

# €2.3 MILLION PERSONAL LIFETIME LIMIT ON PENSIONS

The days of big pension funds are over. If you are lucky enough to have built up a sizeable fund in the past, what you have you can hold, up to a point. It's all about SFTs, PFTs and BCEs – yet more bewildering tax legislation, courtesy of the Finance Act 2011.

Finance Act 2011 reduced the personal lifetime limit – the “Standard Fund Threshold” – on the amount of an individual’s tax relieved pension fund from €5.4 million to €2.3 million. Tax on amounts over the limit could be over 73% so action is required immediately by those affected.

If on Budget Day (7 December 2010) an individual has pension funds worth more than €2.3m he or she can apply for a higher limit.

**SFT:** The Standard Fund Threshold (SFT) is the amount against which the value of an individual’s benefits is tested. The SFT is an individual lifetime limit. A tax charge will arise if the capital value of benefits exceeds the SFT. Each occasion that a BCE (see below) occurs, reduces the “unused” amount of the SFT. The current SFT is €2.3 million. This is reduced from an SFT of €5,418,085 before the Budget. The SFT is subject to revision by the Minister for Finance in December each year.

**BCE:** A Benefit Crystallisation Event (BCE) occurs if the individual takes a pension, annuity or lump sum, exercises an ARF option, transfers to an overseas pension arrangement or receives a pension increase which exceeds the permitted margin. Any BCE since 7 December 2005 must be included in assessing whether the individual’s benefits exceed the SFT or PFT (see below).

**PFT:** If an individual has benefits worth more than €2.3 million at 7 December 2010, they can apply to the Revenue Commissioners before 7 June 2011 for a Personal Fund Threshold (PFT). Any BCE since 7 December 2005 must be included in assessing whether the individual’s benefits exceed €2.3 million. If accepted, the PFT replaces the SFT for the individual. The maximum PFT that can now be applied for is €5,418,085 (i.e. the old SFT limit). If an individual obtained a PFT of greater than €5,000,000 in 2005, that PFT continues to apply.

## HOW DOES IT WORK?

The standard limit is known as the Standard Fund Threshold (SFT). This is now set at €2.3 million with effect from 7 December 2010. It can be adjusted by the Minister for Finance in later years. If an individual’s pension benefits are worth more than this SFT, the excess is liable to double taxation.

This happens normally at the point of retirement. Revenue call this a Benefit Crystallisation Event (BCE). Each time a BCE occurs, a part of the SFT gets used up. When the aggregate of benefits taken at BCEs exceeds the SFT/PFT, there is a tax of 41% payable. This is in addition to any other tax due on receipt of the benefit.

## HOW DO YOU WORK OUT IF THE LIMIT IS EXCEEDED?

Any retirement accounts in a defined contribution scheme or Personal Retirement Savings Account are added together. For lump sums, ARFs and overseas transfers, the value is the actual amount paid or transferred. The value of any defined benefit pension is 20 times the pension accrued at the date of calculation. So all pension funds of the individual are added together to test if the SFT/PFT limit is exceeded.



## WHAT IS THE TAX?

Any amount over the SFT/PFT is subject to an up-front tax charge, currently at the rate of 41%. Tax is payable by the administrator in the first instance but both the administrator and the individual are jointly and severally liable for the tax due. For most schemes, the administrator is the trustee. Legislation allows for the commutation of so much of an individual's entitlement as may be necessary to discharge the tax liability. If the administrator pays the tax without reducing the individual's assets, that tax paid is considered a benefit, and the tax charge is on a grossed up value of the excess. Personal tax is payable as normal on the pension /ARF in addition to the tax charge.

## ARE THESE RULES LIKELY TO CHANGE?

Watch this space. A change of government could result in a change of policy in this area. The rules are unlikely to be made more generous. What is quite possible is that the revised limits will be reduced further.

# EXAMPLE

John is 62 and has a pension promise of 2/3rds of salary at age 65. He has a pension of €5,000 from a former employment which came into payment at age 60. His salary at 7 December 2010 was €250,000 and his accrued pension was €125,000. He had an AVC fund value of €400,000.

John can apply for a PFT of €3,000,000 [(€5,000 x 20) plus (€125,000 x 20) plus €400,000].

The unused PFT is €2,900,000 [€3,000,000 less (€5,000 x 20)].

John retires at 65 on a salary of €300,000 and a pension of €200,000. His AVCs have increased to €500,000. Ministerial orders have increased the SFT at December 2011, 2012 and 2013 so that the SFT at 1 July 2014 is €2,438,000, an increase of 6%. Ministerial orders have also increased the unused PFT by 6%.

His tax liability is calculated as follows:

Pension	€4,000,000	(i.e. €200,000 p.a. x 20)
AVCs	€500,000	
Benefits at BCE	€4,500,000	
Less unused PFT	(€3,074,000)	(i.e. €2.9m increased by 6%)
Chargeable excess	€1,426,000	
Immediate tax	€584,660	

The pension paid to John using the net benefit will be subject to income tax during payment in the usual way.



## WHAT DO INDIVIDUALS NEED TO DO?

If your benefits are currently over €2.3m?

- The individual must apply for the PFT where applicable. The deadline is 7 June 2011.
- All relevant benefits (AVCs, former employers, relevant overseas pensions, personal pensions, PRSAs, public sector schemes) should be included.
- BCEs since 7 December 2005 must be included.
- Individual advice may be required.

## COULD YOUR BENEFITS REACH THE SFT IN FUTURE?

Any individual who will have a future BCE could be affected.

All individuals who are or may be affected by the SFT should consider the following:

- Consider stopping AVCs if your overall benefits are coming close to or exceed the SFT. While there may be some scope for further contributions due to Ministerial orders increasing the SFT/PFT, this increase may possibly be met by investment return alone.
- Consider discussing revised remuneration package with employer – e.g. cease future pension accrual and increase other benefits.
- Consider investment strategy for defined contribution assets – e.g. reducing risk.
- Consider other saving options.
- Consider effect of any changes on death benefits – e.g. a dependant's pension defined as a set percentage of pension expectation may need to be redefined as a higher percentage if future pension accrual is being reduced or stopped altogether.

## WHAT DO EMPLOYERS NEED TO DO?

- Ensure there is communication with those senior employees who are affected.
- Consider what changes are required to benefit provision for those with a PFT.
- Consider what changes are required to benefit provision for those expected to reach the SFT.
- How should defined benefit accrual be valued to consider alternative remuneration packages? The factor of 20 used to value benefits for tax purposes may not be realistic.
- Request scheme rule amendments to confirm any tax liability to be met by commutation of benefits (if such a rule not in place already)
- Consider scheme rule amendments to cap pension value at the SFT/PFT
- Consider employment contract situation
- Consider the implications and effects of a defined benefit scheme deficit.

## WHAT DO TRUSTEES NEED TO DO?

- Communication may be required to affected or potentially affected individuals.
- Ensure procedures in place for testing for tax charge at BCEs – need to ensure full disclosure by members of all retained benefits.
- Check rules to see if they give the trustees the power to deduct and pay the tax on the excess over the SFT/PFT – consider amending rules if necessary.
- Consider revising members' explanatory booklets to reflect SFT issues.
- For Defined Benefit schemes, consider whether an immediate tax charge on retirement may increase the deficit where pensions are paid out of the fund?

**BEWARE:** The SFT and PFT apply to all retirement benefits, regardless of which pension arrangement they come from. So even if an individual's benefits under his or her current occupational pension scheme are nowhere near the SFT, they may have separate AVCs or retained benefits which will bring their total benefits over the SFT.

# DEFERRAL OF ANNUITY PURCHASE

6 March 2011 is the deadline to take defined contribution scheme benefits if you deferred receiving them since December 2008.

In 2008, the Minister for Finance announced that individuals retiring from a defined contribution scheme could take their tax-free cash but defer purchasing an annuity until December 2010. This has been extended to 6 March 2011.

This extension was brought in to allow these defined contribution members the option of transferring their benefits to an Approved Retirement Fund ("ARF"). The ARF option is open to all defined contribution members with effect from 1 January 2011.

The minimum fund/income requirements around an ARF have been increased. Before money can be transferred to an ARF, the individual must have guaranteed minimum pension of €18,000 p.a. (increased from €12,700) or alternatively place €119,800 in an Approved Minimum Retirement Fund (increased from €63,500).

An individual who retired from a defined contribution scheme between 4 December 2008 and 6 February 2011 and deferred their annuity purchase now has until 6 March 2011 to opt to transfer to an ARF. If they do so, they will be subject to the old minimum pension/fund requirements of €12,700 p.a. or €63,500 capital.



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