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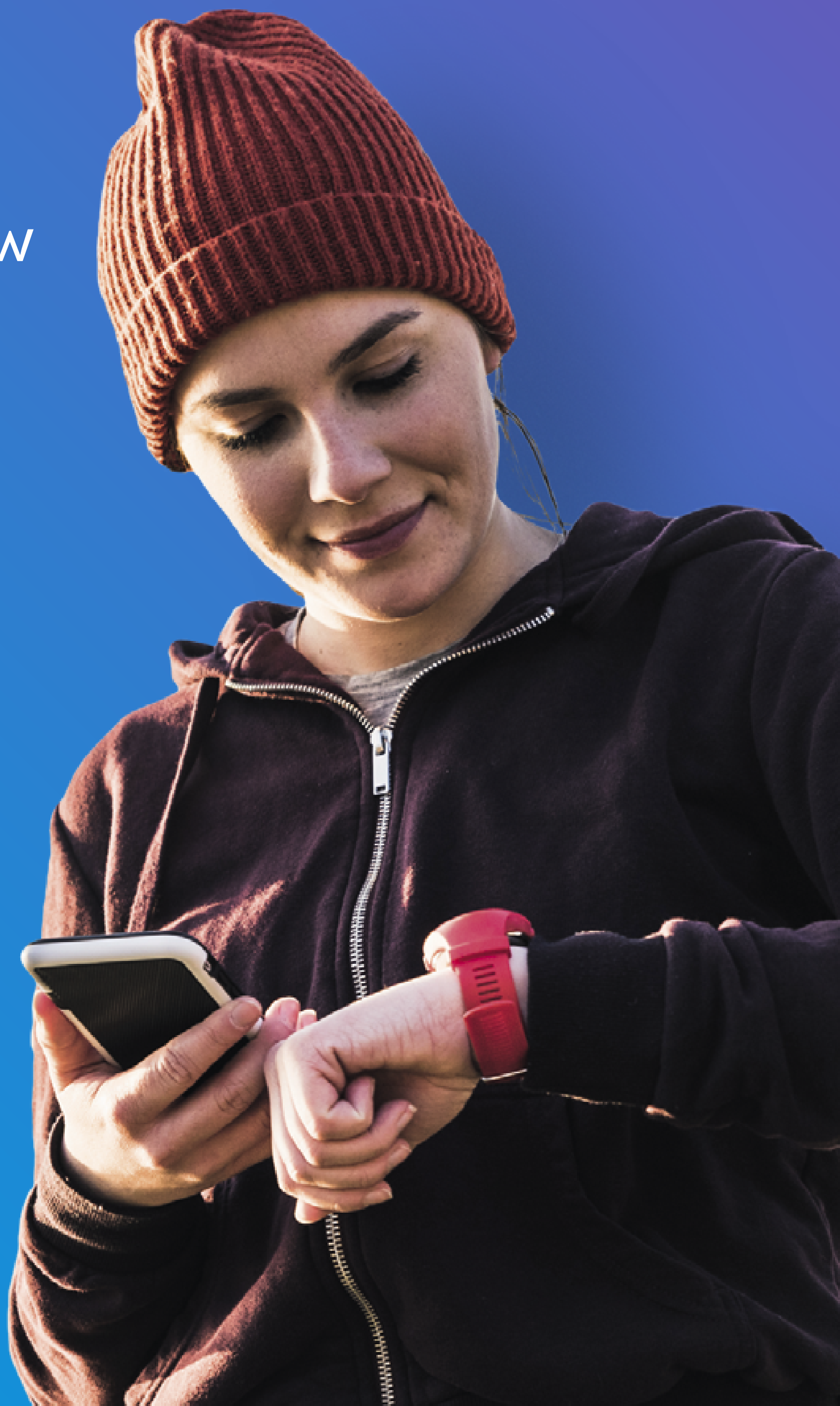
welcome to brighter

standard fund threshold limits

what you need to know



A number of changes to the tax treatment of pension funds were introduced under the Finance (No. 2) Act, 2013. These changes came into effect on 1 January 2014.

The main provisions are summarised as follows:

- The Standard Fund Threshold (SFT) was reduced to €2m with effect from 1 January 2014
- The maximum tax-free lump sum that may be taken at retirement remains unchanged at €200,000 but the maximum lump sum that may be taken at the standard rate of tax was reduced to €300,000
- The valuation of a defined benefit (DB) pension is now based on an age-related factor and split between service accrued pre- and post-2014
- Age-related factors for post-2014 service range from 37:1 for those retiring at 50 or under to 22:1 for those retiring at age 70 or over; the factor at 60 is 30:1 and at 65 is 26:1

What is the impact?

Anyone whose pension benefits exceed the SFT will be liable to a charge on the amount over the threshold.

Who is affected?

The reduction in the SFT is most likely to immediately impact higher earners with a reasonable level of service, especially those who may have paid a significant level of additional voluntary contributions (AVCs). However, the impact of future benefit accrual and salary increases will cause additional individuals to breach the SFT. This is likely to be compounded if the SFT is not indexed in the future in line with at least the Consumer Price Index.

Individuals affected by the cap, or on course to be affected by it, should review their pension arrangements. Employers need to consider if, and how, they will alter benefits for affected employees, given that any reduction in the cap will likely increase the number of employees affected. Mercer is in a position to assist both the affected individuals and their employer in this regard.

It is important to note that an individual's total pension benefits from all Irish occupational pension schemes count towards the SFT limit.

Example

John is a 50 year old with a current pensionable salary of €120,000 and 25 years' service as at 1 January 2014, giving an accrued pension of €50,000 on that date. Using the formula set out by Revenue, his fund value was €1m on 1 January 2014. As a result, he would not have been eligible to apply for a PFT.

His expected fund value at retirement, for comparison with the SFT, is as follows*:

	Normal retirement age of 60	Normal retirement age of 65
Projected salary at retirement	€160,000	€185,000
Expected pension at retirement	€93,000	€123,000
Fund value at retirement	€2,290,000 [€50,000 x 20 + (€93,000 - €50,000) x 30]	€2,898,000 [€50,000 x 20 + (€123,000 - €50,000) x 26]
Chargeable excess	€290,000	€898,000
Excess charge (40% tax)	€116,000	€359,200

** Assuming salary increases of 3% per annum; figures rounded for illustrative purposes.*

In both cases, continuing to accrue benefits and have his pension linked to future salary growth has left John in breach of the SFT at retirement and liable to an excess charge. John may be able to offset some of that charge depending on the level of lump sum he chooses to take from his pension scheme.

It is important to note that even if John no longer accrued additional service in his pension scheme, he would be likely to breach the SFT if he retired at age 65 as long as the link to future salary growth remained in place.

What to do now

We have outlined below steps that should be considered by employers, trustees and employees in relation to the reduced SFT.

employers

- Identify the scope of affected employees, noting that individuals may have significant pension benefits built up in other schemes
- Agree an overall approach for affected employees in line with your compensation and benefits policy
- Decide on what, if any, changes to make to the pension but possible alternatives include:
  - Allowing an affected employee to leave the plan
  - Freezing pensionable salary
  - Lowering normal retirement age
  - Modifying benefits
  - Facilitating transfer to defined contribution

Comment

- Alternative compensation in the form of cash or access to a savings plan may also be an option
- Multinationals should give due consideration to approaches adopted in the UK. Particular care needed over foreign service
- Communication with affected employees will be key

trustees

- May be asked to facilitate changes to the scheme in light of the employer’s proposed approach
- This may include:
  - Implementing higher than usual (cost neutral) commutation rates for those liable to excess tax
  - Facilitating changes to rules such as permitting members to opt out or move to a different benefit structure or providing special early retirement terms

Comment

- May also be involved in communications to identify affected members
- Ensure that adequate records are maintained if special terms are agreed for individuals

employees

- Check their current circumstances, taking account of pension income from all Irish sources
- If SFT is likely to be breached beforethey reach retirement, consider available options - it may be beneficial from a tax perspective to stop or reduce benefits accruing in a pension scheme (if possible), or to stop or reduce AVCs

Comment

- Consider pension benefits (and any changes that may be required) in context of overall savings for retirement

How Mercer can help

You should contact your Mercer consultant to discuss the impact of theses changes on your employees and to share with you our survey results on what other employers are doing in this area. We can help you develop a comprehensive compensation policy, including determining suitable options for those who have reached or, will reach, the limits and assessing who could be affected.

Mercer can provide an executive financial planning service to advise individuals near or at the SFT on their options and help them manage their retirement benefits.

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