



Commission on Taxation Submission

Background

Terms of reference area to which the submission relates: Consider how best the tax system can encourage long term savings to meet the needs of retirement.

The Pensions Board is a statutory board established under the Pensions Act 1990. Among the functions and objectives of the Board are to:

- Promote the security and protection of members of occupational pension schemes and contributors to Personal Retirement Savings Accounts in accordance with the Pensions Act;
- Promote the development of efficient national pension structures;
- Promote a level of participation in the national pension system which enables all citizens to acquire an adequate retirement income, and;
- Provide information and authoritative guidance to relevant parties in support of pension security, structures and participation.

In working towards these aims, it is clear that the current support given to pensions through the taxation system is essential and a measure of the priority given by Government to support both individual efforts to save and the continued development of the pensions industry. These tax relief arrangements have helped a significant proportion of the workforce to provide supplementary pensions for their retirement. It is estimated that over half of those in employment are covered by supplementary pension arrangements.

The Pensions Board is of the view that this support must continue and that it is vital that any changes to the taxation system would not have an adverse effect on pensions coverage or adequacy. The following comments of the Pensions Board are made in the context of the continuation of the current system in the absence of any possible future decision by Government to change pension policy.

Programme for Government and Green Paper on Pensions

The Agreed Programme for Government, published in June 2007, outlines a number of key commitments in relation to pension policy. The Government commits to:

- Increase the basic State pension by around 50% to at least €300 per week by 2012;
- Seek to develop imaginative proposals in the context of the Green Paper (the publication of which is a commitment under *Towards 2016*) and in consultation with the social partners, to provide an SSIA type scheme in an effort to make supplementary pension provision more attractive to those on low incomes;
- Aim to secure the target of at least 50% of pre-retirement earnings from all sources including social welfare supports, private and occupational pensions, and savings and investments.



- Complete the scheme introduced in Budget 2007 to provide a personal pension payment for pensioner spouses in receipt of the Qualified Adult Allowance. The payment will be set at the level of a full rate Non-Contributory State Pension and the income limits will be improved to enable more people to qualify for it. The role and economic contribution of spouses working on the farm will be better recognised within the social insurance system;
- Extend the Age Allowance to Qualified Adults over 80 years old;
- Remove anomalies identified in the pension system, and;
- Ensure women are treated fairly in pension provision.

It should be noted that in relation to the third commitment above, it is the first time that the Government has committed to an explicit target for retirement income. This target complements existing coverage objectives outlined in the National Pensions Policy Initiative. The Government also published a Green Paper on Pensions in October 2007 which builds on a number of reports published by the Pensions Board, including the National Pensions Policy Initiative, the National Pensions Review and the Special Savings for Retirement Report. The Green Paper sets out the pension issues and options facing Ireland over the coming years and is currently subject to a national consultation process. This process is scheduled to conclude by the middle of 2008 and the Government will respond to the issues raised shortly thereafter.

Equity

The present taxation treatment of pensions has encouraged a significant portion of the labour market to fund private supplementary pensions, which is a key public policy objective. It is also generally agreed that the object of tax relief must be to incentivise and support those less able to make adequate pension provision and not necessarily to subsidise those who are in the strongest position to do so.

The OECD's latest economic survey of Ireland refers to international experience which suggests that tax incentives are more likely to be effective at raising overall savings if targeted at low and middle income earners and if designed so that the incentives are easy to understand.

The National Pensions Review includes a recommendation by the Board to increase the level of tax relief to the higher 41% rate for personal contributions to all forms of supplementary pension and a cap on incomes for pension contribution and benefit purposes, if the derived savings are used to improve incentives for lower rate taxpayers and non taxpayers.

In considering the extent to which the benefit of reliefs may be skewed toward the better off, it is important to take into account the tax that will be paid in future years as well as the short-term relief. One estimate, published in the Green Paper, is that this would cost €80 million per year, assuming 20% of pension contributors paid tax below the top rate and 10% of those were tax exempt.

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Method of taxation relief

In the National Pensions Review report, published by the Minister for Social and Family Affairs in 2006 the Board proposed changes to the taxation arrangements for voluntary private provision including that the State incentive for PRSA personal contributions be granted by means of a partial matching contribution of €1 for every €1 invested rather than through tax relief as is the current situation. This idea was also referenced in Chapter 7 of the Green Paper on Pensions. One estimate published in the Green Paper is that this would cost the Exchequer about €400m in a full year, with a further €1bn for each 10% increase in coverage. Other models of matching contributions have been suggested by other commentators since the National Pensions Review was published with the OECD being the most recent to suggest a capped matching contribution. The principle, as we have advocated, has been included in the Programme for Government as follows:

“Seek to develop imaginative proposals in the context of the Green Paper (the publication of which is a commitment under *Towards 2016*) and in consultation with the social partners, to provide an SSIA type scheme in an effort to make supplementary pension provision more attractive to those on low incomes.”

The proposal is based on the success of the structure of the Special Savings Incentive Accounts (SSIA) scheme and on the premise that people find this incentive easier to understand and more transparent than the current regime of tax reliefs.

This new method of providing the State incentive for investing in a PRSA could be monitored to see if it results in an improved level of take up as a result of the incentive being easier to understand.

This method would also have the benefit of allowing for better targeting of incentives in a cost-effective manner that enhances the attractiveness of private pension provision to lower income groups.

Approved Retirement Funds

There are particular anomalies in the taxation system in relation to the treatment of retirement benefits whereby some individuals are required to purchase an annuity while others can benefit ARFs.

At retirement, those qualifying for ARFs can use their retirement funds to withdraw as cash, subject to tax; invest in an ARF, and drawdown at their own discretion; purchase an annuity or any combination of the above, with some restrictions on taking cash and making withdrawals. The only retirees not eligible for ARFs are members of occupational pensions who do not hold or control at least 5% of the shares of the sponsoring employer or holders of buyout bonds. Members of occupational schemes are eligible for ARFS in respect of any Additional Voluntary Contributions they have made.

It has been suggested that making ARFs universally available might increase the attractiveness of pensions saving, and would be more equitable. There are also some potential drawbacks, including the risk of outliving one's pension assets since life expectancy tends to be underestimated by individuals and the impact on the annuity market.



The availability of ARFs for all members of occupational pension schemes could put pressure on their solvency and might eventually damage defined benefit pension provision. This issue has been the subject of a number of representations as part of the Green Paper consultation process and it would seem to be an opportune time to review the current structures.

Life expectancy

Life expectancy in Ireland has been on the rise in recent times. Projections suggest that this trend is set to continue over the medium to long term. We are living longer and healthier lives. Coupled with this, it is projected that there will be a significant rise in the number of over 65's which will lead to a rapid and severe decline in the Pensioner Support Ratio (the ratio of the number of people of working age to the number of people over the pension age). The Green Paper draws on work done for the Actuarial Review of the Social Insurance Fund that the Pensioner Support Ratio will decline from 5.6 people of working age for every pensioner to 1.8 people of working age for every pensioner by 2061.

Barriers to Remaining in Work

Based on the demographic situation outlined above some people may want to remain in the labour force beyond 'normal' retirement age. This will also be in the State's interest. Properly designed imaginative incentives which allow a flexible approach to employment in later years may bring the results needed.

Currently there are a number of barriers to workers remaining in employment past normal retirement age. These barriers revolve around the Revenue Commissioners' rules in relation to pension arrangements and include the following:

- **Differing maximum age limits for retirement.** The Revenue Commissioners stipulate the maximum retirement ages for pension arrangements to gain exempt status (i.e contributions can avail of tax relief, investment returns are tax free and a tax free lump sum is allowed). The age is 70 years for membership of an occupational pension scheme and 75 years for PRSAs and RACs. While some may argue that there should not be a maximum retirement age at all, it would make sense, at the very least to have one maximum age for all arrangements. The Pensions Board would recommend the age of 75, given a choice between the two existing maximum ages.

- **Differing age limits on tax relief applicable to pension contributions.** Currently tax rules set upper limits to the age range at which tax relief applies to pension contributions. Thought could be given to introducing a new range for those aged over 65 which would send a strong signal of State support/incentive to employees to remain in the workforce beyond normal retirement age and to continue to contribute to their pension. Any changes in this area would have to take account of the maximum age limits for retirement which have been suggested in the bullet above.



➤ **Deferring receipt of pension benefits or commencing benefits.**

A related issue is that currently an employee who reaches normal retirement age and continues in service can either elect to defer receipt of pension benefits or choose to commence benefits, taking the tax-free lump sum and/or the full pensions immediately and continue working.

There is potential that this will act as a disincentive to remain in the work force as it effectively rules out the possibility of an employee remaining in work on a part-time basis and supplementing the part-time wage with a partial pension.

Introducing change whereby a worker could elect to draw down a partial pension and supplement it with perhaps a part-time wage may encourage more workers to remain in employment beyond normal retirement age. This measure could introduce added flexibility for employees in relation to the retirement age.

Possible solutions to barriers to remain in work

The Green Paper outlines a number of possible solutions to this issue which further facilitate the employment of older workers, including:

- Providing for flexibility in the retirement age;
- Creating incentives for workers who want to remain in the labour force after the age of 65;
- Facilitating a gradual move to retirement through changed working arrangements;
- Increasing the contributions required for full pensions and/or the qualification period for benefits, and;
- Tightening the conditions for early retirement.

The Pensions Board would welcome the opportunity to discuss these issues in greater detail with the Commission.

Also in relation to the differing maximum retirement age and differing age limits on tax relief applicable to employees, the Commission may be interested in the UK system of a maximum lifetime allowance.

This maximum lifetime allowance stipulates the absolute maximum that an individual can contribute to their pension fund, without stipulating how that fund is built up. This approach has simplified a previously complicated system. An overview of this system is attached at **Tab A**.

Costings

The most recently published costings for various relevant taxation proposals, developed during the Green Paper process, are attached at **Tab B** for information purposes only

Overall Comments

The Pensions Board strongly supports current Government policy which grants taxation relief on pension contributions. This is, perhaps, the most important tool available to encourage individuals to make provision for their retirement.



Key Points of Pensions Board Submission

1. Current support of pensions through the taxation system is essential in achieving Government objectives in relation to pensions and should be maintained (in the absence of any future decision by Government in relation to pension policy post Green Paper);
2. As a guiding principle, any changes to the taxation system should not have an adverse effect on pensions coverage and adequacy and should be equitable;
3. The Programme for Government sets out the targets and direction of Government policy in terms of coverage and adequacy for the future. This direction will also be considered as part of the forthcoming Government response to the Green Paper on Pensions and will include other policy options such as retirement age and the level of benefits;
4. While the Commission on Taxation will be looking at the taxation treatment of pensions, there are other issues which may have an impact on sustainability such as retirement age and these are being actively considered by Government in different fora;
5. In the context of the current system particular attention should be given to looking at new ways to:
 - Encourage individuals to make appropriate provision for retirement, including building on the SSIA experience, and reviewing current arrangements in relation to ARFs and;
 - Removing barriers with the taxation system to working longer for those who chose to, including age limits on tax relief on pension contributions and extending options to defer receipt of pension benefits or commencing benefits.
6. The Pensions Board would be happy to assist the Commission with its deliberations as appropriate.



Tab A - Pensions Tax Simplification in the UK

Pensions Simplification - A Summary of the New Rules

On 6 April 2006, new rules came into effect around how pensions are taxed, offering simpler and more flexible retirement arrangements. This is what you need to know:

1. The many existing sets of rules governing the taxation of pensions were replaced with a single, universal regime.
2. For the first time, everyone will be able to save in more than one pension scheme at the same time.
3. There is no limit on the amount of money you can save in a pension scheme or the number of pension schemes you can save in - although there are some limits on the amount of tax relief you can get.
4. You will get tax relief on contributions up to 100 per cent of your annual earnings. So if you put £100 into your pension scheme, the tax relief the Government gives you on that is worth at least £25.
5. There is an annual allowance of £225k in 2007-08 (rising to £255k by 2010-11). If in a tax year your annual pension savings are greater than this, you may be liable to a tax charge.
6. Even if you are not a taxpayer you can still get tax relief on pension contributions. You can put in up to £2,880 in any one tax year and the government will top this up with another £720 - giving you total pension savings with tax relief of £3,600 per year.
7. The new rules introduce flexible retirement, allowing people in occupational pension schemes to continue working while drawing their pension, where the scheme rules allow it.
8. If your scheme rules allow, you can take up to 25 per cent of your pension fund as a tax free lump sum.
9. If your pension pot is more than the 'Lifetime Allowance' when you come to take your pension you may be subject to a tax charge at that time. But this will only apply if your total pension savings are in excess of £1.6 million from 6 April 2007 (rising to £1.8m by 2010-11 and reviewed thereafter).
10. Those individuals with larger pension pots on 6 April 2006 will be able to protect their funds from the Lifetime Allowance Charge by completing and submitting the appropriate form to HMRC. They have until 6 April 2009 to do this.
11. The rules on when you can take your pension will change. From 6 April 2010 you will not be able to take a pension before you are 55. There are a couple of exceptions: you will still be able to retire early due to poor health, and if you have the right to retire before 50 at 6 April 2006, that right may be protected.
12. A full list of pension scheme rates and allowances are available.