

National Pensions Framework

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The Department of Social and Family Affairs published the National Pensions Framework today, 3 March. There is no immediate change to taxation or pensions legislation as a result of this publication; it sets out a framework for the future provision of pensions. The framework is scheduled to be implemented over a five year period and the principal changes envisaged include:

- Mandatory approach to pension scheme membership
- Effective tax relief on personal pension contributions at 33%
- Approved Retirement Funds (ARFs) for all members of Defined Contributions (DC) schemes
- Tax Free Lump Sum - €200,000 cap
- Increasing the state pension age
- New public service pension scheme

Pensions are complex with a myriad of different arrangements. PwC believes this is a factor in people's inertia in engaging in the process and making a pension savings commitment.

There is a danger that the new mandatory scheme may be seen as a further complexity and indeed a financial burden. On the other hand, the availability of ARFs to all members of DC schemes is to be welcomed, as it offers greater flexibility on retirement.

The framework contains a commitment to simplification of the pensions regime and PwC hopes that this is followed through with a view to encouraging greater participation in pensions.

Mandatory approach to pension scheme membership

By 2014 the framework envisages a new regime for employees who are not currently members of adequate employer sponsored pension schemes. The measures will impact those earning between approximately €18,000 and €50,000 and the mandatory contributions to the pension schemes will be

- 4% of pay by the employee
- 2% by the employer and
- 2% by direct state top-up

Whilst an employee may opt out of this scheme they will be automatically re-enrolled every 2 years. Even if the employee opts out of their contributions the employer will still be required to pay 2%.

There will be a once off bonus top-up by the state after 5 years of continued membership.

The state contribution of 2% is akin to tax relief at 33% of contributions.

The exact workings of the scheme need to be finalised and may be cumbersome and complex to administer. The 4% contribution may be seen as an additional tax by employees and the 2% contribution will be seen as an additional payroll cost by employers.

Effective tax relief on personal pension contributions at 33%

The framework proposes that personal contributions to pension schemes will be matched by a state top-up payment, equivalent to 33% tax relief similar to the arrangement under the new mandatory

pension scheme referred to above.

This carries forward a recommendation made in the Commission on Taxation report of last autumn. This is good news for low income earners who pay no tax or pay tax at the standard rate only but bad news for marginal rate taxpayers who currently get tax relief at 41% plus levies etc. As personal contributions to pensions will no longer be relieved 'at source' through payroll, the new system will lead to increased PRSI costs for employees and employers.

These changes are likely to take a number of years to implement and in the meantime top rate taxpayers should continue to maximise their personal pension contributions before the reduced rates take effect. On a positive note the framework sees no need to adjust the tax treatment of employer contributions made on behalf of employees. This presents an opportunity for employers to ensure that their reward packages optimise the attractiveness and flexibility of employer pension contributions.

Approved Retirement Funds (ARFs) for all members of DC schemes

From 2011 all members of DC pension schemes will qualify for the ARF regime. This means that employees will no longer be forced to buy an annuity with their pension funds at retirement. ARFs will allow them to invest the value of employee and employer contributions, direct how those funds are invested and leave the unused portion of the ARF as an asset to their estate.

This is also good news. Formerly the flexibility of ARFs were available to the Self Employed, Proprietary Directors and AVC holders only.

Given that ARF assets can fall in value individuals should seek professional advice before making any investment decisions at retirement. The security of an annuity for life should always be a consideration for retirement income.

Tax Free Lump Sum - €200,000 cap

The framework reiterates the recommendation that the overall limit on Tax Free Lump Sums from pensions should be confined to €200,000. The current upper limit is €1.35m and no timeframe has specifically been mentioned for the reduction. In addition there is no guidance as to the rate of tax that may apply to lump sums above the €200,000 limit.

Individuals may have earmarked their pension lump sum for certain expenditure, such as paying off mortgages etc. In addition many employees may have paid tax on termination payments when leaving their employers in the expectation of a tax free pension lump sum above €200,000. Tax legislation may be needed to ensure that these individuals do not effectively pay tax 'on the double'.

Individuals who are currently over age 50 whose tax free pension lump sum would be reduced as a result of these changes should take professional advice about their options around early retirement

Increasing the state pension age

By 2014 the framework provides that the state pension age will be pushed out to 66 years, to 67 by 2021 and to 68 from 2028.

This rate of change is far quicker than the measures announced in the United Kingdom where their deferment to age 66 does not start until 2026.

Employers with Defined Benefit, (DB) pension schemes should take advice about any funding implications that might arise where their benefits are integrated with the state pension.

Some employers currently provide early retirement pensions (for example as part of a redundancy programme) that 'bridge' the gap until state pensions commence. The push back of the state pension start date will have an increased cost implication for such a plan in the future.

Extending working lives can have a positive impact on retirement income, especially for those with DC pensions for three complementary reasons:

- Pension pots accrue for longer;
- Longer periods for people to contribute to their pensions; and
- Higher annuity rates for older retirees.

For those with DB pensions, the effect is less dramatic but still significant. Combining these points with the long-term shift from DB to DC means that more people will have a financial incentive to work longer.

A key policy issue to be faced will be the need for the education and training system to

step in and provide opportunities for up-skilling and re-skilling, targeted specifically at the older worker, to enable continued participation in the labour market.

New public service pension scheme

A public service pension scheme will be introduced for new entrants from 2010. It is intended that all civil and public servants will have the same basic scheme. Key elements of the scheme include:

- A minimum public service retirement age of 66 and henceforth linked to the state pension age;
- A maximum retirement age of 70;
- Pensions to be based on career average earnings rather than the current final salary arrangement.

The details are to be finalised by Government in consultation with public service employers and unions and will include consideration of areas such as employee contributions, pension accrual rate, arrangements for groups of employees such as Gardaí, Permanent Defence Forces, Prison Officers, members of the Oireachtas and the Judiciary.

For existing and future public service pensioners consideration is to be given to using CPI as the basis for future post retirement increases compared to the current linkage to salary at retirement grade.

Conclusion

The framework is scheduled for implementation over the next five years - with some elements such as widening the availability of ARFs scheduled for 2011. Without doubt there will be many technical changes to current regulation and practice.

PwC will be monitoring these as they emerge and will keep you apprised of important developments.

