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# Commission on Taxation

Dissecting the detail...

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# Pension & retirement planning

## In this section...

- Introduction of SSIA-type pension scheme
- Link between personal pension contributions and tax relief broken, replaced with State contribution
- The tax free retirement lump sum restricted to €200,000
- Approved Retirement Funds should be more widely available
- Lifetime pensions cap to be reduced
- Corporate pensions regime unchanged
- Miscellaneous other matters to be considered



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## Introduction of SSIA-type pension scheme

The Commission proposes that an SSIA-type plan would run alongside traditional pension plans whereby the Exchequer would pay €1 for every €2 paid by the individual. An annual limit of €3,300 would apply to the combined contributions. Investment growth would be liable to tax at the standard rate (or some slightly higher rate) and, at retirement, there will be no tax payable. In limited circumstances the funds could be accessed before retirement.

While the intention of the proposal seems to be to target unemployed persons, individuals on career breaks etc., the scheme as proposed only excludes individuals who are members of defined benefit pension schemes. If the scheme is introduced in this way it could lead to a significant take up as self employed

persons and members of defined contribution schemes are likely to regard the arrangement as very attractive.

## Link between personal pension contributions and tax relief broken, replaced with State contribution

The proposal would mean that all pension contributions would attract the same effective tax benefit. This means a reduction in benefit for top rate taxpayers but an increase in benefit for persons on the standard rate of tax and those individuals who do not pay tax. It is proposed that for every €1.60 of personal pension contribution the State would top-up the pension by a further €1 (38% of the combined fund). This is the equivalent of an income tax deduction at an income tax rate of 30% and relief for PRSI/levies etc of around 8%. To encourage new pension savers there would be a 'kick-start' phase

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within the first 5 years where the rate of State contribution would be €1: €1.

This proposed system would operate under the ‘relief at source’ approach as currently applies for mortgage interest and healthcare costs.

Tax relief on employee pension contributions is generally operated through the payroll system which means that the contributions are not subject to PRSI. A move to a “relief at source” approach will mean that the amount of the pension contribution will be subject employer PRSI (10.75%) and may also be liable to employee PRSI. This could result in significant costs to employees/employers.

Employees paying tax at the marginal rate might consider reviewing their pension scheme arrangements to move away from personal contributions (‘relieved’ at an equivalent rate of 30%) to employer pension contributions (still exempt from income tax at the 41% rate).

It might also make sense for top rate taxpayers to consider optimising their pension contributions now for 2008 and 2009 before any reduced rates are announced. Standard rate taxpayers may be inclined to postpone any such payments.

### Tax free retirement lump sums restricted to €200,000

The Report proposes that the current lump sum rules (up to 25% of the fund or 1.5 times final salary) should remain but the tax free portion should be capped at €200,000. The excess lump sum above €200,000 would be taxed at the standard rate. The current lump sum limit is €1.35m

Individuals with large pension sums where the tax free lump sum entitlement currently exceeds €200,000 should review their own circumstances to consider an early exit from their pension plan in advance of any possible restrictions.

### Approved Retirement Funds (ARFs) should be more widely available

ARF options are currently available to the holders of personal pension plans, AVC funds and to proprietary directors. ARFs provide an alternative to the purchase of an annuity on retirement and provide the holder with great flexibility in accessing their funds. Any remaining funds may pass to the holder’s family after the individual dies.

The Commission suggests offering ARF options to all Defined Contribution pension members (therefore excluding Defined Benefit members).

Whilst Defined Benefit members are outside the ARF regime there may be planning possible around the transfer near retirement to a Defined Contribution scheme. Professional advice should be taken before electing to give up a Defined Benefit promise in favour of the flexibility of an ARF.

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## Lifetime pension cap to be reduced

The Commission suggests the reduction of an individual’s lifetime cap on pension fund size. The suggestion is that there should be a correlation between the size of the fund and the income amount on which an individual may base annual pension contributions (currently €150,000). If this proposal is introduced the lifetime cap would be reduced from its current level of €5.4m to approximately €3m.

## Corporate pensions regime unchanged

There is no proposed change to the practice of employers funding for an employees’ retirement fund, death in service or long-term illness benefits. The tax free roll-up of investment and capital returns is still intact within pension schemes.

Employers will continue to obtain full corporation tax relief for payments made to an employees’ pension scheme having regard to their salary and service. The scope and timing of employer pension contributions is

generally more flexible than personal contributions and are not subject to the age related or annual earnings limits that apply to individuals. Corporate contributions remain exempt from marginal rate income tax for employees.

## Miscellaneous other matters considered

The Commission suggested a tightening up of the practice whereby certain individuals – owner/managers in particular – maximise their corporate pension funding as they approach retirement.

Having reviewed the current age related contribution limits, the Commission suggested that, on balance, they should be retained. The annual earnings limit of €150,000 for individuals also remains unaltered.

To simplify pensions the Commission suggests a harmonisation of different pension products concerning retirement age, contribution and benefit limits, so we may see more movement on this area over the next year or so.

The Commission favours a ‘soft mandatory’ approach to pension scheme membership whereby individuals are automatically enrolled in employer pension schemes with a deliberate action needed to withdraw.

The Report also recommends that tax breaks on pension contributions should be displayed prominently on monthly payslips to improve the transparency and appreciation of the State support.

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