to pension schemes and plans is currently estimated to yield about €470 million in a full year. Standard rating tax relief on the pension-related deduction (PRD) which applies in the public service (but is not a pension contribution) is estimated to yield an additional minimum of €90 million. The application of a single rate of relief to pension contributions at 33% is estimated to save about €110m while a rate of 30% would save the Exchequer about €200 million (excluding behavioural impacts).

23. It would not be possible to operate a system of tax relief for pension contributions and the PRD under the current "net pay" arrangements (see **28.** below) at both the standard rate and at a rate other than the higher (41%) rate of tax due to the complexities involved**.** It would equally not be possible to deliver a single rate of relief at either 30% or 33% through the existing net pay arrangement. A change in the rate of pension tax relief from the existing marginal rate relief would require a move to a payroll delivery system involving tax credits. While Revenue are confident that an alternative payroll based system could deliver a single rate of relief on pension contributions by way of a notional "tax credit" approach, the position becomes much more complex and costly to deliver if such a system has to handle two different rates of tax credit. Either way, significant administrative, technical and IT development costs and resource investment would arise for Revenue and indeed for other affected parties to some extent (e.g.. employers and payroll development companies) before it could be introduced. This work would take at least one year but the savings to the Exchequer would flow immediately from its introduction.

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Impact on other costs

28. A reduction in the marginal rate of tax relief on pension contributions would represent a pay cut for those PAYE employee members of occupational pension schemes across the public and private sectors liable to tax above the standard rate. There would be an additional impact on public service employees' pay if the tax relief on the PRD was also reduced. This is due to the way in which such contributions and deductions are currently tax-relieved under the "net pay" system whereby pension contributions and the PRD for PAYE employees are deducted from gross pay before applying tax and PRSI. The "net pay" system would have to be replaced in the context of a change to a single rate of relief (tax credit).

29. A change to a lower single rate of tax relief could therefore lead to claims for compensating pay increases for significant numbers of PAYE workers.

30. A reduction in the SFT xx xx xxxxxx would not have the same broad implications as it would impact on higher earners. It could impact, however, on the ability of Irish employers to attract or retain high-quality employees and management.

Sustainability of the supplementary pension regime over the long term

31. Relatively marginal changes to the level of the SFT (xx xxxxxxxxx xx xxx xxxx xxxxxxxx) which have implications for a relatively small number of higher income earners would arguably have little impact one way or the other on the sustainability of the incentive regime for pension saving into the future.

32. Decisions around changes in the rate of income tax relief on pension contributions seem more relevant in relation to the future sustainability of the supplementary pension and incentive regimes. About half of the workforce or close to 1 million individuals do not have supplementary pension coverage. It has been long-established policy to encourage individuals on middle incomes to provide for some level of private pension which would (in addition to the basic State pension) help provide for an adequate replacement income in retirement. Government policy in this area has previously proposed the introduction of a "soft mandatory" auto-enrolment scheme for individuals without supplementary pension coverage when economic circumstances permitted. In that context, and with a view among other things, to minimising the Exchequer cost, a State contribution equivalent to 33% tax relief was suggested to replace standard and higher rate relief on pension contributions for both current pension saving and any new auto-enrolment regime. Contributions would also be required from employers and employees.

33. Economic circumstances are unlikely to permit the introduction of an auto-enrolment regime in the near future. The OECD Review of pension policy in Ireland[2] may, however, focus some attention on the lack of supplementary pension coverage among middle income earners and on a renewed case for an auto-enrolment pension scheme.

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[2] The Minister for Social Protection has engaged the OECD to conduct a short and focused review on the viability and long-term impact of proposed changes in pensions policy in Ireland taking account of the economic downturn. The Review which commenced earlier this year is to encompass the totality of pension provision in Ireland – State, private, occupational and public sector. A report of the Review is anticipated around the end of the year.

34. The debate about the appropriate level of State incentive in the context of a scheme of auto-enrolment will, therefore, continue to focus attention on the sustainability of marginal rate tax relief in the future.

Equity – higher income earners vs lower income earners

35. A reduction in the SFT, for example, xx xx xxxxxxx under the existing regime would impose restrictions on individuals in Defined Benefit pension schemes whose pension entitlements are greater than €100,000 (without a separate retirement lump sum entitlement) or greater than about €85,000 (with a separate retirement lump entitlement as in most public service pension schemes). For DC pension arrangements, the capacity to grow a pension pot to a market value of xx xxxxxxx is likely only to be available to higher earners.

36. A reduction in the higher rate of income tax relief will impact on low to middle income earners as well as on higher earners. A single person commences to pay the higher rate of income tax on income over €32,800 while a married couple (one earner) pays the higher rate on income over €41,800. Individuals on middle incomes above these levels would therefore be impacted by a reduction in marginal rate tax relief.

Equity – funded pension schemes versus unfunded (mainly public service) pension schemes

37. The SFT regime aims to place a cap on the maximum allowable pension fund that an individual can fund from tax-relieved sources. Its effects can differ as between the funded pension sector and the unfunded sector (mainly public service) though it could be argued (without definitive evidence) that the results are broadly the same. In the funded pension sector, the regime acts to prevent over-funding of pension arrangements by penalising pension fund growth or accruals beyond the SFT so that individuals stop making tax-relievable contributions or accruing pension benefits. In most public service schemes, individuals cannot cease contributing or accruing benefits other than to leave their posts. Where the SFT is exceeded in these cases, tax relief on accrued benefits beyond the measure of the SFT are recouped through additional taxation.

38. Reductions in tax relief on employee pension contributions would apply in the same way to PAYE members of funded and unfunded pension arrangements. For the majority of public service pension schemes, however, which operate on a pay-as-you-go basis from current Exchequer expenditure, the rate of tax relief on pension contributions does not ultimately impact on the level of retirement benefits an individual can expect to receive. This would not be the case for funded pension schemes.

39. For the generality of members of funded pension arrangements, tax relief at the marginal rate has arguably been the only real advantage to pension saving over a period when a combination of low interest rates, low investment performance, increased longevity and increased regulatory burdens have put huge pressure on

DB and DC pension schemes and other DC pension arrangements. A reduction in tax relief will increase the cost of pension contributions to funded schemes which may impact further on their ability to fund adequate pensions or pension liabilities and will worsen the comparative position between funded pension arrangements and unfunded public service pension arrangements.

40. A reduction in tax relief on employee contributions to occupational pension schemes (OPS) could encourage a shift towards increased employer contributions to such schemes (possibly in lieu of claims for pay increases – see **28** and **29** above). Employer contributions to occupational pension schemes are, for various reasons, not subject to the earnings limit and age-related percentage limits which apply to employee contributions and to contributions to other forms of pension saving (PRSAs and RACs). Employer contributions to OPS are treated as a business cost and generally deductible at the low 12.5% corporation tax rate.

41. Among the significant issues to be considered if employer contributions were to be included within the annual earnings and age –related limits are:

- 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. These matters would have to be examined in detail with the Pensions Board.

- It would greatly restrict the capacity of individuals to fund for maximum pension benefits late in a career through employer contributions.-

- While public service pension schemes are generally unfunded, pay-as-you-go schemes there is clearly an imputed employer contribution (from the State) to such schemes. This imputed employer contribution to unfunded public service schemes would have to be addressed in the context of any proposal to restrict the level of employer contributions to funded pension schemes.

Equity – DB vs DC

42. The calculation of the maximum allowable pension fund for tax purposes at retirement (the SFT) differs depending on whether the pension arrangement is Defined Benefit (DB) or Defined Contribution (DC). In a DC pension arrangement, where the retirement benefits for each individual depends on the contributions made and the investment performance of the funds, there is a pension "pot" and the market value of that "pot" is what is used to measure against the SFT. In a DB pension arrangement, there are no individual pension "pots" but a pension benefit promise usually based on salary and accrued service. This pension benefit is multiplied by a generic standard capitalisation factor of 20[3] and added to the value of any retirement lump separately accrued to arrive at the overall capital value of the DB promise for the purposes of the SFT.

43. In order for the SFT regime to be administratively workable, the standard capitalisation factor of 20 is used to measure the capital value of DB pension arrangements regardless of age or other variables but this may be considered a low factor in light of current annuity rates depending on the pension package. A DC pension fund of the same market value in capital terms as a DB scheme may not be able to purchase on the open market the equivalent pension benefits as measured in the DB scheme for SFT purposes– it could cost considerably more.

44. While this issue may not have been very significant when the SFT was introduced at a high level (€5m) and increased with indexation (to €5.4m), it has become more significant in the context of the large reduction in the SFT last year which affected more people. Further significant reductions in the SFT may exacerbate the problem.

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46. The UK also uses a standard factor of 20 to value DB pensions for the purpose of testing the capital value of such entitlements against the Lifetime Allowance regime (LTA - the UK equivalent of our SFT regime). In the context of consultations in 2010 on changes to the LTA involving a reduction in the limit

[3] The ability to apply to Revenue to use a higher factor than 20 was removed for administrative reasons when the SFT was last reduced in Budget and Finance Act 2011.

from £1.8 million to £1.5 million which came into effect this year, the UK authorities stated:

"A case could also be made for making the LTA valuation factor age-related, so that the overall value of early retirements are picked up by the pensions tax regime. The Government's provisional view is that changing the valuation factor used for assessing pension accrual against the LTA could complicate any potential protection regime [the broad equivalent of our PFT – see footnote 1]…. The Government is therefore minded to make no change and for the LTA valuation factor to remain at 20…"[4]

Impact on incentive to save over the long term.

47. A recently published report from Deloitte[5] which was commissioned by the Society of Actuaries in Ireland and funded by the Irish Fiscal Policy Research Centre (Publicpolicy.ie) finds that fiscal incentives for retirement savings in the Irish pension system are progressive and compare well internationally but that proposed changes could discourage long-term saving.

48. The results of the research are presented by reference to a Fiscal Incentive Index (FII) calculated as the present value of tax relief received on employee and employer contributions divided by the present value of tax paid on the pension benefits in retirement. An FII measure of 1 or more indicates the present value of the fiscal incentive provided by Government is equal to or greater than the tax ultimately paid on the pension benefit.

49. For the supplementary pension system in Ireland, the report finds the FII index to be above 1 for all employees commencing pension saving at age 30 and over and on incomes of up to €75,000 and for incomes up to €150,000 for employees commencing pension savings at age 40 and over. The principal reasons for the FII being above 1 are the combination of employees moving to a lower tax band during retirement and the availability of a tax-free retirement lump sum. The FII also increases with age but reduces with earnings.

50. The report's conclusions are that reducing tax relief on employees' contributions to supplementary pension arrangements *from marginal to standard rate* would, for many employees, significantly reduce the incentive to save, possibly to the extent that they would no longer be willing to commit their savings to plans that are not accessible until retirement. Reducing the cap on benefits qualifying for tax relief (the SFT) would be preferable, according to the report. Fewer people would be affected and change would affect mainly high income earners and a reasonable level of fiscal incentive would be maintained for middle income earners.

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[4] HM Treasury "Restricting pensions tax relief through existing allowances: a summary of the discussion document responses" October 2010 (p.30)

[5] "Analysis of Fiscal Incentives for Retirement Savings – models and redistributive effects" – October 2012

51. As a point of interest, however, the report also indicates that if tax relief were capped at 33% on employee contributions the FII would remain above 1 for individuals commencing to save at 30 and on earnings up to €75,000 (assuming no change in the SFT).

Pre –retirement access to pension savings

52. There have been ongoing calls to allow people pre-retirement access to their pension savings mainly for the purpose of paying down mortgage and other debts. While these various proposals have been examined, such access has not to date been permitted, mainly because of the likely mis-match between the individuals with most debt and the individuals with most pension savings as well as the potential damaging implications for pension provision over the long term.

53. One of the latest proposals in this area comes from IBEC[6]. IBEC is proposing access to certain non-occupational pension fund savings (Additional Voluntary Contributions – AVCs - and personal pension plans) in order to provide a stimulus to the economy and as an alternative to further changes to the tax relief arrangements (already outlined above).

54. In brief, the IBEC scheme would allow encashment over 3 years of the full value of funds in AVCs (estimates of the value of savings in funded AVCs vary between €4- €6 billion) and of 25% of the funds in personal pension plans such as PRSAs and RACs (estimated value €12 - €14 billion). Early access to Defined Benefit pension schemes would not be permitted because the nature of such schemes would not allow for the easy recognition of individual entitlements while access to Defined Contribution occupational pension schemes would be precluded on the grounds that such access would undermine pensions coverage (and presumably pension adequacy). Funds drawn down would be taxed at the standard 20% rate and no more than 25% of the funds drawn down could be used to pay down debt.

55. 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.

56. 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.

[6] " Early release of non-core pension funds as a stimulus measure" – IBEC Policy brief June 2012

- 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).

57. It is important to emphasise that while AVCs are discretionary contributions to pension savings, they should not be classified as some excess or bonus on top of an adequate retirement benefit arrangement. Individuals can only fund for a pension within Revenue rules and most individuals making AVCs are seeking to make up a shortfall in pension funding for one reason or another to ensure an adequate pension in retirement. Early encashment of such savings now (for whatever good reason) could well prove difficult to replace in the future or in retirement and this could have further implications for the State's resources down the line.

58. Furthermore, if the main benefits of DC occupational pension schemes are to be excluded from early access on the grounds of concern about pension coverage, those concerns as well as concerns about pension adequacy should equally apply to DC personal pension plans of individuals (e.g. PRSAs and RACs).

59. A preliminary economic analysis of the IBEC proposal has been carried out by the Economics section in Fiscal Division and a summary of this analysis follows.

60. From an economic perspective**,** the idea of releasing funds from pension savings into the domestic economy is not without its merits. However, the proposal to limit the extent to which individuals can use these funds to reduce indebtedness and instead focus the measure on retail consumption appears to be targeting the symptom of economic malaise rather than the underlying problem. There would instead be merit in exploring a scheme that allowed individuals to determine the share of funds that went toward deleveraging and towards personal consumption. A scheme targeted at helping individuals reduce indebtedness could help consumer confidence and boost expenditure in a more effective and long lasting way.

61. In terms of how effective a consumption orientated scheme would be the IBEC proposal cites similar schemes in Denmark and Iceland. However there are doubts regarding the extent to which the gains in consumption in Denmark and Iceland are attributable to similar schemes in those countries.

62. The high marginal propensity to import in Ireland would suggest that a high proportion of the benefits of the release of funds may accrue outside of Ireland. It is also unclear as to why individuals with significant savings tied up in pension schemes would wish to use these funds for domestic consumption rather than for paying down debt.

63. Whilst the proposal attempts to account for the potential gains to the exchequer from domestic expenditure as well as income tax at the standard rate on the drawdown, it fails to account of the tax loss to the State from tax relief already given at the marginal rate.

64. As the measure would facilitate individuals who paid in to a pension scheme and benefited from marginal relief to make an early withdraw at the standard rate of tax, it is likely to benefit higher income earners. This measure would be highly regressive and inequitable.

65. Whilst the proposal aims to prevent individuals from drawing down funds from their main DB and DC occupational pension funds, the assumption that additional voluntary contributions or personal pension schemes are some sort of top-up above an adequate level of cover depends on how long an individual has participated in an occupational scheme and the net asset value of the scheme. If incorrectly targeted, the proposal may still have long-term implications in relation to pension provision.

66. Whilst a consumption gain is highly questionable, a well-targeted solution, in other words one that doesn't impact on future pension provision, has sufficient safeguards against abuse (funds withdrawn at standard rate tax and re-invested in pension funds at marginal rate relief) and which facilitates necessary deleveraging may have merit.

67. The TSG may wish to discuss the issues raised in this paper.

Fiscal Division

October 2012.

Appendix
List of organisations involved in more extensive informal consultations on pension incentive regime

- Pensions Board
- D/Social Protection
- ICTU
- IBEC
- CVP
- IFA
- ICMSA
- Publicpolicy.ie
- American Chamber
- Pensions Ombudsman
- D/PER
- BoI
- Smurfit
- Friends First
- Abbott Ireland
- Siemens
- Cadbury
- Goodbody
- Technical Guidance Limited
- Irish Hospitals Consultants Association
- IFG Corporate Pensions