

## Finance Bill 2006

The Finance Bill was published on 2 February 2006. This is the legislation which will bring into effect the changes announced in Minister Cowen's Budget of 7 December 2005. The Bill provides greater clarity on how the new provisions will operate in practice, and also contains some changes related to pensions which were not covered in the Budget announcement. We have highlighted below the main issues as set out in the Bill, although it should be noted that there may be changes in the provisions of the Bill during its passage through the Oireachtais.

The main changes which were not announced in the Budget are

- Incentive for SSIA holders
- Higher contribution limits for over 55's
- Restriction on holding property assets in SSAs and ARFs

### Incentive for SSIA holders to invest maturity proceeds in pensions

The recently published National Pensions Review recommended that the Minister take the opportunity to incentivise those who would shortly be receiving the proceeds of maturing SSIA's to reinvest these in a pension. The Bill provides that for anybody who had gross income not greater than €50,000 in the preceding tax year, and who did not pay higher rate tax in that year (or for a married person, who would not have paid tax at the higher rate had he or she been assessed separately), the Government will provide a tax credit of €1 to each €3 of SSIA funds transferred to a pensions vehicle, up to a maximum Government contribution of €2,500 i.e. if the individual transfers at least €7,500. In addition, there will be an additional tax credit equal to maturity tax on that part of the SSIA proceeds which is transferred to pension. The tax credit and additional tax credit will be paid by Revenue to the administrator of the pension scheme or PRSA. The individual cannot claim tax relief in respect of the amount transferred from the SSIA to the pension scheme or PRSA.

This is clearly a significant benefit for a non-taxpayer, but is similar in effect to the relief which a 20% taxpayer would receive if he or she paid additional pension contributions from income, when account is taken of PRSI relief.

### Higher contribution limits

Relief will be available on pension contributions of 35% of remuneration (up to the cap) at ages 55 to 59; for anybody who has attained age 60, relief will be available on contributions up to 40%. This applies to AVCs or contributions to a PRSA. As announced in the Budget, the cap of €254,000 will be indexed in line with an earnings figure from 2007.

### Limitation on use of pension assets for acquisition of property assets

With effect from 2 February 2006, the assets of a pension scheme cannot be used to acquire a residence or holiday home for a scheme member. This restriction already applied to assets in an ARF or AMRF. Again with effect from 2 February 2006, assets in an ARF or AMRF cannot be used to purchase a commercial property for business use by the ARF holder or a connected person.

## **Maximum Retirement Fund**

As announced in the Budget, the maximum allowable pension fund on retirement for tax purposes will be €5 million or, if higher, the value of the “uncrystallised pension rights” on 7 December 2005. Both sums will be adjusted annually from the tax year 2007 in line with an earnings adjustment factor to be announced annually by the Minister. Where a fund exceeds the relevant limit, the excess in the pension fund will be liable to a once-off income tax charge at the 42% rate when it is drawn down, so as to recover the excess relief granted.

This Bill makes it clear that this provision applies to all approved retirement benefit schemes, PRSAs and retirement annuities. This includes public sector and statutory schemes, and qualified overseas plans. For defined benefit schemes, the value of the pension entitlements is to be determined by multiplying the annual pension by a “relevant valuation factor” (RVF) which is specified as 20, unless it can be demonstrated to Revenue that this is “clearly inappropriate”, in which case a different lower RVF approved by Revenue can be used. The RVF of 20 is higher than that implied by current market annuity rates for a level pension, and somewhat lower for an inflation proofed pension.

The Finance Bill provides that the amount of any tax due can be taken from the pension plan i.e. for a PRSA or DC arrangement, it can be drawn from the accumulated fund at retirement and for a DB scheme, it can be provided by commutation of pension, without requiring the use of the tax free lump sum.

As the value at 7 December 2005 can be taken as the maximum allowable value if it exceeds €5m, the Bill provides that an individual who wishes to avail of this higher limit must notify Revenue in writing by 7 June 2006 (or on any earlier “benefit crystallisation event”) and provide whatever information Revenue require to enable them to issue formal certification of that value. For a defined benefit scheme, the value is to be assessed by applying the RVF to the benefit determined on the assumption that the individual was retiring at the earliest age at which he would have been entitled to retire on an unreduced pension.

There are also provisions for dealing with increases granted in pensions after commencement where these are more than the greater of 5% per annum, and CPI + 2% per annum, where this takes the value over the maximum permitted.

## **Tax free lump sums**

Where existing lower limits do not apply, the maximum lump sum which may be taken tax free at retirement on or after 7 December 2005 will be €1.25 million, being 25% of the new maximum fund amount of €5 million. The balance of any lump sum taken which is greater than this amount will be subject to higher rate tax. The Bill provides that this limit will be indexed in the same way as the maximum fund i.e. in line with earnings. This tax charge does not apply to lump sums paid on death.

## **Approved Retirement Funds (ARFs)**

As announced in the Budget, an annual 3% drawdown will be deemed to have applied to the value of assets in an ARF at 31 December each year and will be taxable. This will be phased in over three years from 2007, at 1% in 2007, 2% in 2008 and 3% from 2009 onwards. Any actual distributions from the ARF during the year will be deducted from this figure for that year and any net amount will be taxed at the individual’s marginal income tax rate in the January following. The charge will apply to ARFs created on or after 6 April 2000. This deemed income drawdown will not apply in the case of Approved Minimum Retirement Funds.

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