4.4 Anomalies & inequities

The current private pension tax pension tax relief system contains many anomalies and inequities:

- **Marginal rate tax relief on personal contributions provides more relief for the same contribution than a standard rate taxpayer paying a similar contribution**:

  This inequity is often presented as:

	Higher rate taxpayer	Standard rate taxpayer
Pension contribution	€1,000	€1,000
Less tax relief @ marginal rate	**€400**	**€200**
Net cost of pension contribution	€600	€800

The higher rate taxpayer appears to get tax relief at 40% (€400 in our example) while the standard rate payer appears to get 20% (€200) for the same pension contribution, a difference of 20%.

However, this picture is not complete as it fails to allow for the fact that personal contributions are not deductible for USC and PRSI purposes. This means that the individual must earn more than the pension contribution, in order to cover the cost of the USC, PRSI and the pension contribution. He/she also must pay income tax on the extra earnings required to cover this cost.

For example, a higher rate taxpayer has to earn €1,250 gross income to be able to afford a €1,000 pension contribution while a standard rate taxpayer has to earn €1,123 to afford the same level of contribution. (See Appendix 1).

The pension tax relief obtained as a % of gross income is 32% for a higher rate taxpayer and 17.8% for a standard rate taxpayer, a difference of 14.2% instead of the perceived 20%.

We therefore feel that comparisons of tax relief obtained on personal contributions as between higher rate and standard rate taxpayers should be based on a common gross income figure, in order to be valid.

If we standardise the comparison to €1,000 of gross income and then take the maximum gross pension contribution which can be funded from that gross income (after allowing for USC, PRSI, Income tax and the pension tax relief) we get:

Table 2 Maximum gross pension contribution that can be funded from €1,000 of gross income

		Higher Rate taxpayer		Standard rate taxpayer
Gross income		**€1,000**		**€1,000**
Used as follows:				
USC	8%	€80	4.75%	€48
Employee PRSI	4%	€40	4%	€40
Income tax	40%	€400	20%	€200
Gross pension contribution		€800[21]		€891[22]
Total outlay before pension tax relief		€1,320		€1,178
Deduct tax relief on pension contribution	40%	-€320	20%	-€178
Total outlay after pension tax relief		**€1,000**		**€1,000**
Pension tax relief as a % of gross income		32.0%		17.8%

[21] €1,000 * (1-8%-4%-40%)/(1-40%)

[22] €1,000 * (1-4.75%-4%-20%)/(1-20%)

- **Tax- relief limits: personal vs employer contributions** Personal contributions are subject to an annual age related % limit and NRE limit of €115,000 for tax relief, but employer contributions are not.

  The latter is unlimited other than by Revenue restrictions on funding to the level to provide the estimated maximum approvable benefits at normal retirement age.

  An unincorporated self-employed individual, for example, is subject to several limits; the annual NRE and age related % limits on his or her own tax relieved contributions and the Standard Fund Threshold limit on emerging benefits.

- **Tax-relief limits: occupational pension scheme vs PRSA contributions** Employer contributions to an employee's PRSA are a BIK for income tax in the hands of the employee (with employee income tax relief restricted to the age and NRE related limits) but an employer contribution to an occupational pension scheme is not a BIK. This means that more tax-deductible employer contributions can be made to an occupational pension scheme for an employee than to a PRSA.

- **Back-funding opportunities: personal vs employer contributions** Employers can contribute tax-efficiently for employees and former employees to occupational pension schemes for past service liabilities, stretching back many years, but personal contributions (employed and self-employed) can only be backdated one year for tax relief purposes.

  Therefore, an employee or unincorporated self-employed individual has significantly lower scope for backdating tax-deductible pension funding, and receives less relief on that funding, than an employer who can make substantially higher employer contributions on behalf of an employee to a scheme for past service liabilities, limited only to funding for Revenue maximum approvable benefits.

- **USC and PRSI treatment: personal vs employer contributions** Personal contributions are not deductible for USC and PRSI purposes, but employer contributions to an occupational pension scheme are, in effect, as the employer contribution is not a Benefit in Kind (BIK) for the employee.

  This gives rise to a disparity in the level of *gross* pension contribution and associated tax relief & PRSI cost as between employer and employee contributions, which can be funded from the same €1,000 of employer gross trading income:

Table 3 Cost to the Exchequer of pension contributions per €1,000 of gross employer income

	Higher rate taxpayer	Standard rate taxpayer
Employer gross trading income	€1,000	€1,000
Employer pension contribution to an occupational pension scheme (not a BIK)	€1,000	€1,000
Tax relief cost (income tax, PRSI (employer + employee), and USC foregone by BIK exemption)	**€567**[23]	**€357**[24]
Alternatively: €1,000 gross trading income paid (less employer PRSI @ 10.85%) to PRSI Class A employee as gross income of	€902	€902
Gross employee pension contribution which can be funded by that employee from that gross remuneration. (See App 2)	€722	€803
Tax relief cost (income tax relief provided at marginal rate on gross pension contribution) (See App 2)	**€289**	**€161**

The amount forgone by the Exchequer under various pension contribution scenarios arising from €1,000 of employer gross trading income is therefore summarised as:

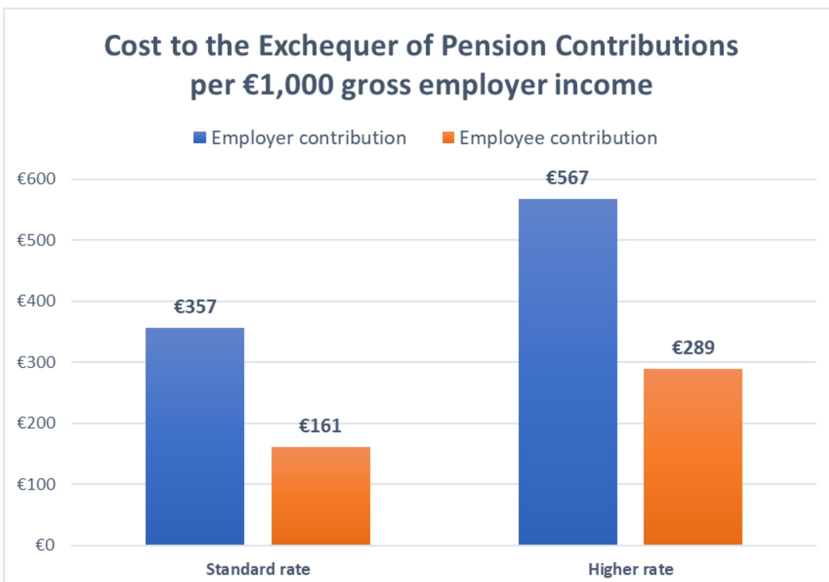

Figure 4:2 Cost to the Exchequer of pension contributions per €1,000 of gross employer income

[23] Gross employee income which can be paid from €1,000 gross trading income = €1,000/1.1085 (employer PRSI) = €902. Employee taxes and PRSI on €902 income tax @ 40% + USC @ 8% + PRSI @ 4% + employer PRSI @ 10.85% = = €567.

[24] Gross employee income which can be paid from €1,000 gross trading income = €1,000/1.1085 (employer PRSI) = €902. Employee taxes and PRSI on €902 income tax @ 20% + USC @ 4.75% + PRSI @ 4% + employer PRSI @ 10.85% = €357.

The table and chart above provide some useful insights:

- Employer contributions are significantly more tax-efficient for the employee (and hence cost the Exchequer more) than a personal contribution funded by the *same* level of gross trading income, i.e. out of €1,000 gross employer trading income, a €1,000 gross employer contribution can be paid as against a personal contribution of €722 for a higher rate taxpayer and €803 for a standard rate taxpayer.
- For the same gross trading income, an employer contribution for a standard rate taxpayer costs the Exchequer more in lost taxes and PRSI revenues (€357) than a personal contribution by a higher rate taxpayer (€289).
- The quantum of inequity between the tax benefit and cost of employer contributions over personal contributions is greater than that between standard and higher rate relief on personal contributions, i.e. the tax treatment of employer contributions versus personal contributions is more of an inequity than marginal rate relief on personal contributions.

- **PRSI treatment: Annuity vs ARF/AMRF** For retirees under age 66, pension and annuity payments are not subject to PRSI, but AMRF and ARF withdrawals are subject to PRSI for Class S (as they are not classified as being in the nature of a 'pension').

- **Tax-relieved lump sum options: Defined Contribution vs Defined Benefit vs PRSA** Members of Defined Contribution ("DC") occupational pension schemes can take *either* 25% of their fund or up to 1.5x final remuneration[25] (salary/service) as a tax-efficient lump sum at retirement. (If they choose the salary/service option, they must use the balance to purchase an annuity.) Members of Defined Benefit ("DB") schemes or public sector schemes do not have the 25% lump sum option, while holders of PRSAs do not have the salary/service lump sum option.

- **Lump sums on death in service: PRSA/RAC vs DB/DC.** PRSA and RAC funds are payable in full as a lump sum if the holder dies before drawing the benefits. However, lump sum death in service payments from a DB or DC occupational pension scheme are subject to a limit of 4 x final remuneration plus the accumulated value of any employee contributions. The excess, if any, must be used to purchase taxable annuities for the deceased dependant(s), if any.

- **Chargeable excess tax: DC vs DB/public sector** The chargeable excess tax system values DB or public sector pension benefits at terms substantially lower than the current open market cost to provide those benefits. This means that significantly higher value benefits can be provided under a DB/public sector pension than by a DC scheme, before any excess tax charge arises.

  This can be demonstrated by way of an example of a DB/public service-type pension of €50,000 pa payable from age 65:

[25] Assuming at least 20 years completed service by normal retirement age

Table 4 Value of €50,000 pa pension for Threshold purposes

Pension of €50,000 pa	**Multiple**	**Capital Value used for Threshold purposes**	**Chargeable excess?**
Valued for Threshold limit, accrued before 1st January 2014	20.0	**€1,200,000**	No
Valued for Threshold limit, accrued from 1st January 2014	26.0[26]	**€1,560,000**	No
Cost to provide pension if purchased on the open market by a DC scheme	42.3[27]	**€2,115,000**	Yes

- **Chargeable excess tax: DB/public sector benefits accrued pre-2014 vs benefits accrued thereafter benefits** The chargeable excess tax system values DB/public-sector pensions accrued up to 1st January 2014 at a fixed 20:1 but values such pensions accrued after that date at higher age-related multiples. This benefits those who substantially accrued their DB pension prior to 1st January 2014. There are no equivalent grandfathering arrangements for DC pension savings.
- **Chargeable excess tax: DB pensions with v without indexation increases or survivor's pension.** The chargeable excess tax system values DB pensions at the same rate, regardless of whether the pension will or will not increase in retirement, and regardless of whether a survivor's pension is payable or not. This particularly benefits public service pay parity pensions with 50% survivor's pension, which are valued the same as a funded DB pension with no increases and no survivor's benefits.
- **Avoiding chargeable excess tax: public sector vs DB/DC** Public service employees who hold private sector pension benefits likely to exceed the relevant Threshold limit due to a combination of their private and public sector benefits, can encash[28] these private sector benefits prior to retirement with one tax charge, currently 42%. In effect such public sector employees can hand back the income tax relief assumed to have been obtained on the 'excess' private benefits, and hence avoid a double tax charge on those benefits as chargeable excess.

  This allows such public service employees avoid (or reduce) the double tax charge (approximately 69%) on retirement. There is no corresponding provision for those in the private sector holding only private pension benefits.
- **Paying the chargeable excess tax: public sector vs private sector.** Public service employees who incur a chargeable excess tax liability on public service superannuation benefits can opt to pay the tax by way of equal annual instalments (no interest added) via a reduction in their gross pension over a period of up to 20 years. On death within this 20-year period, there is no recovery of outstanding instalments and no reduction in the spouse's death in retirement pension.

  Chargeable excess tax on funded private sector pension arrangements is payable in full within 3 months of the end of the month in which the benefits giving rise to the chargeable excess tax are crystallised. There is no refund on early death.

[26] *See Table of relevant age-related factors at end of Schedule 23B TCA 1997*
[27] Based on 6 October 2018 open market annuity rates for a joint life pension, 50% reversion, increasing at CPI, subject to a cap of 5% pa, nil commission
[28] S787TA TCA 1997