Irish Association of Pension Funds

Budget Submission

November 2002

1. Introduction

The Irish Association of Pension Funds (IAPF) was established in 1973 and is a non-profit, non-commercial organisation. Our members provide retirement security to over 200,000 employees, pay pensions to nearly 70,000 people and are responsible for some ε50 billion in retirement savings.

As the voice of Irish pensions our principal aims are:

- To represent the interests of pension scheme members, trustees and sponsoring employers;
- To promote financial security for all retired people; and
- To provide a forum for discussion and debate of pension issues.

IAPF hope that this submission will be useful to the Minister and his officials in framing the forthcoming and future Budgets as well as in the Government's general deliberations on pension policy matters in Ireland.

2. Individualisation of Tax Bands

As noted in the IAPF's submission last year, the individualisation of tax bands was introduced by the 2000 Finance Act and further extended in the 2001 and 2002 Finance Acts. While we acknowledge the rationale behind this approach, we believe that consideration should be given to creating a framework whereby the benefit of the widening of tax bands could be passed onto pensioners.

Individuals below State retirement age have the option of working in order to take advantage of the individualised tax bands. This option is generally not available to those spouses who have chosen to stay at home and who are now past State retirement age.

Married couples in this situation are not in a position to take advantage of the individualised tax bands and a likely consequence of further moves towards individualisation will be to increase the proportion of married pensioners subject to the higher rate of income tax as compared to the proportion of those still in the work force.

A particular anomaly arises when an individual who is receiving the State Retirement Pension or Old Age (Contributory) Pension is in receipt of additional payment in respect of a qualified adult dependant. Under the current regime, no allowance is made in tax bands for this additional payment.

IAPF Recommendation

To take account of these points, the IAPF recommends that the Minister either:

(i) Increases the tax bands applicable to married pensioners; or

(ii) Introduces an additional tax credit applicable after State retirement age, which may be transferable between spouses.

The IAPF recommends that the increase in the tax band or additional tax credit applicable to married pensioners be at least as great as the full qualified adult dependant's allowance under the State social welfare system.

3. Providing an income in retirement

Background

IAPF aims to encourage a position where:

- Pensioners have an adequate income in retirement and in order to protect an individual's standard of living this needs to relate to pre retirement income;

- Pensioners have an income for all of their retired years of an amount sufficient to meet a specified minimum standard of living;

- Pensioners have a mechanism whereby their pensions can be increased whilst in retirement. Given increased longevity IAPF believes that it is important that the value of a pensioner's income is not eroded over time. The mechanism for providing such increases can either be:

  a) Provided as part of the pension scheme's basic benefits (e.g. guaranteed pension increases under an occupational pension scheme);

  b) Selected (and paid for) by the member at the time of retirement (e.g. through the purchase of an annuity with provision for annual increases);

  c) Available to the member and under his/her control during retirement (e.g. through setting aside capital via an ARF).

The IAPF also wishes to encourage a position whereby individuals may make provision to cover the cost of long term care where such need arises. Given the expected reduction in the provision of informal care and the significant increase in the cost of care, this will be a key issue for many pensioners into the future.

IAPF believe that these aims can best be met by encouraging individuals to set aside part of their income during their working lifetime to provide income in retirement. This is the principal aim of the current regime for the provision of retirement benefits in Ireland.

IAPF believes that the Government should continue its commitment to a stable taxation system for pension provision and that pension savings should continue to be afforded the greatest tax incentives because the savings set aside are locked away for a considerably longer period than other tax incentivised savings schemes and the ultimate capital accumulated will be used to provide an income in retirement.

Approved Retirement Funds (ARFs) and Approved Minimum Retirement Funds (AMRFs)

IAPF supports the Minister's view that additional flexibility and choice has been needed from the pension scheme member's point of view in relation to the method of securing an income in retirement.

IAPF notes the introduction of the retirement options in the Finance Act 1999 and the extensions made in the Finance Act 2000. However, the IAPF would encourage caution in any further extension without modification of the existing requirements and the development of safeguards for pension fund members. The IAPF believe that if these options were extended, without modification, to all benefits arising under occupational pension schemes, it would not be in the long-term interests of the majority of members of these schemes.

In the case of defined benefit pension arrangements such extension would also not be in the interest of those members who choose not to transfer their entitlements. The financing of such schemes would suffer from anti-selection, reduced risk pooling and a resultant adverse reduction in investment alternatives. IAPF fear that such experiences would result in an increase in the cost of funding present benefit promises or alternatively a reduction in the adequacy level of retirement benefits provided by occupational pension schemes, depending upon the reaction of the sponsoring employer in each case.

The education of current pension scheme members who, before retiring, may have been familiar and reliant upon fixed salaries and wages as to the investment risks associated with ARFs will be highly important to ensure that the availability of ARFs (or extension thereof) does not expose pensioners to excessive risk of an inadequate income in retirement.

IAPF is committed to continuing its work with the Revenue Commissioners and the Pensions Board to develop proposals which would encourage simplification of the current regulatory and revenue regime governing occupational pension schemes with the objective of enabling the introduction of greater flexibility for members and sponsoring employers of occupational pension schemes. IAPF believe that a structured approach to the improvement of our current system can achieve greater flexibility without threatening the benefits of this system enjoyed by pension scheme members (both in public service and the private sector), employers and the State.

IAPF believe that some amendments to the existing provisions relating to ARFs and AMRFs will assist their operation while maintaining the spirit and integrity of the Minister's objectives. IAPF have set out below a number of recommended amendments to the tax treatment and regulation of these funds and would be happy to liaise further with the Minister's officials on these and other points.

Approved Minimum Retirement Fund

IAPF recognises the value of the Minister's objective in providing for the establishment of an Approved Minimum Retirement Fund where an individual does not have a minimum guaranteed retirement income of €12,700 per annum. IAPF believes that the minimum income requirement of €12,700 p.a. is pitched at a very low level and makes no allowance for the increase in earnings or the cost of living since its introduction in 1999.

IAPF recommends that the Minister raise this minimum income requirement to €15,000 per annum which is broadly in line with the increase in National Average Earnings over the period. This would result in a minimum income requirement equivalent to 60% of National Average Earnings which would provide a reasonable minimum income "safety net". IAPF also recommends that the minimum income requirement be reviewed periodically in line with changes in National Average Earnings.

It is of considerable concern that the alternative to the minimum income requirement is a minimum capital requirement of €63,500. Such a capital amount is wholly inadequate to meet the minimum income objective of the Minister for any individual aged less than 65 with no immediate entitlement to a State pension.

Consequently, IAPF recommends that the current capitalised value of a ε15,000 income stream (reduced by the amount of guaranteed income available to the individual) be used as a benchmark to determine the minimum capital requirements for the AMRF. This could be calculated in line with market rates or a prescribed table. For example, based on standard mortality tables issued by the Institute and Faculty of Actuaries, the following capitalisation factors could apply:

Under age 60	16
Age 60 to 64	14
Age 65 and over	12

As there is no requirement for the assets within the AMRF to be used to provide an income before age 75 (when it becomes an ARF) and in the interests of simplicity, IAPF recommends that a capitalisation factor of 12:1 be adopted.

In addition, IAPF recommends that a prohibition be introduced to prevent individuals from charging, assigning or otherwise transferring the beneficial interest in an AMRF to a third party. This will assist in ensuring the continued security of retirement income for AMRF holders.

To enhance the accessability of ARF's as currently designed, IAPF suggest that provision be made to enable the encashment or conversion to ARF status of an AMRF prior to age 75 in circumstances where an individual attains the minimum guaranteed income level after his/her AMRF has been set up e.g. in circumstances where the individual has substantial guaranteed deferred income at the time he/she sets up his/her AMRF.

Tax Treatment Following Death

IAPF recommends that provision be made for circumstances of transfer following death to non-marital adult dependants (other than children). IAPF recognises that such transfers must be subject to Capital Acquisition Tax as currently chargeable but would recommend that they only be subjected to Income Tax on drawdown at the dependant's marginal rate where the transfer is made to an ARF held in the dependant's name.

Legal Ownership

IAPF recommends that provision be made to allow for the co-ownership of ARFs thus ensuring that the contingent interests of spouses and dependants can be represented in transfers made to such funds. This would have the additional advantage of reducing administrative costs on death and ill health. This could be rectified immediately for spouses without affecting existing taxation provisions.

IAPF would strongly urge the Minister to consider these proposals and make the necessary amendments in the 2003 Finance Act.

4. Entitlement to State Retirement Pension

For pensioners in receipt of the Old Age (Contributory) Pension, the entitlement to a Dependant's Pension on behalf of their spouse is means tested. The structure of the means test includes an effective attribution of income to the capital value of accumulated assets of the couple.

One anomaly has arisen in recent years whereby pensioners who have acquired a second property (perhaps as part of an incentivised rural development scheme) lose their entitlement to the Dependant's Pension as a result of the assessed income that this second property is deemed to earn.

This particularly affects individuals who would ordinarily qualify for the Dependant's Pension under the means test (i.e. if the property were held in the name of one of the couple) but who have placed such property assets in their joint names. Many representative organisations recommend that married pensioners place their assets (including property assets) in joint names to ensure a more smooth transition of assets in the event of the death of one of the couple.

IAPF recommends that the means test in such circumstances be altered to ignore specified non-income producing assets.

5. Capital Acquisitions Tax

The problem in relation to non-marital couples and pensions still exists and we would urge the Minister to institute reform in this area.

Under existing provisions, a spouse is exempt from CAT liability. This means that in the event of the death of a pension scheme member, where a spouse receives a pension, there is no CAT liability, but, of course, an income tax liability does arise.

The position in relation to couples in non-marital situations is very different. An increasing number of pension scheme rules provide for a non-marital partner to qualify for pension benefits on the death of the "member" partner. However, because the couple is not married a CAT liability arises on death based on the aggregate of the capitalised value of any resulting pension and any lump sum payment.

A further anomaly arises because ongoing pension payments remain subject to income tax. So, in effect, the pension is taxed twice – firstly as a capital amount and then as an income receipt. This is a clear case of double taxation. Indeed at the current levels of CAT and Income Tax a pension paid in these circumstances could end up being taxed at a combined rate of 64%.

This anomaly is compounded by the fact that although the CAT liability relates to anticipated future pension payments it has to be funded, as a lump sum, presumably by borrowing or by the disposal of other assets. Conceivably this liability could result in the surviving partner refusing the benefit.

In the UK, Capital Transfer Tax is payable on the lump sum benefit amount only. Whilst IAPF recognises that the blanket tax treatment of non-pension asset transfers to non-marital partners may not be desirable, we feel that if a pension benefit is granted by the trustees of an occupational pension scheme (whether by way of a discretionary exercise of power or otherwise), the resulting benefit should be taxed only once, and would suggest that such benefits be taxed at the relevant income tax rates applying.

6. Personal Retirement Savings Accounts

IAPF welcomes the imminent introduction of PRSAs. However, there are a number of areas where we believe that their introduction will increase the complexity of pension provision in Ireland and would recommend that the following areas be reviewed.

Tax treatment of employer's contributions

IAPF believes that the tax treatment of employer contributions to PRSAs is over-complicated and inconsistent with the treatment of employer contributions to normal occupational pensions schemes. The BIK system will result in employees not already within the self-assessment tax system to be brought into it if their employer makes contributions to a PRSA on their behalf. IAPF believes that employer contributions to PRSAs should be encouraged and would recommend that as few obstacles be placed in the way as possible. IAPF therefore recommends that employer contributions to PRSAs should be treated in a consistent manner to the current treatment of employer contributions to an occupational pension scheme.

PRSA AVCs

The area of PRSA contracts being used as a vehicle for AVC contributions appears also to be unnecessarily complex. IAPF believes that a general review of the area should be conducted with a view to simplifying the overall PRSA AVC regime. One particular aspect that IAPF believes should be immediately addressed relates to employees who are members of an occupational pension scheme perhaps covered for death in service benefits only. Many employers include all new employees for death in service benefits immediately on commencing employment. This is a valuable benefit providing protection for dependants and, in many cases, spouse's and young children. Many employers subsequently admit such employees into their pension scheme for full pension benefits after a period of time, perhaps a probationary period of employment. As the PRSA legislation is currently framed, such members can only take out a PRSA AVC and into which their employer cannot contribute. This would appear to be an anomaly and IAPF believe that such members should be allowed take out an ordinary PRSA.