

Reduced lifetime limit for pensions implications and considerations

Introduction

Budget 2011 reduced the lifetime limit on tax relieved pension plans from €5.4m to €2.3m and this introduced immediate and far reaching implications for individuals and employers.

At retirement the excess above the threshold will be liable to a 41% tax within the pension fund. The net amount after will then be liable to further personal tax (up to 41%) and Universal Social Charge of 7% leading to an aggregate tax rate above 69% in respect of any excess above the limit.

Due to the penal taxation on pension funds exceeding the limit immediate action is needed.

The following are the steps that need to be worked through by employers and individuals in addressing this change.

Step 1

Identifying those impacted by the new rules -

- Applies to all pension benefits accumulated to 7 December 2010
- Applies to Defined Benefit and Defined Contribution arrangements
- Remember to include benefits from all previous employments (personal pensions, AVCs etc)
- For DB schemes consider multiple of 20 X the annual pension accrued to 7 December 2010
- Does your pension scheme have deferred members who have breached the cap?
- Would a 'ready reckoner' help your individuals to assess if and when limits might kick in?
- How should senior employees be made aware of this issue and the potential tax consequences?

Step 2

Prioritise individuals who already exceed the €2.3m limit

- Individuals need to agree an immediate Personal Fund Threshold with Revenue
- Employer to consider revised reward package going forward when pension funding stops
- Will there be additional payroll costs associated with a revised package going forward?
- How do you compute the compensation in lieu of additional pension accrual?
- Are there any planning points around the 'frozen pension' growing beyond the threshold in the future?
- DC schemes; growth might exceed indexation rate (if any) applied by Revenue to limits
- Would revaluation of DB benefits bring the benefits above the threshold amount?
- How will the individual save for retirement outside the pension plan?
- Is it possible to consider early access to pensions for those who already exceed the threshold?
- Are there wider implications of paying cash compensation in lieu of pension benefits in certain industries?

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You can find out a little more at

www.pwc.com/ie/pensions

Alan Bigley
Partner

Direct Dial: +353 (0) 1 792 6403
email: alan.bigley@ie.pwc.com

Brendan Bartley
Director

Direct Dial +353 (0) 1 792 8705
email: brendan.bartley@ie.pwc.com

Munro O'Dwyer
Director

Direct Dial +353 (0) 1 792 8708
email: munro.odwyer@ie.pwc.com

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Step 3

Making a Personal Fund Threshold application

- Must be submitted and agreed with Revenue by 7 June 2011
- DC schemes; how do you value term related investments e.g. property based schemes, guaranteed fixed term investments etc?
- Consider certain pension benefits that might be exempted from inclusion, pensions in payment, state pensions, overseas pensions etc
- DB plans: 20 X multiple applies to capitalise the value of annual pension promise
- In the past alternative multiples has been agreed in certain circumstances
- Higher multiples will be inefficient where staying within DB plan to retirement
- Individuals to consider the probability of survival/funding level of their DB plan
- Submission of PFT forces individual to consider their probable exit strategy at retirement
- Personal advice should be taken before filing the Personal Fund Threshold to Revenue
- Individuals may need advice regarding new retirement options, ARFs, 5% drawdown etc before deciding on pension options

Step 4

Planning for individuals who are likely to exceed the limit in the future

- For those close to the €2.3m threshold ensure measure in place to track their approach to the limit
- Remember to account for investment growth even on funds that are currently below the limit
- How soon does that mean that contributions should cease?
- Does Employer / Employee cease immediate funding?
- Do higher risk investment strategies with pension assets still make sense?
- Use 'ready reckoner' to continue to evaluate value of funds
- For those in DB schemes can an adjustment to the benefit promise now help to keep the valuation within the limit?
- For those individuals with scope for significant funding is there any merit in funding quickly with immediate access to prevent investment growth from eating into the threshold?
- In certain sectors e.g. public service, semi state etc it may be difficult to withdraw from the pension scheme once limit is reached? Other compensation structures may need to be considered