

Budget 2011 Bulletin

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The 2011 budget has had a significant impact on pensions, more so than any budget in recent years. Many of the measures had been flagged in advance, however there were some surprises.

‘Sovereign Annuities’

Of particular significance for Defined Benefit schemes is the ‘Sovereign Annuity’ concept put forward by the Irish Association of Pension Funds and the Society of Actuaries in Ireland. The Government has confirmed that measures will be implemented to facilitate this.

The National Treasury Management Agency (NTMA) will issue bonds which will assist with the creation of ‘sovereign annuities’. The bonds and annuities will then be available for purchase by pension scheme trustees and other investors. We expect that legislation covering the funding standard (which was being reviewed in any event) will allow for liabilities to be valued with some reference to these bonds.

At this stage the structure and features of these bonds and annuities are unknown and the devil may well yet be in the detail. For instance, there are indications from the budget documentation that schemes will only benefit from the yield on the sovereign bonds to the extent that they actually invest in them. If so, this could place trustees in a potentially difficult position.

It is clear that schemes and employers are likely to require a fundamental review of the operation of their schemes and in particular, their investment strategies. Many schemes which to date have paid pensioners from fund resources may take the opportunity to consider a buy-out (or buy-in) of these pensions. LCP is at the fore-front of advising schemes on de-risking strategies and we will be working with our clients to ensure they take advantage of any opportunities that emerge.

Relief on Employee Contributions

PRSI and Universal Social Charge relief has been removed from employee pension contributions. This will hit the pay packets of all employees paying pension contributions and reduce take home pay by between 5% and 8% of the pension contributions made by employees.

In addition, 50% of the relief currently available from the employer PRSI exemption for employee contributions is being removed. This will mean that from 2011 employers will pay up to 5.375% of the total of the employee contribution in PRSI.

The reduction in relief on member contributions was expected as the first step in the Government’s plan ultimately to restrict tax relief on pension contributions to the standard income tax rate. It remains to be seen if subsequent governments will continue this plan. As has been widely reported, such a move would greatly dis-incentivise pension savings, a point that seems to have been accepted by both Fine Gael and Labour who have mentioned a 0.5% levy on pension funds as a potential alternative to reductions in contribution relief. Such a move would bring its own issues; such as potentially reducing the funding levels of schemes that are already in difficulty.

Changes to the Contribution Limit

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The annual earnings limit which determines the maximum tax-relievable contributions for pension purposes was reduced from €150,000 to €115,000. Combined with the removal of PRSI relief, this will have a very significant impact on the attractiveness of pension contributions to higher earners and the self employed.

In a further move, the budget documentation indicates that those who propose to make a pension contribution in 2011 in respect of the 2010 tax year will be subject to the new €115,000 limit in respect of this contribution. This is significant for many self employed people who generally only make pension contributions when their accounts are finalised.

Individuals in these situations would appear to have until the end of 2010 to avail of the €150,000 limit.

Retirement Lump Sums

In a move that had been well flagged and indeed expected, tax-free lump sums from pension schemes are to be restricted. Up to €200,000 will still be available tax free, the next €375,000 will be subject to tax at the standard income tax rate (currently 20%) and the balance of any lump sum will be subject to the individual's marginal rate of income tax.

This change will take effect from 1 January 2011, so there is still time for some people to avail of the old rules.

Reduction in the Standard Fund Threshold

The "Standard Fund Threshold" (SFT) concept introduced in 2005 imposed a ceiling on the capital value of a member's pension benefit or fund. This threshold was initially set at €5m and had subsequently been indexed to €5.4m. The threshold is now being reset to €2.3m.

Some of the detail follows:

- The new limit is effective from budget day (7 December 2010).
- Individuals with accrued benefits in excess of €2.3m on budget day will be able to apply for an individual "Personal Fund Threshold" (PFT). This application must be made to the Revenue within six months of the budget (i.e. 6 June 2011). The Revenue will then certify the PFT.
- Individuals with existing PFTs will retain them.

This change will bring significantly more people into the SFT net. Anyone with a current fund in excess of €2.3m or an entitlement to a defined benefit pension of more than €115,000 will be subject to the new limit.

LCP will work with clients impacted by this change to ensure they apply for a PFT before the June deadline.

Changes to Imputed ARF Distributions

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Currently those holding ARFs are deemed to have drawn down 3% of their fund each year for tax purposes whether or not they have taken any funds from the ARF. This percentage is being increased to 5% with effect from 31 December 2010.

This is potentially a significant change for those with ARFs. One of the benefits of ARFs is the ability to access funds when they are needed. In this way some people use ARFs to support a phased approach to retirement i.e. they take little or no money from their ARF in the early years where they may be working part-time with the intention of taking a greater level of income in later years.

Many ARF holders may now feel compelled to take a greater level of income from their ARF and therefore are at increased risk of having an insufficient fund when it is most needed.

It is worth noting that the deemed disposal rules do not currently apply to retirements from PRSAs. However, it is probably only a matter of time before this is addressed.

It would appear that distributions for 2010 are subject to the 5% deemed distribution.

Extension of Flexible Options in Retirement

As was promised by the National Pensions Framework document published last March, the availability of Approved Retirement Funds (ARFs) is being extended to all Defined Contribution (DC) arrangements. These changes are to be implemented in the Finance Bill.

The legislation will include a number of changes to the existing conditions for availing of ARFs:

- The AMRF (Approved Minimum Retirement Fund) option is being retained but the 'set-aside' requirement will be the lesser of 10 times the State Pension (currently approximately €120,000) or the remainder of the fund after taking any lump sum.
- The specified or guaranteed income requirement is being increased from €12,700 to 1.5 times the State Pension (currently approximately €18,000).

Pending the passing of the relevant legislation the ability to defer the purchase of an annuity will continue.

LCP have always been of the view that there was no sensible reason why DC members could not avail of ARFs subject to acceptable controls and we welcome the suggested changes. We also feel that consideration should be given to further extending ARFs to members of Defined Benefit schemes which would benefit the schemes and offer members greater flexibility.