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The Real Standard Fund Threshold

The Irish Revenue incentivise pension saving by providing tax relief on contributions and tax-free investment growth on returns made; however, they do impose restrictions on how much you can save using a pension in terms of your contributions and the overall fund you can build.

The current Standard Fund Threshold in Ireland is €2,000,000 and many see this as the maximum possible fund that can be built up without being hit with Revenue's chargeable excess tax of 40%. However many Defined Contribution (DC) savers can fund for a higher amount without incurring the chargeable excess tax.

The rationale is that you can fund to €2,150,000 and avoid chargeable excess tax by using the tax paid on pension lump sum as a credit to offset this chargeable excess tax. This assumes the client takes €500,000 of the fund as a lump sum (allowable under the 25% route for a DC Fund of €2,000,000 or higher). The first €200,000 is tax free and the remaining €300,000 is taxed at 20% or €60,000. This tax paid on the lump sum can be offset against the chargeable excess tax bill reducing it to nil effectively allowing the client to fund to €2,150,000 without paying any chargeable excess.

Example

Chargeable Excess Tax Calculation	
Total Fund	€2,150,000
Standard Fund Threshold	€2,000,000
Amount Subject to Chargeable Excess Tax	€150,000
Tax Payable @ 40%	€60,000
Less Credit for Tax Paid on Lump Sum*	-€60,000
Remaining Chargeable Excess Tax Payable	€0.00
Funds payable @ drawdown	
Total Fund	€2,150,000
Less Chargeable Excess Tax	€0.00
Gross Pension Lump Sum	€500,000
Net Pension Lump Sum	€440,000
Amount to purchase an ARF or Annuity	€1,650,000

*First €200,000 tax free with next €300,000 subject to tax @ 20% (€60,000). The €60,000 tax paid on pension lump sum can be used as a credit against Chargeable Excess tax where it arises.

Tax Efficient Savings

It would not be tax efficient to build a fund in excess of €2,150,000 as those excess funds are subject to an immediate tax charge of 40% (under the chargeable excess tax regime) and could also be subject to a further tax as the remainder (60%) would need to be accessed as either Taxable Cash or invested in an ARF or Annuity with any payments from such contracts also taxable under the PAYE system. So in the worst case scenario if the fund over €2,150,000 was taken as taxable cash and that withdrawal was subject to highest possible rates of Income Tax, PRSI & USC of 52% (40% Income Tax, 4% PRSI & 8% USC) the effective tax rate on the funds over €2,150,000 could be as high as 71%. This is illustrated in the example below.

Example – Excess fund of €100,000

Excess Pension Fund	€100,000
Less Chargeable Excess Tax @ 40%	€40,000
Taxable Cash	€60,000
Potential Taxation on Taxable Cash	€31,200 (40% Income Tax, 4% PRSI & 8% USC)
Net Fund	€28,800

There are some strategies advisors and their clients can undertake to try and mitigate these issues. These are explored in further detail below.

1. Review investment strategy

Such a scenario warrant's a review of the investment strategy being adopted with pension assets. The potential for a cumulative tax rate of up to 71% on growth above the amount of €2,150,000 means that the reward for taking risk is punitively taxed whilst the risk in terms of the exposure to an investment loss remains. In our experience many advisors and their clients will seek to de-risk the portfolio in this scenario.

2. Accessing benefits early

As outlined above, with the growth of pension assets subject to punitive tax rates, it may make sense to access pension benefits at the earliest opportunity. This results in the value of the pension fund being crystallised for the purposes of the Standard Fund Threshold.

- **Approved Retirement Fund (ARF) –** A lump sum is paid out and in most cases the balance of the fund will be transferred to an Approved Retirement Fund (ARF). Those ARF assets can then grow outside the Standard Fund Threshold regime.
- **Vested PRSA –** This is also true where the clients hold a vested PRSA which is a PRSA from which the pension lump sum has already been paid.

This can be particularly advantageous when clients are in their 50's and therefore have no obligation to take withdrawals from their ARF or Vested PRSA and therefore the entire fund can grow entirely tax free. There is an obligation to take a withdrawal of 4% per annum of the ARF or vested PRSA from age 61 onwards which is taxable but the remaining fund (96%) can grow tax free. From age 71, that withdrawal must increase to 5% per annum. In all cases regardless of age, where ARF and Vested PRSA assets increase to €2,000,000 or higher a withdrawal of 6% per annum is required.

3. Segmenting Benefits

The general Revenue Rule is that all benefits in occupational pension schemes and personal retirement bonds (PRB) in relation to same employment must be matured simultaneously. However, where funds can be transferred to a Personal Retirement Savings Account (PRSA), there is an opportunity to drawdown benefits on a phased basis.

The Transfer of Funds from an occupational pension scheme to multiple PRSA's is an option for clients who wish to defer drawdown of a portion of funds. It is still a requirement for those Transfer's that a Certificate of Benefit Comparison must be obtained (unless the Scheme is being wound up) although it is expected that this obstacle will eventually be removed as part of the pension simplification changes in the industry.

Example – Fund of €3,000,000

Chargeable Excess Tax Calculation	
Total Fund	€3,000,000
Standard Fund Threshold	€2,000,000
Amount Subject to Chargeable Excess Tax	€1,000,000
Tax Payable @ 40%	€400,000
Less Credit for Tax Paid on Pension Lump Sum	-€60,000
Remaining Chargeable Excess Tax Payable	€340,000
Total Fund	
Total Fund	€3,000,000
Less Chargeable Excess Tax	€340,000
Gross Pension Lump Sum	€500,000
Net Pension Lump Sum	€440,000
ARF	€2,160,000

Alternate Scenario

The fund of €3,000,000 is transferred to multiple PRSA's. In this example this is just two PRSA's but in reality many clients will choose to spread their funds across a larger number of PRSA's if they wish to further segment these drawdowns.

Product Type	Fund
PRSA 1	€2,150,000
PRSA 2	€850,000
Total	€3,000,000

PRSA 1

PRSA 1 is drawn down. Net Pension Lump Sum of €440,000 is paid and ARF of €1,650,000 set up. No chargeable excess tax is applicable.

Funds payable @ drawdown	
Total Fund	€2,150,000
Less Chargeable Excess Tax	€0.00
Gross Pension Lump Sum	€500,000
Net Pension Lump Sum	€440,000
Amount to purchase an ARF or Annuity	€1,650,000

PRSA 2

Drawdown of PRSA 2 could be deferred until maximum age of 75 which is an automatic crystallisation event for a PRSA. This deferral of benefits can be advantageous for the following reasons:

- Benefits payable under the PRSA on the death of the policyowner are not a Benefit Crystallisation Event in the context of the Standard Fund Threshold. Therefore chargeable excess tax would not be payable on this portion of the fund in the event that it is payable on death of the PRSA policyowner prior to age 75.
- The full value of the PRSA could be paid to the estate of the policyowner in the event of payment on death prior to age 75.
- This could lead to a possible saving of €340,000 of chargeable excess tax.
- This PRSA may be seen as more akin to a life insurance policy for this period between the date it is set up and age 75.

Assuming the contract remains in place, Benefits will need to be drawdown at age 75 at which time chargeable excess tax will apply. If no instruction is received to mature the benefits at this time, an automatic crystallisation event occurs in which case chargeable excess tax would also apply.

Warning: The value of your investment may go down as well as up.
Warning: If you invest in these products you may lose some or all of the money you invest.
Warning: The income you get from this investment may go down as well as up.

For further information please contact your Broker Consultant or Zurich Technical Services on 01 209 2020.

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