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Contents

Page No.

1 Occupational and personal pensions
An explanation of defined benefit schemes, defined contribution schemes, Additional Voluntary Contributions, Personal Retirement Savings Accounts, buy-out bonds and small self-administered pension schemes.

4 What happens when you leave your job
If you cease to be an active member of your pension scheme, what happens to your stake depends on the terms of the scheme and on the law.

5 What happens if the pension scheme ends

5 Accessing your pension benefits
This includes the age for getting benefits, Approved Retirement Funds, taxation arrangements and what happens after you die.

7 How pension funds are treated in the social welfare means test

8 Other pension issues

Issues about pensions

This issue deals with various aspects of pension contributions and payments including what happens when you leave your job, transfer your pension scheme abroad, the tax that applies to the different pension arrangements and how pension funds are treated in the social welfare means test. The rules are very complex and here we look at the general position.

In recent years, there have been many changes in the rules governing pensions and new pension products have emerged. Many people are concerned about the security of their pensions or what will happen to existing pension arrangements if they lose their jobs or go abroad for a period. Many defined benefit pension schemes are being closed to new entrants. Members of defined contribution schemes now have more options about how they organise their retirement income. It has been suggested that people should be able to access their pension funds if they are having problems paying their mortgage, although this is not possible at present. The tax arrangements for pension contributions are widely known but the tax arrangements for the benefits from pension funds are less well known.

Occupational and personal pensions

In general, occupational pension schemes are trusts established for the benefit of the members of the scheme. They are regulated by the Pensions Board. Personal pensions are insurance policies. Each pension scheme or insurance policy can broadly set its own rules in relation to aspects such as the levels of contributions and benefits, coverage for dependants and for ill-health and early retirement provisions.

INSIDE: Pension scheme benefits p2, Refund of contributions p4, Early retirement p5, Tax deductions and PRSI p6, Pension funds and the social welfare means test p7, Pension pot p8

However, the rules for occupational pensions must accord with the requirements of trust law, the Pensions Acts and the rules established by the Revenue that decide whether or not the contributions to the scheme attract tax relief. The Pensions Acts are very complex and detailed and deal with the funding standards for pension schemes and the rights of individual members of schemes to information, among other things.

The rules for personal pensions must also accord with the Revenue rules.

The rules set by the Revenue mainly aim to ensure that the funds are used to provide retirement income and not simply to avoid tax or to finance other activities. The Taxes Consolidation Act 1997, as amended, sets out the circumstances in which the Revenue may approve pension schemes for the purposes of tax relief and then gives Revenue the discretion to approve schemes which do not meet all those circumstances. In practice, the vast majority of approved pension schemes are approved under Revenue's discretionary powers. Revenue has published a detailed *Pensions Manual* which sets out the way in which it operates its discretionary powers – this is available at **revenue.ie**.

Benefits

The benefits that you get from your pension scheme depend on the type of scheme it is and the rules which apply. In general, schemes provide for a payment to you in your retirement and most schemes include provisions for payments to your dependants after your death although, in some cases, there may be a separate scheme for dependants.

The amount of your pension depends on the terms of the scheme and the Revenue rules. There are age-related limits on the earnings that attract tax relief and there are limits on the benefits which you may receive – the maximum amount you may receive at normal retirement age is a pension of two-thirds of your final pay.

Defined benefit schemes

A defined benefit scheme, as the name suggests, defines the benefits you will receive on retirement. For example, it may state that you are entitled to a lump sum of the amount of your annual salary at retirement and an annual pension of one-eightieth of your final salary for each year of service; some schemes may simply provide for a specified amount. The contributions may have to be varied from time to time in order to make sure that the fund can meet the level of benefits.

Some schemes have provisions for the employer to top up the fund if necessary. If this provision is not included in the scheme, then there is no obligation on the employer to top up the fund. In some cases, employers do this voluntarily.

In practice, defined benefit schemes are having difficulties in ensuring they have an appropriate level of funding and many employers no longer provide such schemes for new employees.

When you retire, your pension is paid from the fund. You do not have the option of investing your fund in annuities or Approved Retirement Funds (ARFs).

Defined contribution schemes

A defined contribution scheme is one in which the contributions are set and the benefits are dependent on the amount in the fund at the time of your retirement. As a result, you do not know what level of pension you will get. When you retire, you can use the money in the fund to buy an annuity – that means you buy an insurance policy which provides guaranteed regular payments for the rest of your life in return for your investment. Alternatively, as a result of new rules introduced in 2011, you may invest your fund (or part of it) in an Approved Retirement Fund (ARF) or an Approved Minimum Retirement Fund (AMRF). The option of investing in an ARF must be exercised not later than the date on which the annuity or pension would otherwise become payable.

Additional Voluntary Contributions

Additional Voluntary Contributions (AVCs) are, as the name suggests, extra contributions which you may decide to make, in addition to the contributions being made under the occupational pension scheme. Most occupational pension schemes have a facility for making AVCs but to have such a facility is not a legal requirement. If a particular scheme does not have such a facility, your employer is obliged to facilitate your access to a Personal Retirement Savings Account (PRSA) to be used for AVC purposes.

You can decide how much to contribute in AVCs and you can stop making contributions when you choose. You are, of course, subject to the limits on tax relief and benefits set by the Revenue for all pension arrangements.

When you retire, you may use your fund to buy an annuity or you may invest your fund (or part of it) in an Approved Retirement Fund (ARF) or an Approved Minimum Retirement Fund (AMRF) - see page 6.

Personal pensions

A personal pension is more correctly called a *Retirement Annuity Contract* (RAC). The rules governing RACs are set out in the Taxes Consolidation Act 1997. An RAC is a contract between you and a life assurance company. RACs are not regulated by the Pensions Board but are regarded as financial services, which are regulated by the Central Bank of Ireland.

In order to have an RAC, you must have earnings from a trade or profession or from non-pensionable employment.

You may contribute any amount towards your RAC but there are annual age-related limits on the amount which attracts tax relief in the same way as for occupational pensions. The premiums you pay are invested by the insurance provider – you can exercise various choices about where the investment is made. You may transfer your fund from one insurer to another.

In general, an RAC allows you to take benefits anytime after the age of 60 and before the age of 75. You do not need to be retired. In certain occupations, benefits may be taken between 50 and 60 but this needs specific Revenue approval. You can take benefits at any age if there is medical evidence to show that you are "permanently incapable through infirmity of mind or body" of carrying on your own occupation or any occupation of a similar nature for which you are trained or suitable.

You have a number of options as to how you use the money in your fund. You may take up to 25% of the fund as a tax-free lump sum. You may buy an annuity – that means you buy an insurance policy which provides guaranteed regular payments for the rest of your life in return for your investment. Alternatively, you may invest your fund (or part of it) in an Approved Retirement Fund or an Approved Minimum Retirement Fund.

Personal Retirement Savings Accounts

Personal Retirement Savings Accounts (PRSAs) are designed to enable people, especially those with no occupational pension provision, to save for retirement. A PRSA is a contract between an individual and a PRSA provider in the form of an investment account.

Everyone under the age of 75 may contribute to a PRSA even when they are not working. No minimum or maximum limits have been set on how much an individual can pay. The usual rules about tax relief on contributions apply. Employees whose company has not put a pension scheme in place or who are excluded from their company's pension scheme must be given access to at least one standard PRSA by their employer.

Employers are not themselves obliged to contribute to the PRSA scheme. If employers do contribute, the amount involved is regarded as a benefit-in-kind to the employee and is taxable as such. PRSAs can be transferred from one provider to another.

If you have a PRSA you may start to avail of it at anytime after 60 years of age and before 75. You don't have to retire to draw on your fund. The usual rules about early retirement and retirement on the grounds of ill-health apply (see page 5).

If you die before drawing on your fund, your total contributions are passed on to your estate. Income tax does not apply but the normal rules about Capital Acquisitions Tax do. If you die after you start to draw down benefits, the tax rules are the same as for Approved Retirement Funds.

You may invest the proceeds of your fund in an Approved Retirement Fund or an Approved Minimum Retirement Fund.

Buy-out bonds

A *buy-out bond* is an insurance policy or bond which is bought in your name by the trustees of a pension scheme as an alternative to you claiming the usual benefits under the scheme. There are detailed rules set by the Revenue about the operation of buy-out bonds. The bond may provide you with a lump sum and/or a regular income in retirement – the benefits you get depend on the terms of the individual bond.

Small self-administered pension schemes

There is no specific legislation dealing with small self-administered pension schemes. The Revenue have discretion to approve such schemes. They may be established by an employer for a director(s) and/or employee(s). In practice, such schemes are usually established by the owner of a business for him/herself and have only one member who is also the trustee of the scheme, although they can generally have up to 12 members and still be considered small.

Schemes established mainly for directors of a company may also be considered small.

As well as the normal requirements for approval of pension schemes, these schemes must meet further requirements – this is to ensure that they are established for purposes of providing a pension in retirement and not simply as tax avoidance schemes. They must have an approved Pension Trustee – that is, a person with appropriate experience in preparing financial reports and related activities. All trustees are subject to the requirements of trust and pension law but trustees of these schemes must meet other specific requirements. This trustee cannot be changed without specific approval from Revenue.

Such schemes must submit annual accounts to Revenue; these accounts must set out the contributions made, the investment income and other information.

From January 2011, these accounts must be transmitted electronically. (This requirement to supply such information to Revenue does not apply to occupational pension schemes generally or to personal pension plan providers.)

There are detailed rules about scheme investments to ensure that they are at arm's length from the members of the scheme and that they will be able to provide benefits at the appropriate time. Certain transactions by the scheme can be regarded in the same way as a pension payment and are subject to tax.

While a scheme can provide for commutation where the member is seriously ill, such a decision is subject to Revenue approval (in general, such decisions are made by the trustees).

What happens when you leave your job

If you change job or you are made unemployed or if you leave your job for any other reason (other than reaching normal retirement age or dying) you cease to be an active member of your pension scheme. You may have built up a considerable stake in that pension scheme and what happens to that stake depends on the terms of the scheme and on the law.

Refund of contributions

If you have been in the pension scheme for more than two years you cannot get a refund on your contributions. If you have been a member for less than two years, you can get a refund of your own contributions but not of any contributions made by your employer. You are liable to tax at 10% on the amount of the refund. If you take a refund, you are generally no longer entitled to any benefits from the scheme but there are some limited exceptions to this. If you place your refund in a PRSA, there is no tax payable.

Preserved benefits: deferred or frozen pension

In this situation, your and your employer's contributions remain in the scheme and you are eligible for benefits in the normal way when you reach normal pension age. The rules in relation to ill-health and early retirement can apply in the same way as if you continued to be a scheme member. You are sometimes described as having *preserved benefits* in the scheme.

Deferred annuity or buy-out bond

Instead of the deferred pension arrangement, the scheme may provide that the benefits be provided by an assignment to you of a paid-up insurance or annuity policy already held by the scheme. Alternatively, the scheme may buy a buy-out bond in your own name.

Transfer to another employment

If you change job, a scheme may make a transfer payment of your stake to another approved scheme, to a buy-out bond or to a PRSA (although there are some restrictions on transfers to PRSAs).

Transferring to a scheme abroad

It is possible to transfer your pension fund benefits or your PRSA assets to an overseas arrangement. The rules are complex and are set out in the Occupational Pension Schemes and Personal Retirement Savings Accounts (Overseas Transfer Payments) Regulations 2003 (SI 429/2003) and in the Revenue *Pension Manual*.

Under an occupational pension scheme, these rules provide that you may transfer the benefits only when you have left the relevant employment and you have preserved benefits. The trustees of the scheme or the PRSA provider must also be satisfied that the overseas arrangement provides similar benefits for your retirement and is appropriately regulated. If the transfer is to an EU member state, the overseas scheme must be operated or managed by an Institution for Occupational Retirement Provision (IORP), as defined in the EU Pensions Directive (Directive 2003/41/EC). A transfer to a country outside the EU may only be made to a country in which you are employed at the time of the transfer.

The transfer must be made for genuine reasons and not for the purpose of avoiding Irish tax rules.

When you leave employment and consequently leave a pension scheme, the trustees of the pension scheme are required to provide full details of the rights and options available to you. You can apply for a transfer payment within two years of the end of your employment (or longer if the scheme allows) but before the preserved benefit becomes payable. Arrangements to make the transfer payment must be made by the scheme within three months of the application being received.

What happens if the pension scheme ends

Your pension scheme could end because your employer decides to stop paying into it or is liquidated or made bankrupt. There is no law requiring an employer to continue to contribute to a pension scheme. If all contributions to a scheme end, then the scheme is *paid up*. The funds in the scheme are held by an administrator to be paid out in accordance with the rules of the scheme.

If it is decided to wind up a scheme and there are sufficient assets in the scheme to meet the liabilities, then your pension may be transferred to another approved scheme or to a PRSA or to a buy-out bond in your name or an individual scheme policy may be assigned to you.

In defined contribution schemes, the benefits are dependent on the amount available in the fund.

If there are not sufficient assets to meet the liabilities when a defined benefit scheme is wound up, there are rules about the order of priority for payment of pensions.

The order of priority is:

- AVCs
- Current pensioners
- Future pensioners
- Future increases to both current and future pensioners

Accessing your pension benefits

Age for getting benefits

In order to get Revenue approval, an occupational pension scheme must specify a normal retirement age. In general, this must be between 60 and 70 but exceptions may be made for specific occupations.

You have to retire to avail of your occupational pension. The age at which you can retire is usually set in your conditions of employment. Generally, you may take benefits from personal pensions and PRSAs (see page 3) from age 60 whether or not you are retired.

Early retirement

If you retire early due to illness, your pension benefits may be payable immediately. The benefits to which you are entitled depend on the terms of your pension scheme.

It is possible to have a scheme that allows you to get a pension equivalent to what you would have got if you had worked until normal retirement age. If you are very seriously ill, that is, not expected to live for more than a year, your pension fund may be commuted if the scheme allows for this. Commutation in this context means being turned into cash. You may get a tax-free lump sum and the rest of the fund would then be taxed at 10%.

Otherwise, early retirement benefits may be paid from the age of 50. The maximum pension you may get is calculated using a complex formula which is related to your years of service and the number of years left until normal pension age.

If you retire early, you may defer your benefits until you reach normal retirement age.

Approved Retirement Funds

Approved Retirement Funds (ARF) and Approved Minimum Retirement Funds (AMRF) are not pension schemes. They are investment funds into which the proceeds of certain pension arrangements can be invested at retirement. They are not regulated by the Pensions Board but, as financial services products, they are regulated by the Central Bank of Ireland. They are managed by qualifying fund managers – banks, building societies, assurance companies and other financial institutions.

As stated previously, you may invest the proceeds of your RAC, PRSA, AVCs or defined contribution occupational pension in an Approved Retirement Fund or an Approved Minimum Retirement Fund. You may take up to 25% of the fund as a tax-free lump sum. (You may take the entire amount in cash but, if you do, 75% is subject to income tax in the year you receive it.)

You may place your money in an Approved Retirement Fund (ARF) if you are aged over 75 or if you have a guaranteed income of at least 1.5 times the level of the State Pension (Contributory) – close to €18,000 per year in 2011. You may have more than one ARF and you may transfer amounts between ARFs.

If you do not have this guaranteed minimum income and are aged under 75, you must invest in an Approved Minimum Retirement Fund (AMRF). You must set aside in the AMRF 10 times the maximum rate of the State Pension (Contributory) – €119,800 at present – or a lesser amount if less is available in your pension fund. If you do invest in an AMRF, you do not get access to the capital in the fund until you reach the age of 75. At that stage the AMRF is converted to an ARF. The AMRF may be converted to an ARF at an earlier stage if you meet the minimum income requirements.

The minimum income requirement is assessed at the point of retirement. So, if you retire at 60, it cannot take account of your entitlement to a State Pension (Contributory) because that is not payable until later. The State Pension (Contributory) can be taken into account when it becomes payable.

Alternatively, you may buy an annuity with the first €119,800 of the pension fund and place the balance in an ARF (or take it in cash, which is immediately taxable).

You may withdraw income or capital from an ARF at any time, subject to tax.

The initial capital invested in an AMRF cannot be withdrawn but any income or gains may be. Transfers may be made from one AMRF to another AMRF. You cannot have more than one AMRF.

Transition arrangements

The minimum income requirement for an AMRF was €12,700 a year before the passing of the Finance Act 2011 on 6 February 2011 changed it to €18,000. This €12,700 minimum income requirement continues for a period of three years for people who already had an AMRF at that date or who had availed of the deferred annuity purchase option and invested in an AMRF before 6 March 2011. If they meet the €12,700 requirement within three years their AMRF becomes an ARF. (The deferred annuity purchase option was a discretionary measure introduced in December 2008 which allowed people to defer buying an annuity for two years because of the poor performance of pension funds; the deferral period was extended to 6 March 2011.)

Taxation of proceeds of retirement funds

Any income or gains to the funds within the ARF or AMRF are not subject to taxation.

Once you receive income from the ARF or AMRF, it is subject to income tax and the Universal Social Charge in the normal way. If you do not take an income from an ARF, you are assumed to receive 5% of it each December and this is taxed in the normal way.

Withdrawals from an ARF are called distributions. The qualifying fund manager is obliged to deduct tax and other relevant charges from the amount being paid (or assumed to be paid). There are strict rules about the use of an ARF for other than the provision of an income. For example, if you use your ARF as security for a loan, or if any of the assets of the fund are sold to you or to a person connected with you, the transaction is regarded as a distribution and is subject to income tax. You may, however, use your ARF to buy an annuity for yourself and that is not regarded as a distribution.

Annuity payments are taxable in the normal way.

PRSI

In general pension payments are not subject to Pay Related Social Insurance (PRSI) so, for example, PRSI is not chargeable on annuity payments. However, ARFs are not pensions but are regarded as investments and the income from them is subject to self-employed PRSI (Class S). No PRSI is payable after the age of 66.

ARFs after you die

If you die and neither your spouse nor your children are the beneficiaries of your ARF, then the remaining funds are treated as a distribution to you in the year of your death and income tax is applied to that distribution in the normal way.

If your spouse inherits the ARF and the proceeds are put into an ARF in your spouse's name, he or she is not liable for income tax or Capital Acquisitions Tax (CAT) on the amount involved.

Children aged under 21 who inherit are not liable to income tax but may be liable for CAT if the amount is above the relevant threshold. Children aged over 21 who inherit are liable to income tax at the standard rate (20%) and may be liable for CAT, depending on the amount involved.

Other beneficiaries are liable for income tax and CAT in the normal way.

Similar arrangements apply when the spouse who inherited the ARF dies – children under 21 do not pay income tax while children aged over 21 are liable to income tax at the standard rate and CAT may apply.

Very small funds

In some cases, the pension fund available may be so small that the costs of setting up an annuity or other arrangement may not be justified (such funds are referred to by the Revenue Commissioners as *trivial*).

In certain circumstances, the Revenue allow you to receive the amount in the fund less 10% tax – this is known as commutation of the fund (payment in one sum). This may happen if the total benefit you could receive from the fund is less than €330 a year or if, after receiving any lump sum due, the remaining amount available for pension benefit is less than €20,000. There is a process for determining the fund value of a defined benefit pension to see if it is less than this. The €20,000 limit is reviewed from time to time.

These rules are not set out in legislation but are made by the Revenue under its discretionary powers in relation to pensions. They apply to all pension arrangements including buy-out bonds.

The details are published in the Revenue *Pensions Manual*.

How pension funds are treated in the social welfare means test

Some people who are receiving benefits from a pension fund may also be eligible for a social welfare means-tested payment, for example, Jobseeker's Allowance or State Pension (Non-Contributory). In practice, the vast majority of people who have pension fund benefits also qualify for the State Pension (Contributory) from age 66 but there may be some who do not and they may apply for a State Pension (Non-Contributory).

If you have a pension fund to which you have no access, for example, you are aged 55 and cannot access your pension benefits until you are 60, then your pension fund is not considered at all in the means test.

If you have a pension fund which you are entitled to access but which you have not actually accessed, the cash and/or capital value of the fund is taken into account in the means test. If you have a buy-out bond, its terms determine whether or not you can access it and, therefore, whether or not it is taken into account. For example, its benefits may be immediately available to you or they may be deferred until normal retirement age. If the benefits are immediately available to you, then they are taken into account in any social welfare means test.

The social welfare means test assesses cash income and capital differently. In general, the full amount of cash income is taken into account while a formula is applied to capital to decide what it is worth each week to you (even if you are not getting any income from it). If you are receiving a regular pension payment, that is regarded as cash income.

A lump-sum payment is treated as capital. If you spend your lump sum, you may be questioned about how it was spent. If you gave away some or all of it, it may still be assessed in the means test.

A capital sum in which you only have a life interest, for example, an investment which pays you regular pension payments but will not ever be owned by you or your estate, is not taken into account as capital (the regular payment is taken into account as cash). For example, your capital in an AMRF is not available to you and so is not taken into account in the means test. It does become available to you at age 75 because it becomes an ARF so it can be taken into account.

The Citizens Information Board provides independent information, advice and advocacy on public and social services through citizensinformation.ie, the Citizens Information Phone Service and the network of Citizens Information Services. It is responsible for the Money Advice and Budgeting Service and provides advocacy services for people with disabilities.

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If you are aged under 75 and have an ARF, you must have a guaranteed minimum income already so you should not be eligible for a social welfare means-tested payment.

Other pension issues

Pension levy

A pension levy of 0.6% is being imposed on the capital value of pension funds to help pay for the Jobs Initiative (see *Relate*, June 2011).

How exactly the levy affects individual members of pension schemes depends on how the trustees of the scheme decide to deal with it. They may reduce current or prospective benefits.

If they do, the reductions must be applied in an equitable manner across all scheme members, including active, deferred and retired members.

Pension pot

Since December 2005, there has been a limit on the maximum pension fund you can have available at retirement – this is commonly referred to as a pension pot. The limit, which is known as the *Standard Fund Threshold* was set initially at €5 million. It increased in line with the cost of living until it was reduced to €2.3 million in the Finance Act 2011.

If you had already built up more than this you could have made a declaration of this higher amount – called a *Personal Fund Threshold* – before 7 June 2011 and this would then be your maximum pension fund limit.

If your pension fund at retirement is greater than the relevant limit, you are liable to income tax at the top rate of 41% on the excess amount.

Approximately 1,200 people declared a Personal Fund Threshold under the Finance Act 2011 provisions.

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