Proposals to boost long term savings/pensions

Objectives

- To provide creative yet practical ideas that encourage long term savings to meet retirement needs
- To simultaneously, strive to stimulate economic activity, increased employment and benefit the Exchequer's tax take where possible

Principles

- Any changes to the existing pension regime should ensure there is a consistent and level playing field for all product providers
- Simplifying pensions is key. Research shows their complexity discourages investors

Executive Summary

Proposals

1. **Allow full mobility between pensions contracts**
   - The UK introduced full mobility in 2006 and has enjoyed a marked increase (15% in first year) in pensions take up and the amount saved since that time. We would hope for a similar boost to pension savings in Ireland
   - As pension savings grow - increased employment potential and associated knock on economic benefits
   - Long term - increased tax take from higher retirement income and potential savings on social welfare payments as the need for high future old age pension payments is lessened

2. **Eliminate arms length rule to stimulate pensions savings especially amongst the self employed**
   - Boost pensions take up
   - Provide economic stimulus via knock on effects of increased property investment
   - Increased Exchequer tax take

3. **Re categorise Approved Retirement Funds as pensions, to allow Ireland become a global hub for UK expatriate pensions**
   - Economic benefit of billions of extra euro to be managed in Ireland Inc
   - Increased tax take for the Exchequer

4. **Tax those who are retired equally**
   An anomaly exists between the treatment of personal retirement savings accounts (PRSAs) and Approved Retirement Funds (ARFs) for retired investors. ARFs are taxed at 3% each year on the value of the underlying fund - PRSAs are not.
   - Taxing PRSAs would remove this anomaly and provide additional income for the Exchequer

Submission for Commission on Taxation

Proposal 1

Allow full mobility between pension contracts
The UK allows complete freedom of movement between different types of pension contracts since A day 2006. There are very few remaining differences in the treatment of these different pension schemes. *Pensions take up has increased by 15% one year following its introduction.

For example, UK investors can now move freely between their executive pension plan (EPP), personal pension plan or stakeholder pension (UK equivalent of our PRSA).

Ireland lags behind the UK on this flexibility. To maintain Ireland's reputation for implementing progressive pension policy and to stimulate increased pension take up we believe it makes sense to match the UK measures.

* Cost of tax relief in 2005/06 = £25,400m. Total contributions are £87,586 million.
Cost of tax relief in 2007/08 = £29,300m. Total contributions are £101,034 million (a 15% increase).
Statistics for pension take-up in year 2 should be available in June 2009.
Source: HMRC

Reason for lack of mobility - currently investors cannot switch between PRSAs and PPPs
The historical reason for restricted movement between pension contracts in Ireland occurred at the launch of PRSAs. The government understandably wanted them to succeed. Permitting switches from PRSAs into PPPs would not have helped their success. PRSAs have failed and consequently this restriction has become redundant.

The logic for freedom of movement between pensions is the same for Ireland. Workers are increasingly mobile between self-employed and employed status. The consensus industry view is that the existence of separate pension pots that cannot be combined doesn't make sense e.g. the self employed pension pot and the occupational pension scheme pot must currently remain separate.

Full mobility between PPPs, EPPs, BOBs and PRSAs
Full mobility between pension contracts would allow switching between executive pension policies (EPPs), personal pension plans/RACs, PRSAs and Buy Out Bonds as and when the investor chooses. See notes for definitions.

Pro's

Merged pension pots allow greater purchasing power, investment choice and lower charges.

A. Allowing investors to merge their pension pots means greater purchasing power. For example, buying a property tax efficiently within a pension might be attainable and desirable when valuations become attractive in the future. Access to PPPs, EPPs and approved retirement funds (ARFs - see notes for definition) would also mean significantly increased access to other investment asset choices to cater for people's different life stages and varying appetites for investment risk. Better value on charges is an additional attraction.

B. Make pensions more interesting and give investors control
Permitting the option of buying property/direct shares/commodities/green investments/wide range of equity funds etc makes pensions more attractive. This is especially the case compared with the more limited choice of funds currently available to many private sector investors via their occupational pension schemes. More choice and personal involvement in pensions makes them a more compelling proposition.

C. Allowing investment diversification means a higher probability of an individual's pension fund increasing in value
Give the majority of private sector employees a better chance of growing their fund to achieve a comfortable retirement by allowing greater access to asset classes and thus a more diversified investment portfolio.

D. Simplify pensions thus increasing attractiveness for end investor
Allowing pensions to be merged into one pot simplifies pensions for the end consumer. Picture a pension investor who has changed employment status more than once in their working life, 30 years later trying to track down several different pension schemes, their values - and being in receipt of several different payments instead of one?

E. Convenience of having all pension plans in one place
If you can merge various pension plans in to one it is much simpler and easier to manage.

F. These ideas shouldn't be too costly. Legislative changes would be required.

G. Equality of investment choice for private sector
Allowing free movement between all pension contract types would mean equality of investment choice for all private sector pension investors. The majority of the private sector are currently not only at a major disadvantage compared with the generous guaranteed public sector pensions but within the private sector, the self employed have significantly more investment options compared with PAYE workers e.g. typically high net worth self employed individuals/directors are the main beneficiaries of investment choice, for example they can choose to purchase property, direct shares, commodities, green investments etc via their pension.

The mechanism

Change legislation to allow investors switch between Personal Retirement Savings Accounts (PRSAs), Personal Pension Plans (PPPs) aka Retirement Annuity Contracts (RACs), EPPs and Buy Out Bonds.

Cons
An increase in pension take-up that is less significant than hoped for?
(However, the UK has already implemented these changes and pensions take up did increase meaningfully i.e by 15%).

Proposal 2

Eliminate arms-length rule to stimulate pensions savings and the economy

The arms length rule prevents individuals, typically the self-employed or business owners from buying or selling property within their own pension fund from connected parties e.g themselves, family, business/connected partners.

For example, for a self-employed newsagent/solicitor/mechanic/beautician etc the elimination of the arms length rule means they could sell their own premises (where they own it) into their pension. This makes sense from their viewpoint and Revenue's, so long as the property valuation is fair.

History of arms length rule

The arms length rule was introduced to avoid abuse of the tax reliefs available where, for example an investor could sell their business premises valued at €350,000 to their pension for €175,000 thus in breach of Revenue rules by apportioning an extra €175,000 into their pension and thereby circumventing Revenue practice.

Our view is that current policing requirements mean these abuses are no longer possible, as the properties must be valued and signed off by independent regulated providers. In addition, the Revenue penalties for abuse are prohibitive.

The number of regulated providers is limited and thus easily checked by Revenue. For example, you can only purchase property via your pension using a provider such as a pensioner trustee/life company or qualifying fund managers. These providers act as Revenue watch dogs and use their own professional valuers on an investor's behalf. They must also file these valuations for compliance purposes. In addition, most purchases require a mortgage which is an additional check on the value assigned to the property.

Furthermore, changes to Revenue powers mean they can now tax specific pension assets that have breached their rules. For example, if you have improperly used your €350,000 property within you pension, Revenue can impose a penal tax at the marginal rate of income tax, on the property's value of 41% of €350,000 or a bill of €143,500.

The UK abolished the arms length rule in 2006 (on A day) for all commercial property transactions.

We believe the removal of this rule for commercial and residential property would have numerous positive effects on the industry and pensions take up. It also has the potential to help reignite property market activity and provide a certain amount of associated economic stimuli.

Pros (Using aforementioned example)

- The pension fund releases €350,000 to the individual pension owner who can use it as cash flow for their business in the current cash-strapped environment
- The individual's pension fund now owns a property worth €350,000 and benefits from the rental income stream it generates. It might prompt businesses owners who are currently renting their premises to purchase, (given current depressed prices and the extra benefit to their retirement savings) a property they know and are happy to invest in for the long term. This might prove a compelling reason to stimulate pension take-up for first time pension savers
- The potential knock on effects include the estate agent, solicitor, valuer, product provider etc benefiting financially from the transaction etc
- The Exchequer's income is potentially boosted by stamp duty and associated property taxes

Cons

- The legislation may need to be restrictive to prevent investors attempting to classify holiday homes or private residences as investment properties. Limiting the legislation to commercial properties only, might make sense
- It might also be prudent to limit the legislation to Irish properties only, to permit effective policing by Revenue

Proposal 3

Recategorise Approved Retirement Funds as pensions, to allow Ireland become a global hub for UK expatriate pensions

Approved retirement funds (ARFs) are not recognised as pension vehicles internationally. Consequently, their tax treatment is not the same or as favourable as widely recognised pension products such as pension annuities.

This is because the Irish government was innovative when introducing ARFs as an alternative to the pension annuity (a fixed income for life) - the principle type of retirement pension available in the UK and Ireland.

Pros

Ireland becomes a global hub for UK expatriate pensions - €billions under management

If the Irish Revenue Commissioners were to recategorise Approved Retirement Funds as pensions, this could be the catalyst to allow Ireland become a global hub for managing UK expatriate pensions. Thus UK expatriates in Europe could use Ireland as the centre for the investment and administration of their pension money. This has the potential to be positive for Ireland Inc re employment, economic stimulus and tax take over time. The ARF concept is unique to Ireland and doesn't exist in the UK or Europe.

Increased tax take for government

If the Exchequer charged a few basis points on all funds under management (the assumption is billions of euro under management - over time, assuming its success) this could create substantial future revenue for the government. Additional jobs created would provide additional tax take via income tax, PRSI, VAT etc.

Proposal 4

Tax those who are retired equally

Retired individuals who own approved retirement funds (ARFs) must pay a 3% imputed distribution tax on the value of their Approved Retirement funds. Whereas those who own a PRSA in retirement pay no imputed tax. Retired PRSA investors are using this loophole to avoid paying the tax.

Pros

Imposing the imputed distribution tax of 3% on PRSA fund values would mean equal treatment of retired PRSA and ARF investors.

Cons

PRSAs would no longer be exempt from imputed distribution tax.

Notes:

1. A BOB is a lump sum investment which is the transfer value of an individual's company pension scheme into a bond (BOB) which the investor (not company pension trustees) owns and can invest as they choose.
2. An approved retirement fund (ARF) is an alternative retirement option to an annuity. It allows individuals to purchase property, shares, funds, green investments, deposits, commodities etc in their retirement years and use those investments to fund their retirement. If they die, the value of their fund is passed on to their estate - a major attraction. Up until the introduction of ARFs in 1999 the only choice available to pensioners was an annuity - a fixed income for life based on long term interested rates - deeply unattractive in recent years due to historically low rates. An additional disadvantage was that if the pension owner died soon after the annuity was taken up - the annuity typically died with him or her. This proved a major disincentive for people who had saved all their life and knew their families would not benefit from their life savings in the event of their early death.
3. An executive pension plan (EPP) is designed for proprietary directors (owning or controlling 5% or more of a company's shares) or a company employee. It's a single member pension plan. The company invests money on behalf of the company director/employee and the director/employee can also invest their own money.
4. A personal pension plan (PPP) is designed for those who are self-employed or those working for companies but don't own a company pension scheme.

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