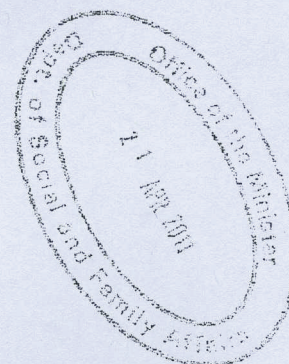




**An Bord Pinsean  
The Pensions Board**

Ms Joan Burton, T.D.  
Minister for Social Protection  
Áras Mhic Dhiarmada  
Store Street  
Dublin 2



20 April 2011

**Reducing aggregate tax expenditure on pensions savings**

Dear Minister,

As you are aware, The Pensions Board has a statutory role to advise you, at your request or on its own initiative, on matters relating to pensions generally. The purpose of this letter is to bring to your attention the effects of possible changes in the tax treatment of occupational pensions.

The Pensions Board recognises that reductions in private pension tax reliefs are included as revenue-raising measures in the EU/IMF Programme of Financial Support and that changes in the tax treatment of pensions were set out in the programme for Government. The Board is also cognisant of the very significant budgetary challenges facing the Government and the constraints imposed by the EU/IMF programme. In this context, the objective of this letter is ensure that the effects of intended, proposed or recent changes to the tax treatment of pensions are clearly understood, in order that you can advise the Government appropriately.

In this letter we have examined the effects of applying a levy, and of reducing the marginal rate of tax relief on contributions. We have also highlighted anomalies in the treatment of Personal Retirement Savings Accounts (PRSAs).

**Levy**

The application of a levy on pensions (taken here to mean a once-off or recurring charge on the assets of pension schemes) is more complex than might be thought, and raises a number of issues, especially those of equity among the different types of pension, the effect of a levy on scheme solvency, equity among pension contributors and pensioners across the age cohorts and equity among members of funded and unfunded pension schemes.

1. There are six different types of pension to which a levy might potentially apply. A brief description of each is as follows:

- Occupational pension schemes – these are trusts which may be defined benefit or defined contributions. Not all defined benefit schemes are subject to the

funding standard in the Pensions Act, and any levy would have to be clear about the schemes to which it applies.

- Retirement annuity contracts (RACs or personal pensions) – these are (almost entirely) insurance contracts. They are usually defined contribution but there are instances of guaranteed benefits, and any levy would have to be clear about whether such benefits could be proportionately reduced or would fall to be borne by the guarantor.
  - PRSAs – these are individual contracts issued by providers, who are usually insurers or credit institutions. Benefits are defined contributions but, as for RACs, some benefits may be guaranteed
  - Buy-out bonds – these bonds are insurance contracts issued to former pension scheme members, and may be DB or DC.
  - Annuities – annuity contracts can be issued by insurers to individuals, or to scheme trustees in the name of members. All of these contracts are by definition defined benefit. It should be noted that many occupational pension funds pay pensions directly (and the liabilities comprise approximately half of the liabilities of defined benefit schemes): the decision whether or not to buy annuity contracts is taken case by case (even member by member) and consistency would be a significant issue were it decided to exclude annuity contracts from the scope of a levy.
  - Approved Retirement Funds (ARFs) comprise some or all of the pension assets of retired people, who have chosen to draw their benefits in this form rather than as an annuity payment. There is in effect no restriction on the type of asset included in an ARF. Again, if it is decided to include the assets of occupational schemes corresponding to the obligations to retired members, consistent treatment of ARFs should be considered.
2. Where a levy is applied to defined benefits (whether occupational schemes or guaranteed insured or other benefits), it must be made clear (and if necessary included in legislation) whether benefits can be reduced by a corresponding amount. If defined benefit schemes are not permitted to reduce benefits in the event of a levy, the effect will be to worsen the solvency problems of defined benefit schemes. The solvency of insurance companies is obviously a matter for the Central Bank, not the Pensions Board, but if insured pension benefits are subject to a levy and benefits cannot be reduced, this will affect the solvency of insurers.
3. For defined benefit (DB) pension schemes, a recurring levy should be immediately reflected in the funding standard, as it affects the future ability of a scheme to meet its obligations. The result of this will be to capitalise the total levy immediately, rather than over the period over which the levy will actually be paid. In this context, it should also be borne in mind that private sector DB schemes are already under significant

funding pressures at present with members facing the likelihood of increased contributions or benefit reductions.

4. Part of the assets of Irish occupational pension funds are in respect of members employed in other EU member states, mostly UK. In recent years, there have been efforts made to promote Ireland as a centre for such cross-border pensions. Were a levy to be introduced, a decision would be needed about whether to include such assets. Under current legislation, the assets of overseas members are not ring-fenced and, in particular in defined benefit schemes, separation of assets on this basis is not currently permitted. As a result, even if the amount of a levy were intended to be limited to the assets corresponding to Irish members, the effect of the operation of section 48 of the Pensions Act would be to reduce the value of the benefits of overseas members.
5. There are also numbers of Irish members of overseas schemes, usually UK. If overseas schemes were held to be exempt from an ongoing levy, there would be an incentive to redomicile schemes, especially larger defined contribution arrangements, in another EU Member State: this cannot be prevented under E.U. rules for cross-border pensions, and would not be especially difficult.
6. Any proposal to impose additional taxation by way of a levy must consider its impact both on affected taxpayers and on the rest of the taxpaying community and longer-term implications for pensions coverage. A levy on pension funds:
  - Has an impact proportional to the size of the fund, and therefore has a greater impact on taxpayers with larger funds, who tend to be in higher income cohorts. Larger funds are also correlated with taxpayers in higher age cohorts, although this will also be impacted by whether or not funds representing pensions in payment are included in the levy base.
  - Could complicate efforts to increase pensions coverage by creating doubt amongst potential members as to the tax treatment of pension assets
  - Has no impact on taxpayers with entitlement to unfunded pensions, who are predominantly in the public sector.
  - Has no impact on the almost 50% of the population without occupational pension coverage.

#### Tax relief

1. If tax relief on employee contributions is limited to 20%, there may be an incentive to replace employee contributions with employer contributions in return for a reduced salary. There are legislative provisions that seek to prevent such salary sacrifice arrangements. These are likely to be successful in the short-term, but in the longer term, it is not practical to prevent replacement in respect of newly-hired employees and for employees who are willing to trade pay increases for pension contributions. The most logical response to this would be to impose some type of benefit in kind tax

on employer pension contributions, which would require legislative prescription of the taxable amount for defined benefit arrangements.

2. For some higher rate taxpayers, the effect of reducing the marginal rate of relief is that pensions are no longer the most tax-efficient means of saving: the treatment of life insurance and in some cases deposits could be more favourable. For higher paid taxpayers, if pensions are no longer the best way to save for retirement, there will be a number of implications:
  - It is common in the Irish private and public sector for membership of the employer's pension scheme to be a condition of employment. However, this will be considerably less defensible where such membership is in effect forced contribution to what might amount to a sub-optimal arrangement in some circumstances. However, the experience in the U.K. in the 1980s when compulsory scheme membership was banned was that there was a considerable fall in scheme membership.
  - Alternatives means of saving place no restrictions on access to savings before retirement or on the form in which benefits can be taken. This makes them even more attractive and the result is likely to be a considerable fall in tax relieved pension savings by higher income taxpayers, especially where people receive proper financial advice.
  - Even in those cases where pensions savings can be clearly recommended at the lower rate of relief, this is not likely to be true for all such savings. In particular, once the pensions savings exceed the level that is likely to provide the maximum amount of tax free cash at retirement, further contributions may not be tax-efficient. This will damage efforts to improve current levels of adequacy and to encourage additional voluntary contributions.

### Consistency

It is important that any changes to the tax treatment of pensions are consistent between different forms of pensions and do not create anomalies. An example of such an anomaly is the effect on pensions provided through PRSAs of the introduction of the income levy in 2009 and that applies also to the Universal Social Charge (USC). As a result, PRSA employer contributions are treated less favourably than identical contributions to defined contribution occupational schemes. This has undermined the policy of PRSAs as a vehicle for encouraging pension provision: it appears that no new employer sponsored PRSA arrangements are being set up, and the only reason not to wind-up existing arrangements is the hope that the anomaly will be resolved in the short term. The result has been at a minimum needless uncertainty for employers and employees, and if there is no resolution, there will be needless restructuring expense which undermines pension credibility.

**Further information**

The Pensions Board would be happy to discuss any of the above with you or your Department. We would also be happy to provide any further information you might want.

Yours sincerely

*Brendan Kennedy*

*JW*

Jane Williams  
Chairperson