



Society of Actuaries in Ireland

Private Pension Tax Relief

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15th November 2018



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Society of Actuaries in Ireland

Private Pension Tax Relief

Tony Gilhawley



Pros and Cons of private pension tax relief

Cons	Pros
✗ Marginal rate relief is inequitable	
✗ Small number of high earners benefit disproportionately	
✗ Cost of €2.5bn; poor value for money	
✗ Deadweight effect	
✗ Has failed to produce high coverage and quality of cover is poor	
✗ Needs to be reformed	



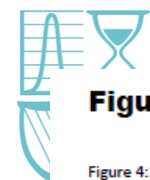
Pros and Cons of private pension tax relief

Cons	Pros
	✓ Relief does encourage private pension provision
	✓ Middle income earners benefit most
	✓ Deferral of tax
	✓ There has already been substantial restrictions in relief for high earners over the last decade



Pros and Cons of private pension tax relief

Cons	Pros
✗ Marginal rate relief is inequitable	✓ Relief does encourage private pension provision
✗ Small number of high earners benefit disproportionately	✓ Middle income earners benefit most
✗ Cost of €2.5bn; poor value for money	✓ Deferral of tax
✗ Deadweight effect	
✗ Has failed to produce high coverage and quality of cover is poor	
✗ Needs to be reformed	✓ There has already been substantial restrictions in relief for high earners over the last decade



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A lot more detail in the Paper



The EET system

Private Pension Cover

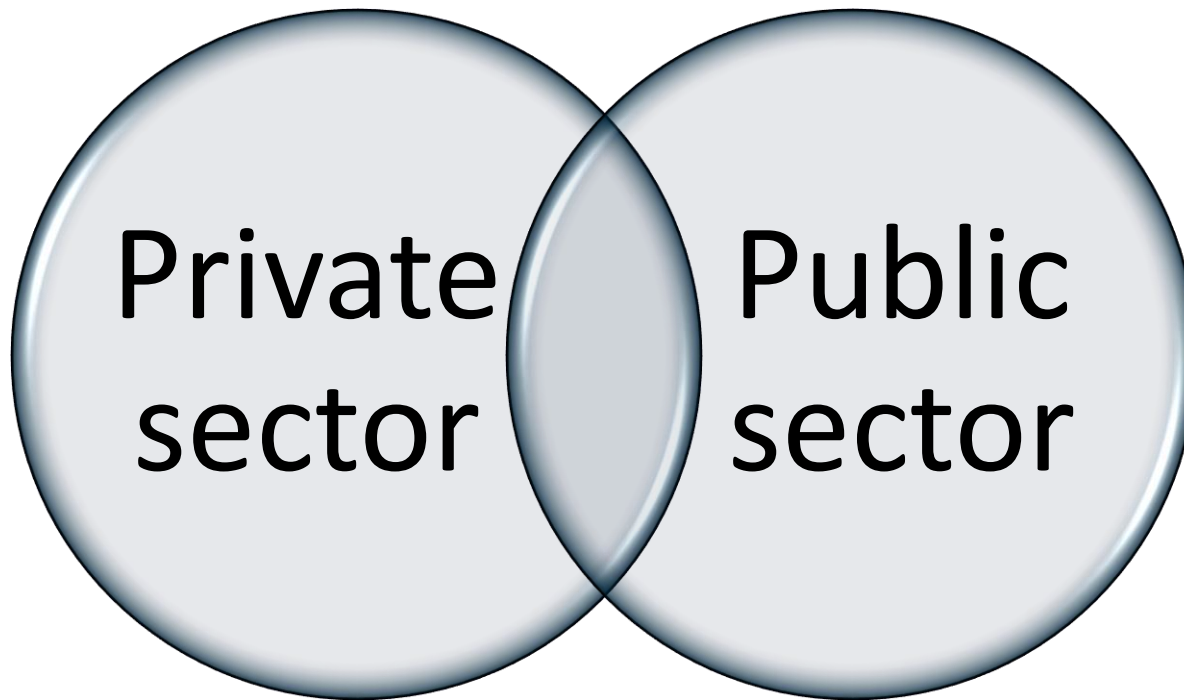
Taxation of retirement income

Cost of relief



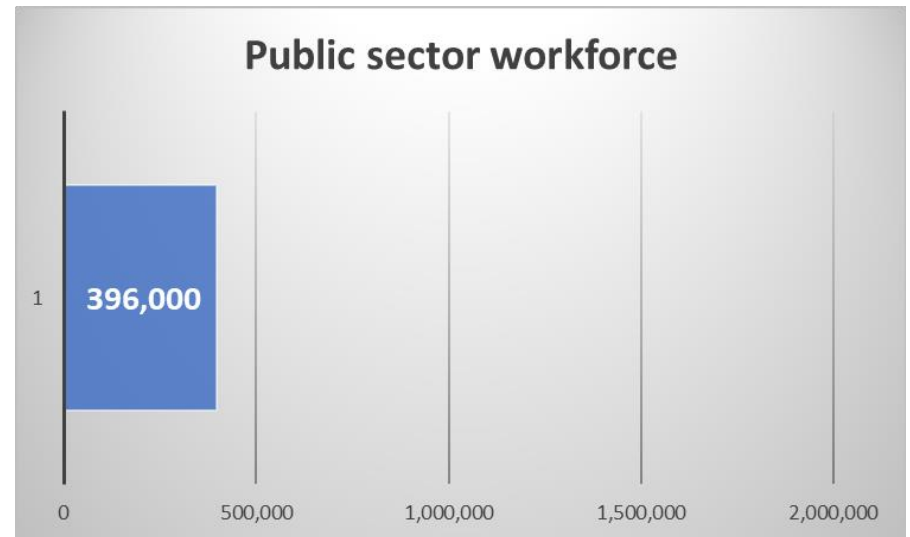
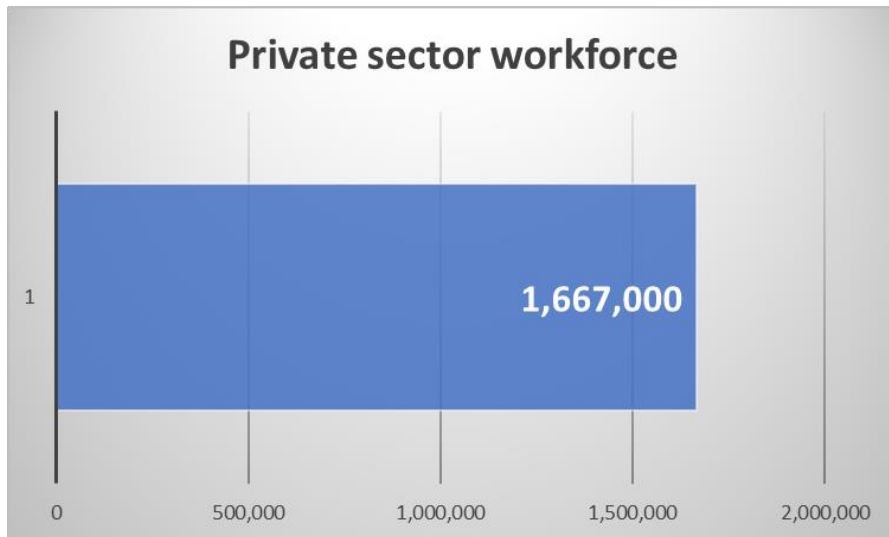
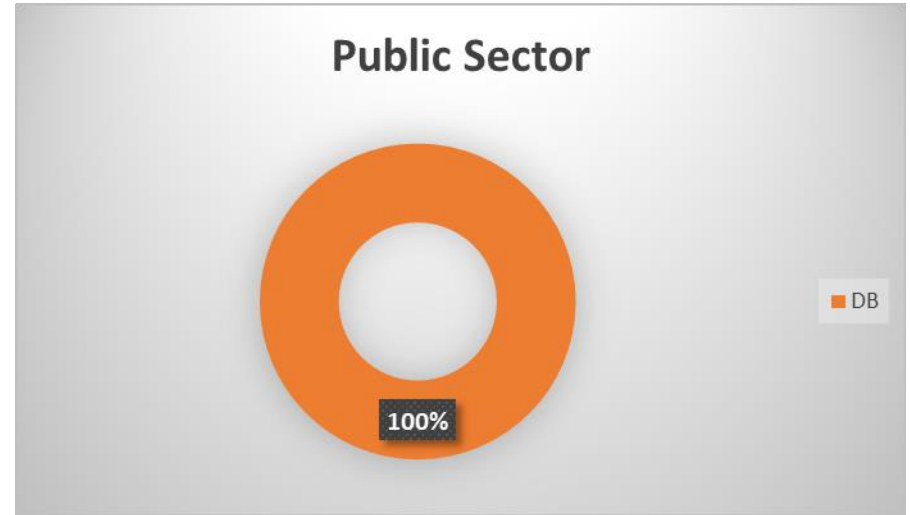
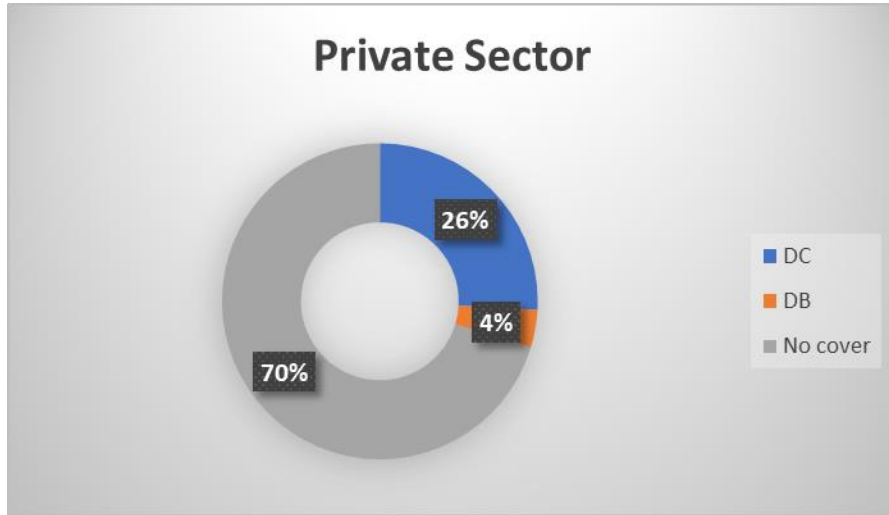
Findings

Reform





About 900,000 with 'active' private pension cover



About 1.2m with no private pension cover



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What is the policy objective?



The policy objective?

Private Sector

- Top up State Pension
- Match public service?

Public service

- Subsidise cost of contractual contributions?

“All aspects of quality of life (control, autonomy, self-realisation and pleasure) increase consistently with household income.”

TILDA 2017



Replacement rates don't matter?

*“Retirement income replacement rates are **not** associated with quality of life post-retirement.*

It is actual income in retirement, rather than retirement income replacement rates, that seems to affect quality of life of Irish retirees”

TILDA 2017

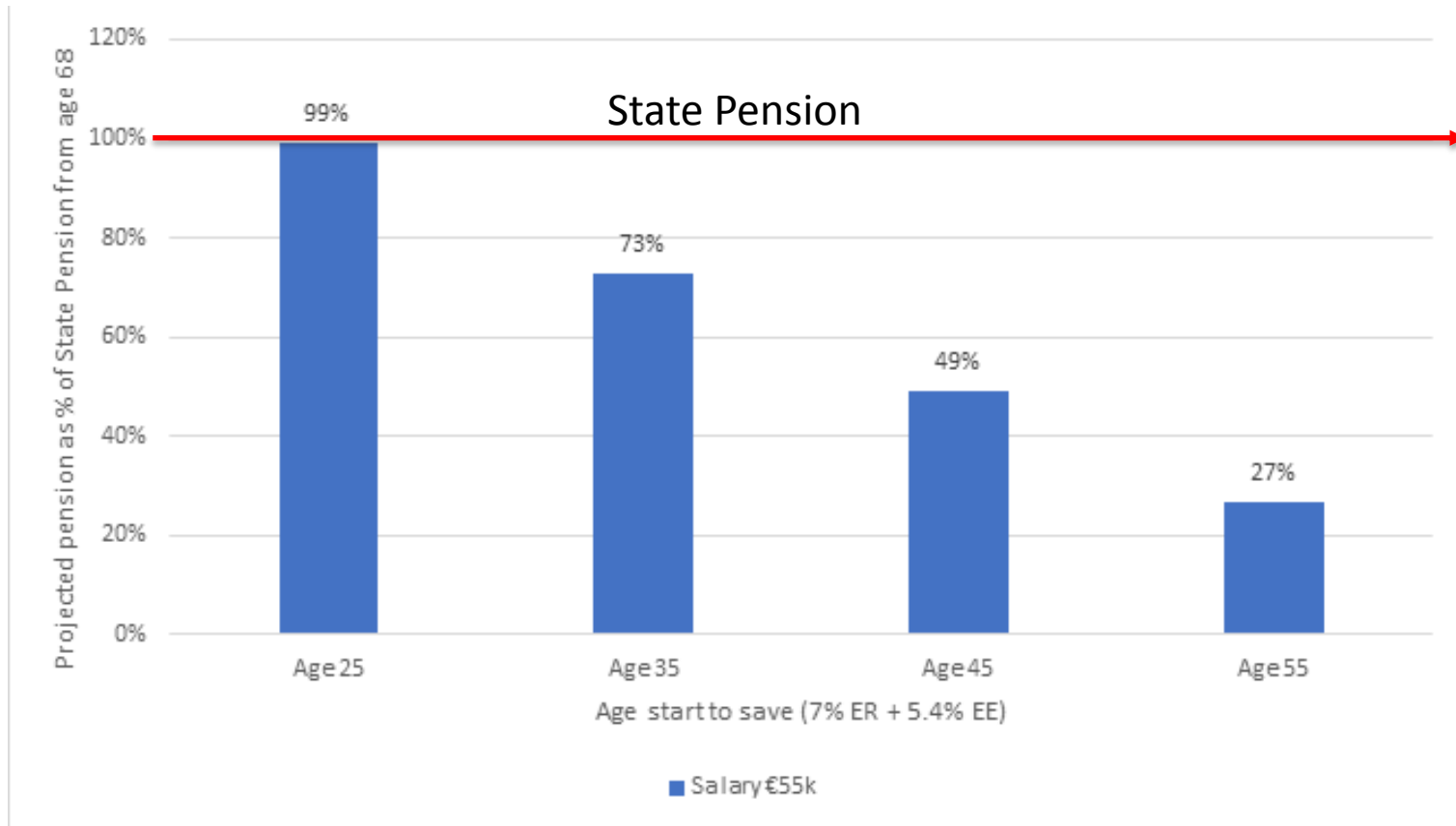


Measuring performance?

“How should the economic and social benefits of tax relief on pension contributions and investment returns be considered/measured and how do you believe the system of tax relief performs in that context?”



Projected DC outcome as % of State Pension



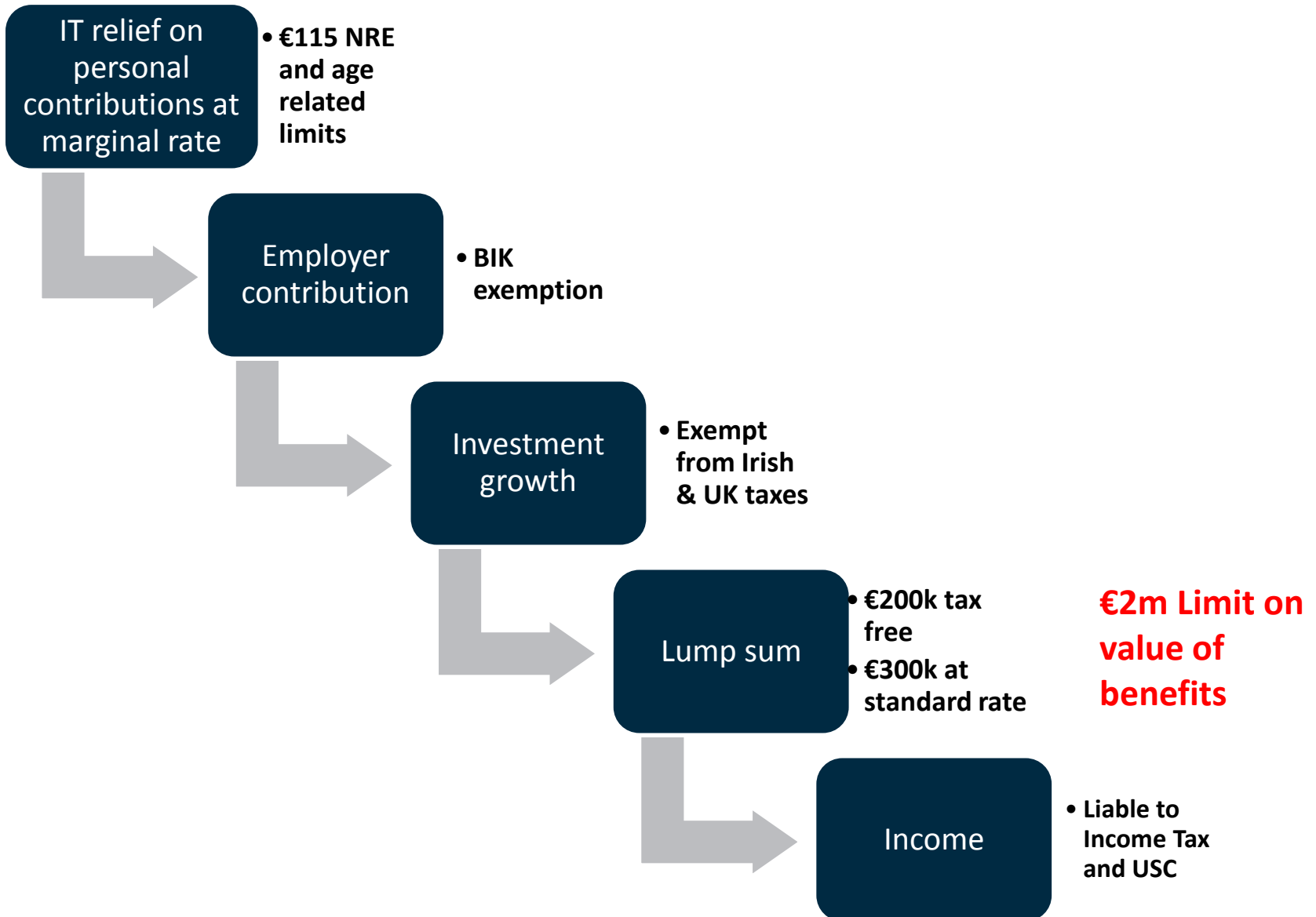


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The EET system



The Irish EET system





The equity argument

Marginal rate relief on personal contributions

	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 affordable contribution from €1,000 gross remuneration

	Standard rate	Higher rate
Net remuneration	€480.00	€712.50
Affordable gross pension contribution	€480/60% = €800	€712.50 / 80% = €891
Tax relief	40% x €800 = €320	20% x €891 = €178



Tax relief ... anomalies & inconsistencies

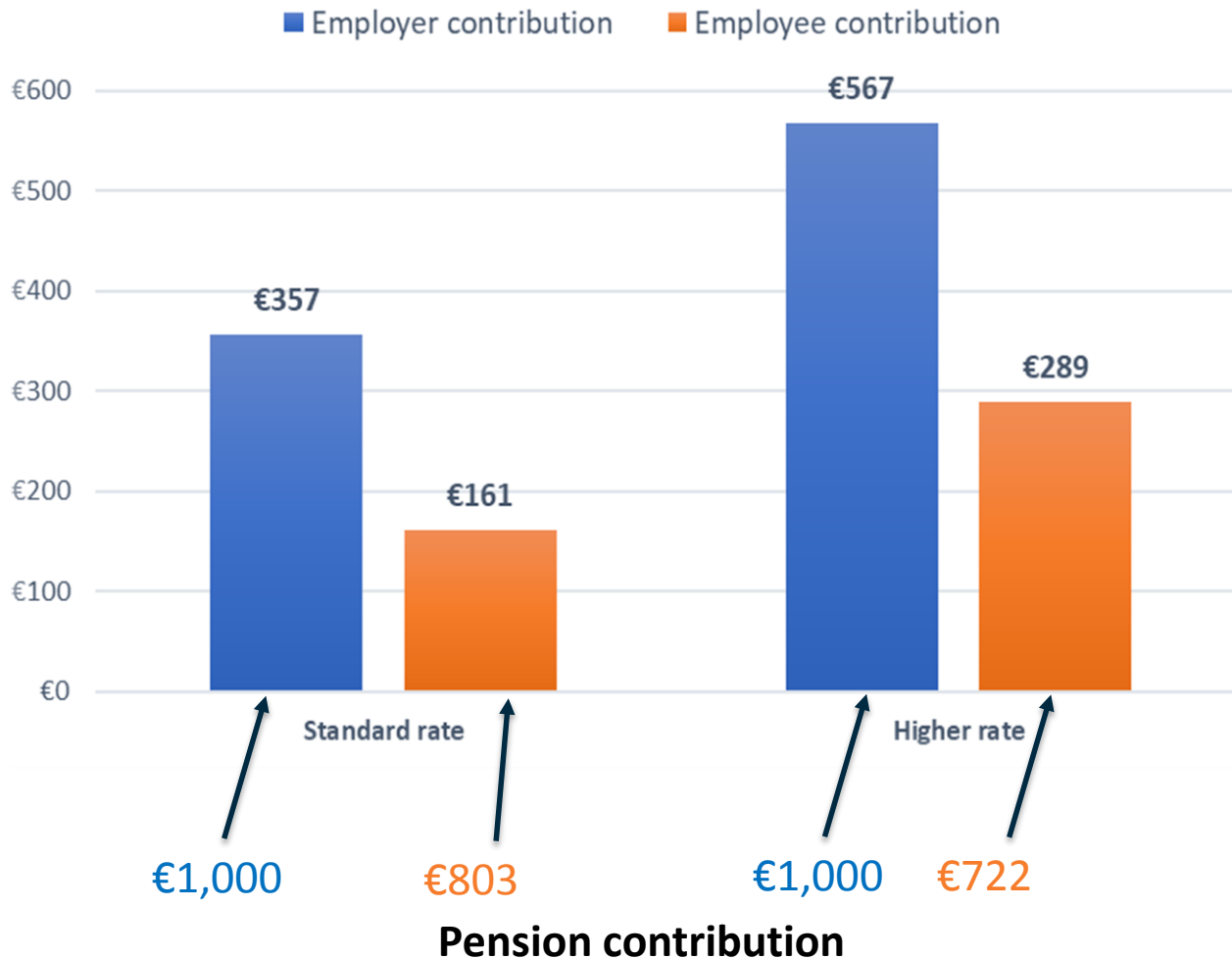
Marginal rate relief on personal contributions – from SAME GROSS INCOME

		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		€891
Total outlay before pension tax relief		€1,320		€1,178
Deduct tax relief at marginal rate on respective 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%



Tax relief ... anomalies & inconsistencies

Cost to the Exchequer of Pension Contributions
per €1,000 gross employer income





Other tax anomalies

NRE limit on personal but not employer contributions

OPS v PRSA employer contributions

Funding past service

Chargeable excess tax value of DB pensions

Payment of chargeable excess tax



Chargeable excess tax anomaly

Pension of €50,000 pa	Multiple	Capital Value used for Threshold purposes	Chargeable excess?
Valued for Threshold limit, accrued before 1 st January 2014	20.0	€1,200,000	No
Valued for Threshold limit, accrued after 1 st 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



Restrictions already imposed since 2008

NRE limit : €275,239 to €115,000

SFT from €5.4m to €2m

Tax free lump sum limit from €1.35m to €200k

Non deductibility of personal contributions for USC and PRSI

The pension levy: €2.4bn



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Private Pension Coverage



Private pension coverage

“Despite existing tax incentives in place to encourage pension saving, private pension coverage in Ireland remains at below 50% (reducing to circa 35% when the private sector is considered in isolation.”

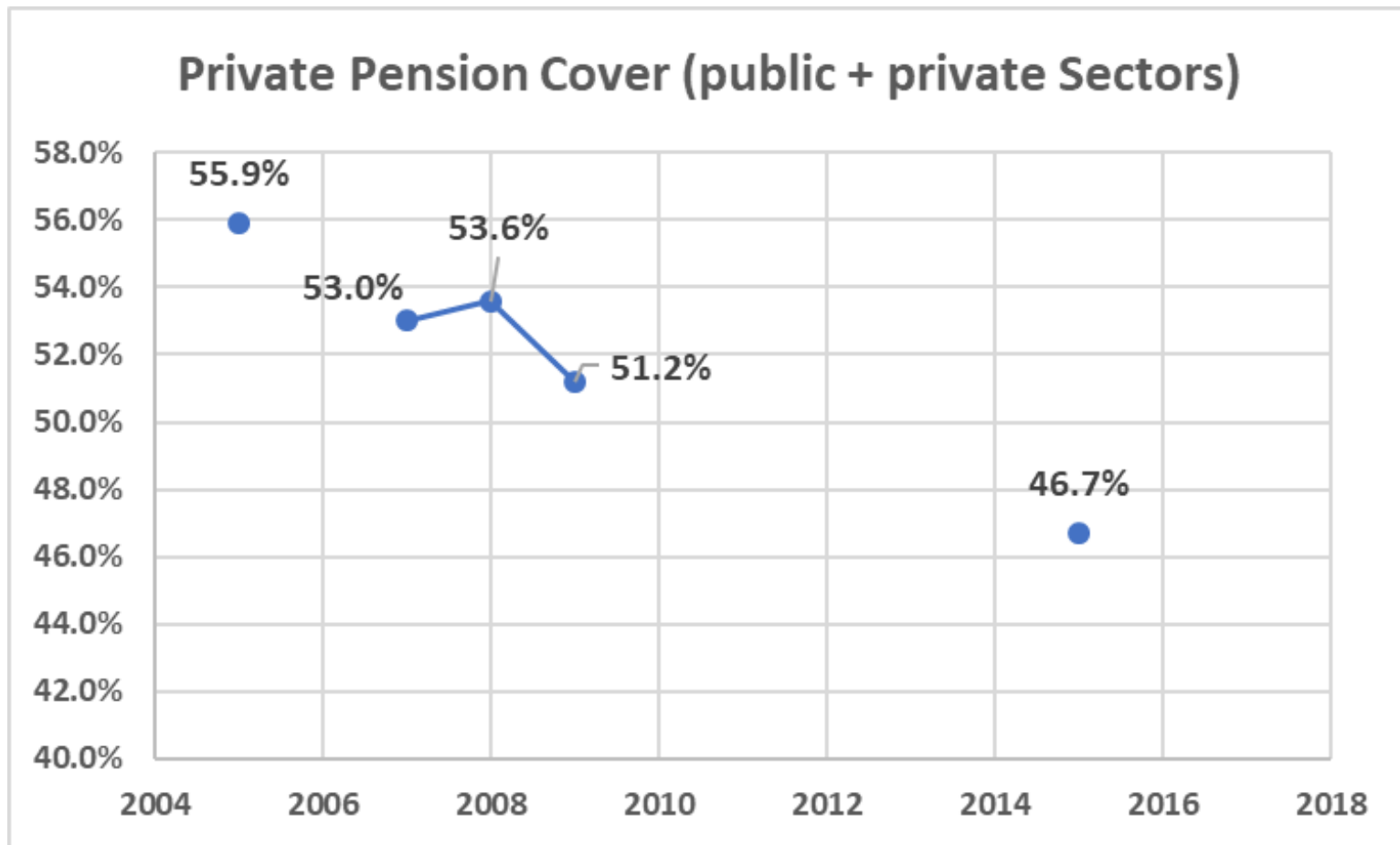
Department of Finance | IDPRTG Pensions Reform Consultation Paper

“Despite significant State incentives being available through tax relief to employers, employees and the self-employed, private pensions coverage has not increased to an appropriate level.”

A Strawman Public Consultation Process for an Automatic Enrolment Retirement Savings System for Ireland, page 7

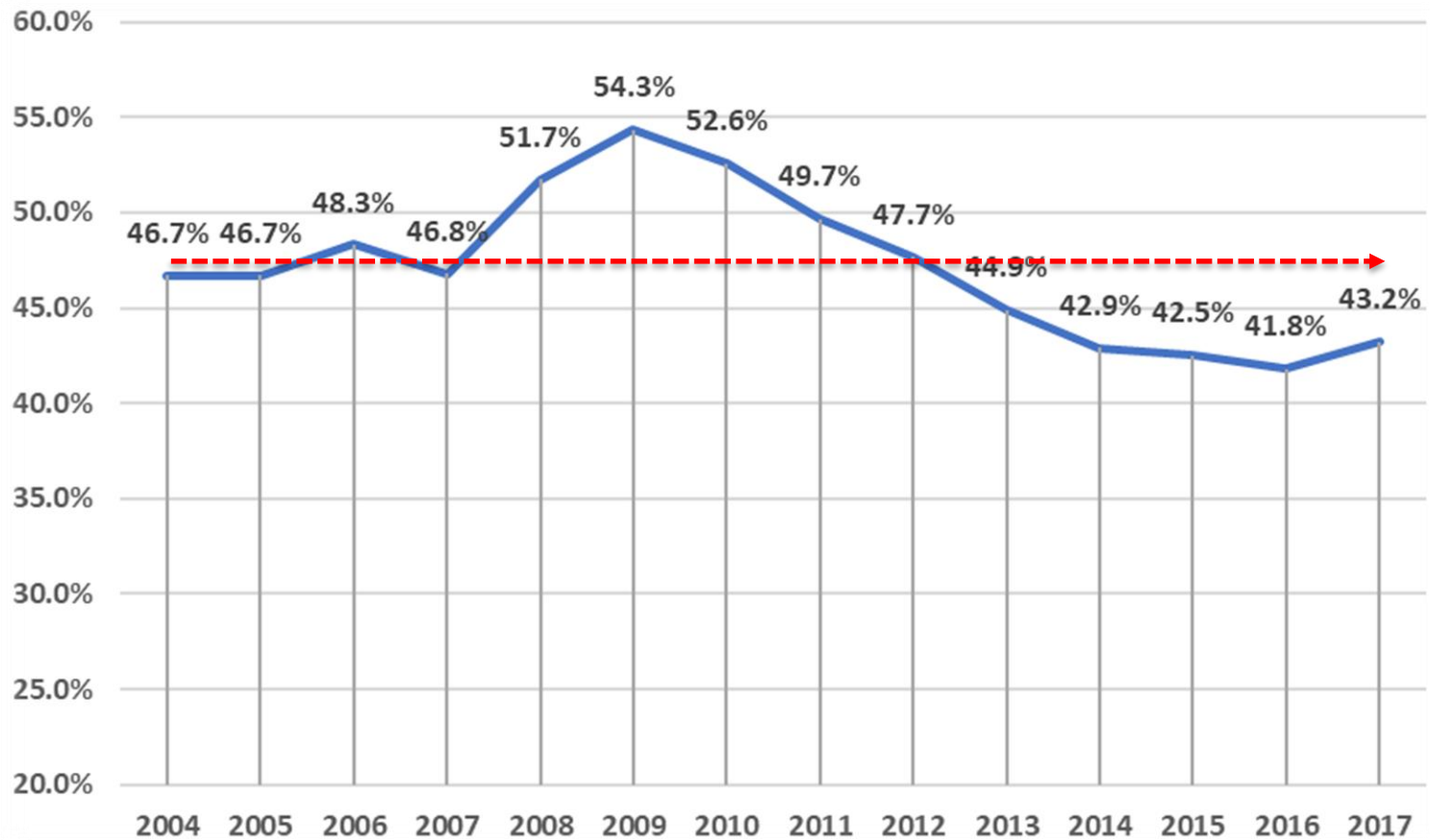


CSO QNHS Pension Modules





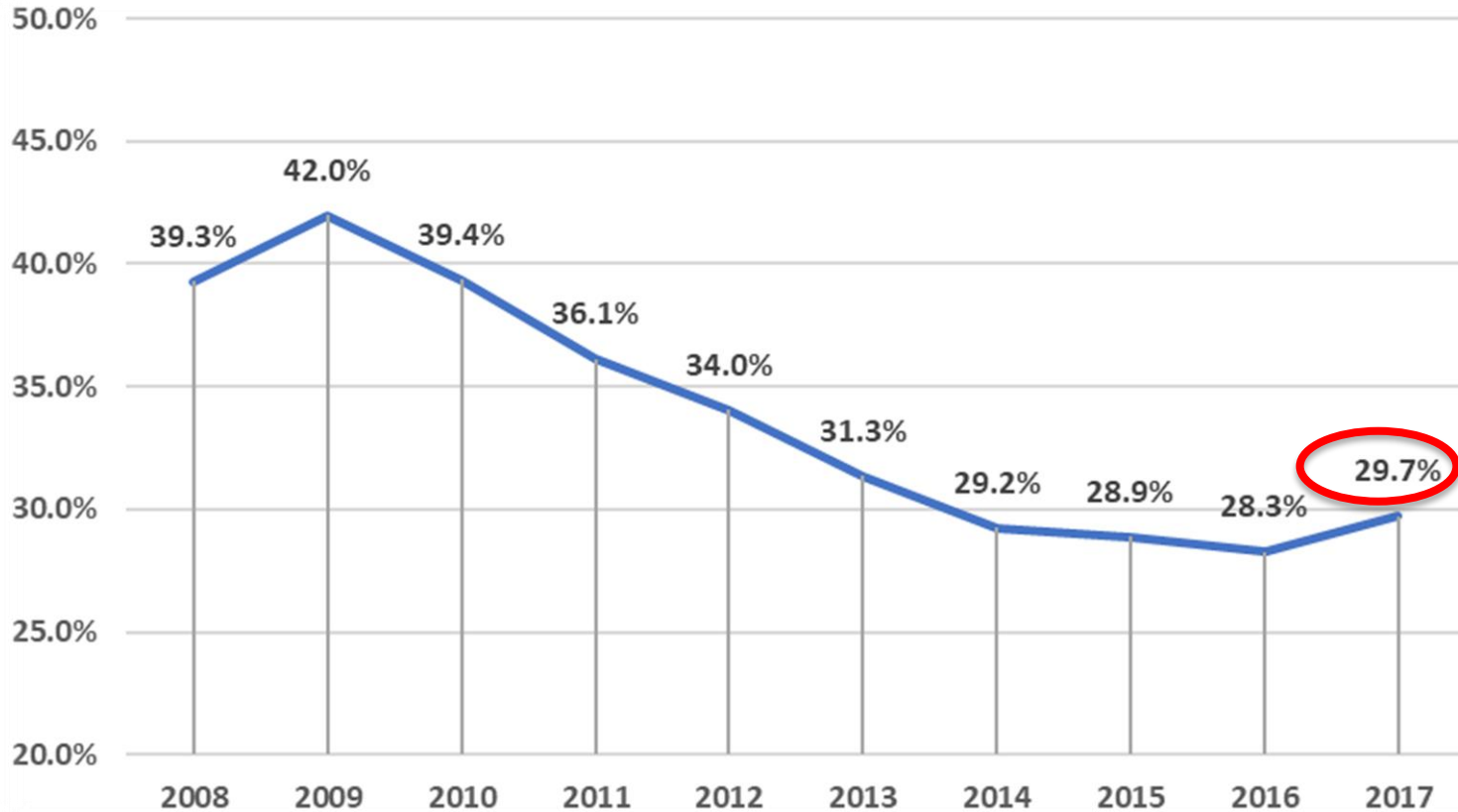
Our estimate of active private pension cover (public + private sectors)



Members of funded schemes + Public service numbers + RAC/PRSA contributors

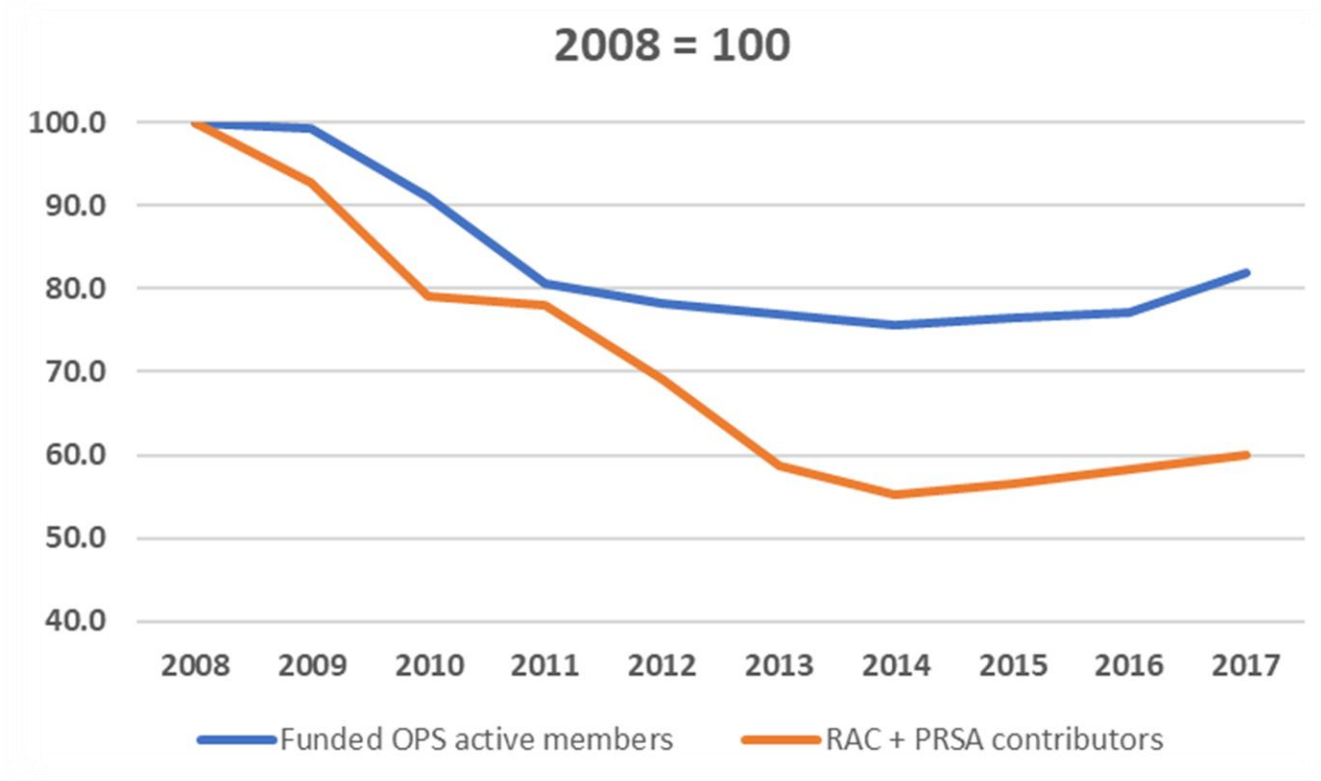


Our estimate of cover in the private sector only



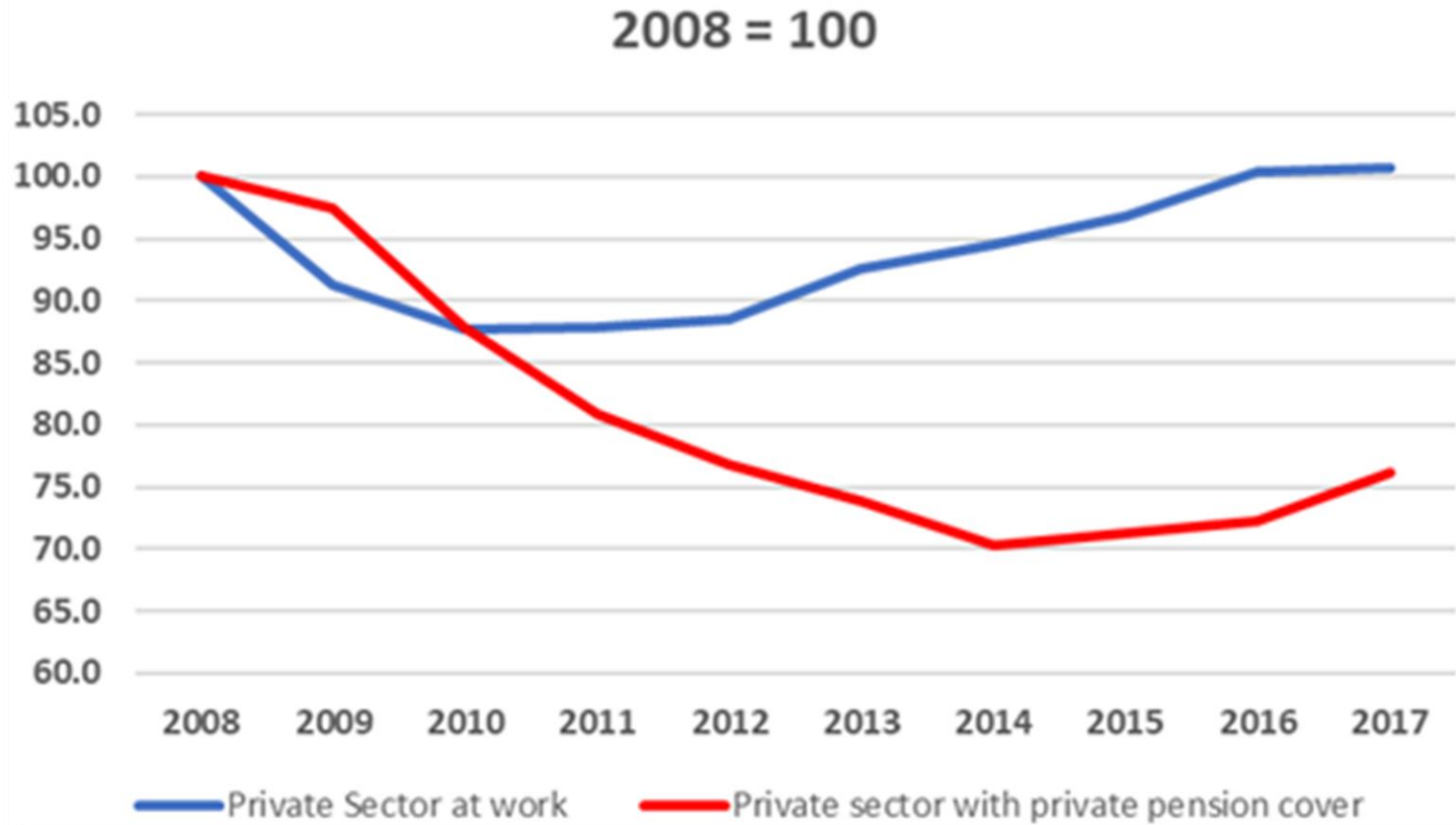


Number of 'actives' in the private sector





Private sector numbers





Private pension cover is highly correlated with earnings



2015 CSO QNHS Pensions Module and Labour Force Survey



Private pension cover by gross income

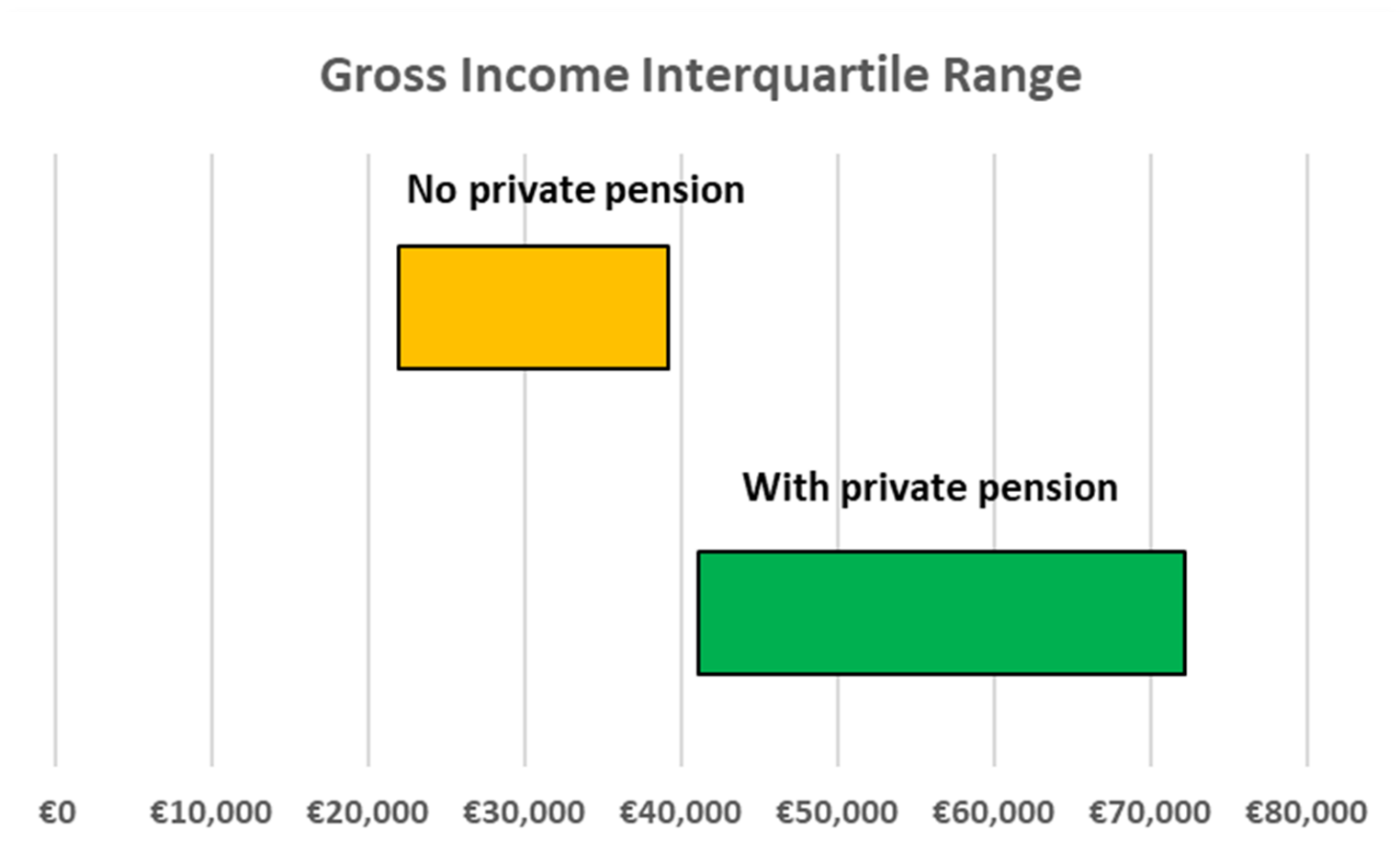
Full time employees (public & private sectors)

	1 ST QUARTILE	MEDIAN	3 RD QUARTILE
<i>With</i> private pension	€41,065	€54,586	€72,170
<i>Without</i> private pension	€21,850	€28,540	€39,122

Source: CSO SILC 2016



Private pension cover by gross income



Source: CSO SILC 2016



Private sector with 'active' private pension cover



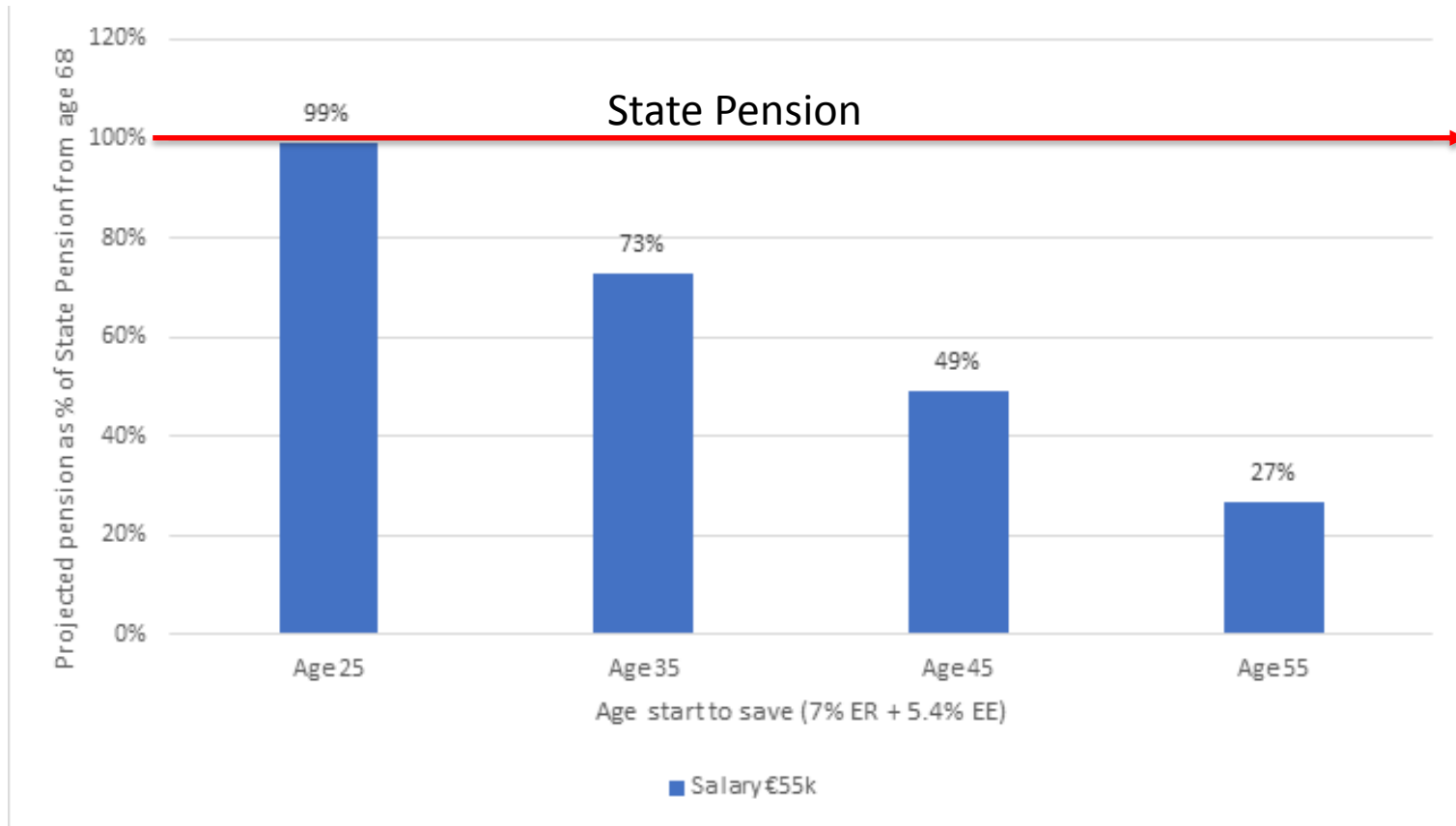
DB



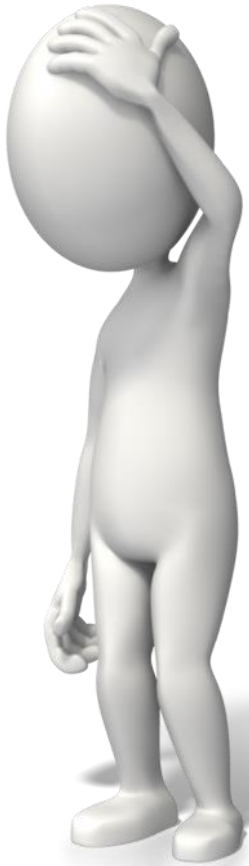
DC



Quality of DC coverage in private sector



Projected DC outcome as % of State Pension



***Where did
coverage fall?***



Where did private pension cover fall?

	2015 Cover (%)	Change since 2008 (5)
Construction (F)	34.1	-13.4
Administrative and support service activities (N)	24.9	-13.0
Transportation and storage (H)	42.6	-10.7
Wholesale and retail trade; repair of motor vehicles and motorcycles (G)	26.5	-9.7
Accommodation and food service activities (I)	13.1	-9.6
Industry (B to E)	52.1	-9.1
Arts, entertainment, recreation and other service activities (R,S)	23.3	-6.9
Professional, scientific and technical activities (M)	49.5	-6.5
Financial, insurance and real estate activities (K,L)	75.2	-5.3
Information and communication (J)	58.9	-4.6
Public administration and defence; compulsory social security (O)	89.1	-4.5
Education (P)	72.6	-3.5
Human health and social work activities (Q)	58.5	1.8



Age cohorts

Age cohort in Q4 2005	2005Q4	Age of cohort in Q4 2015	2015Q4	Change
25 - 34 years	53.5%	35 - 44 years	55.3%	1.8%
35 - 44 years	66.3%	45 - 54 years	54.4%	-11.9%
45 - 54 years	64.8%	55 - 64 years	49.3%	-15.5%



***Why did cover
fall?***



Why?

Celtic Tiger boom/bust

Affordability

A break in the pensions saving habit

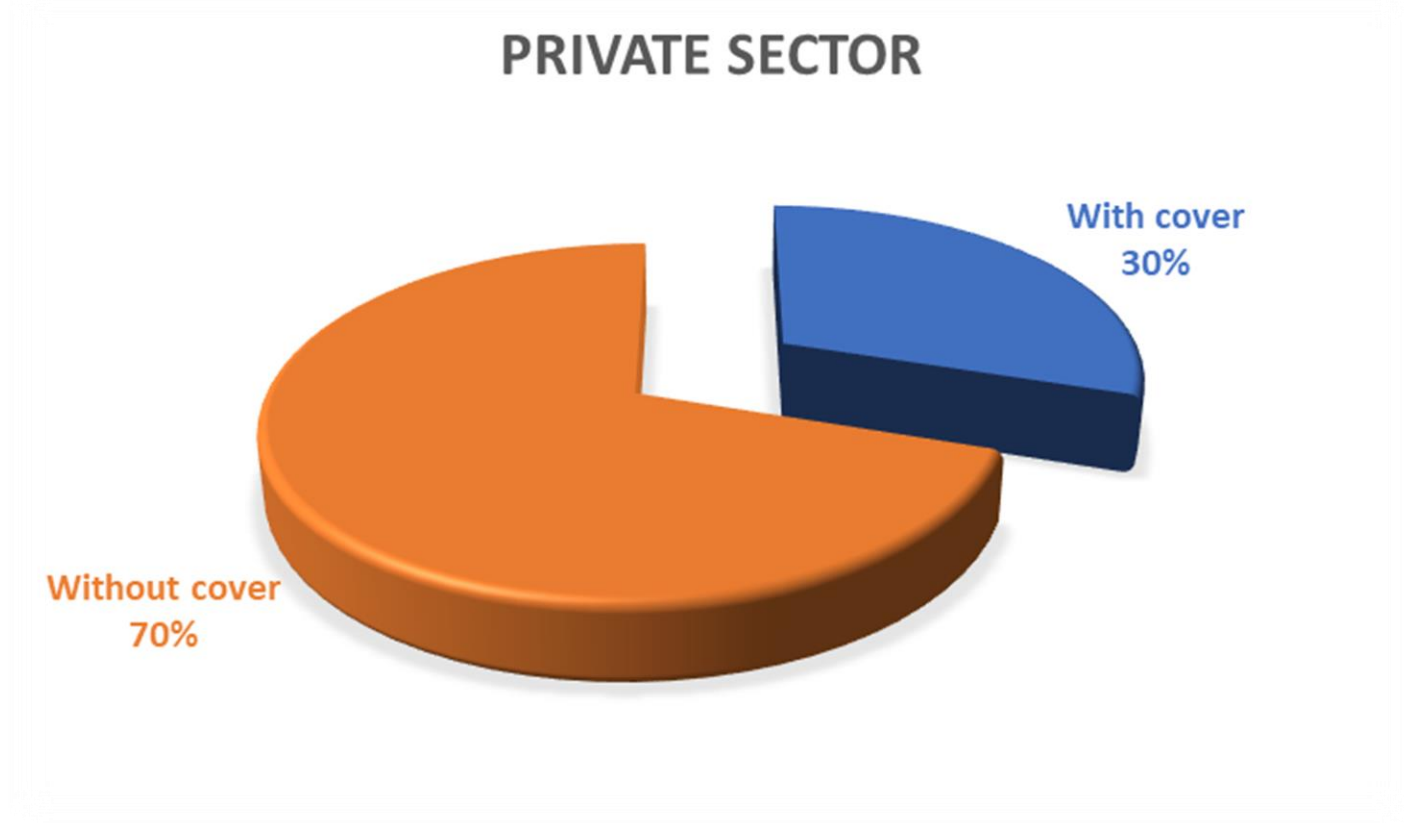
Reduction of debt and build up of deposits

Pension levy

Lag/Lead effect



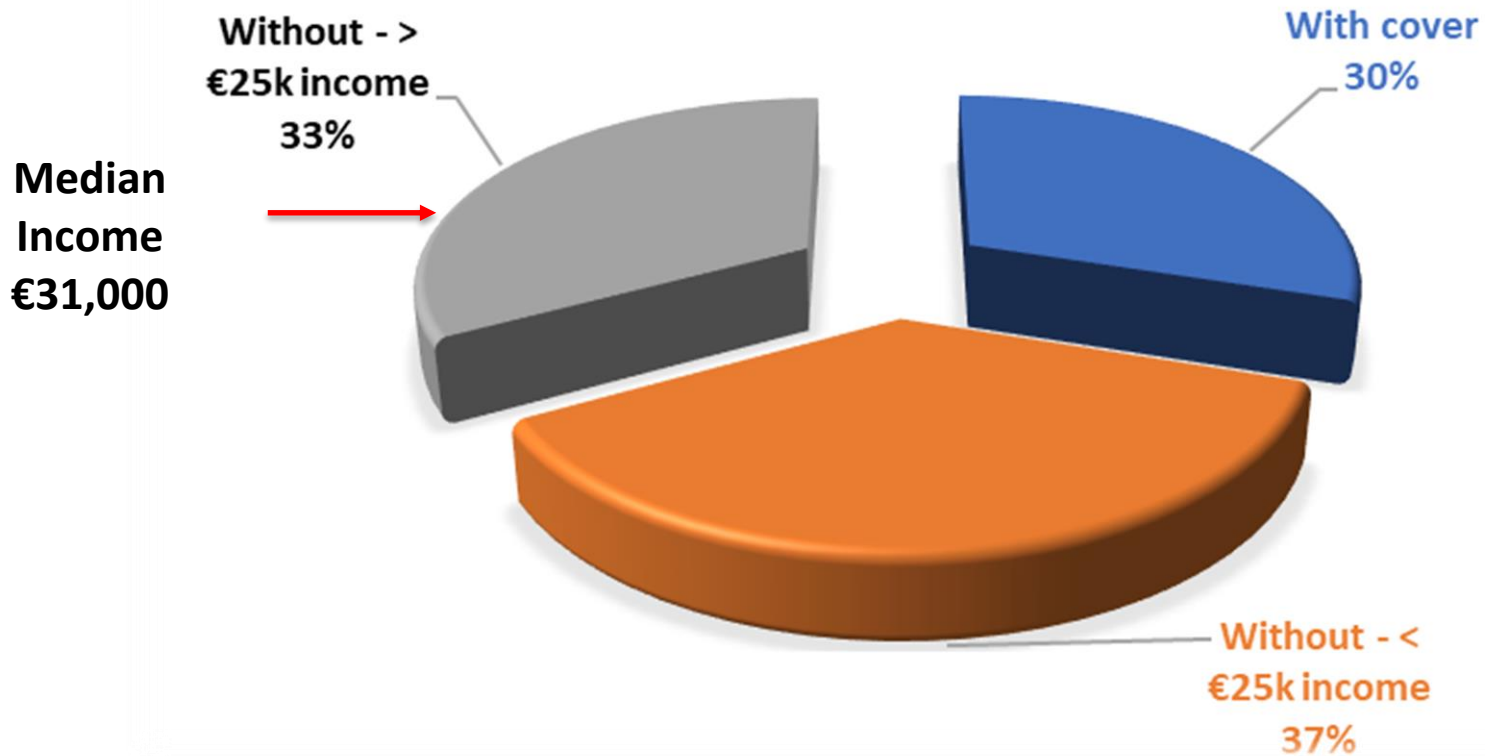
Does everyone need a private pension?





Does everyone need a private pension?

PRIVATE SECTOR





Other means of providing for retirement?

Spouse/partner's pension

Personal saving and investment

- 193,000 self assessed taxpayers (1/3rd) have rental income, average €20,000 pa

Downsize

Work on

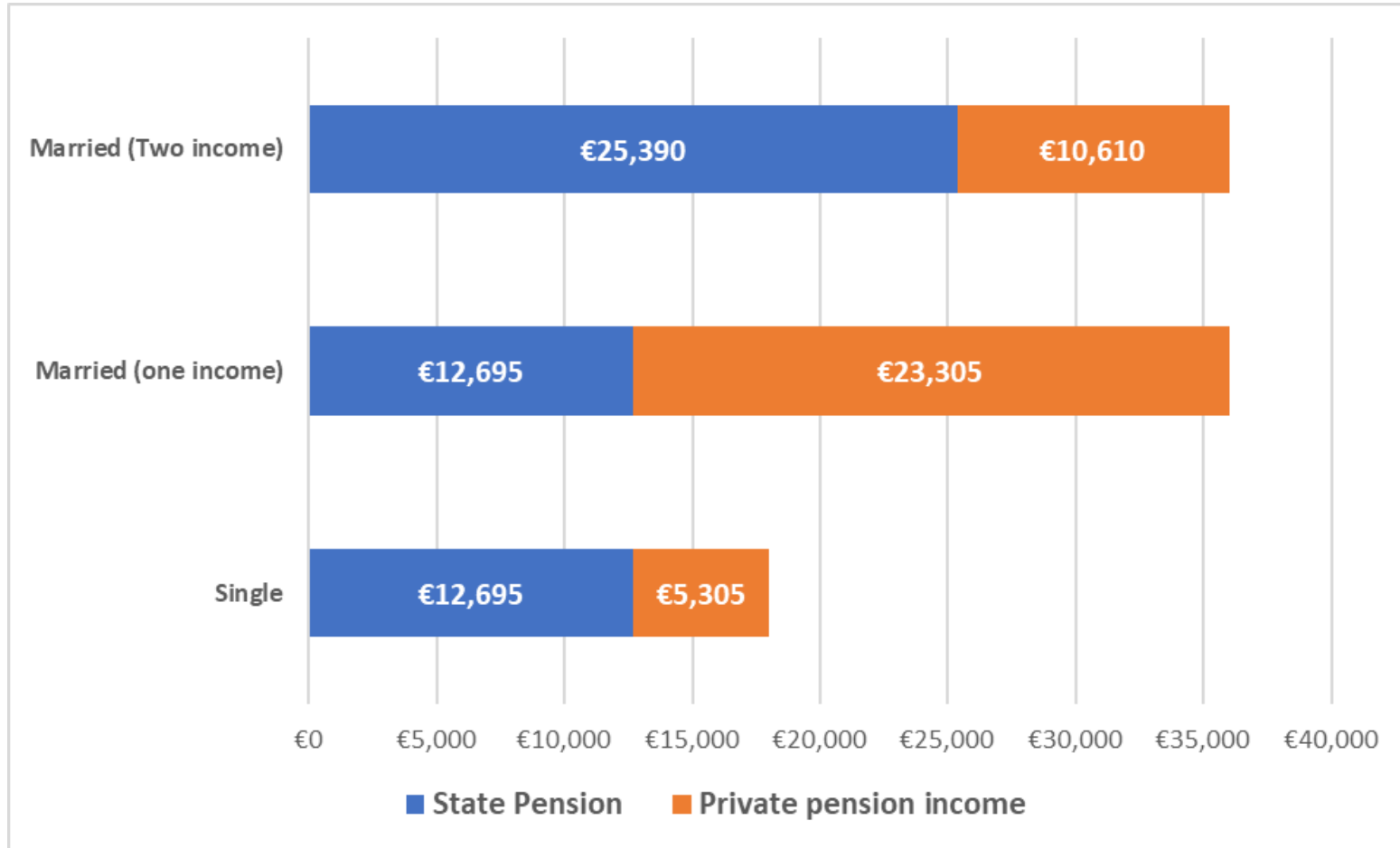


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Taxation of retirement income



Income Tax Exemption Limit





Other 'tax breaks' for over 65s

No USC on State Pension

Age tax credit of €245

No PRSI

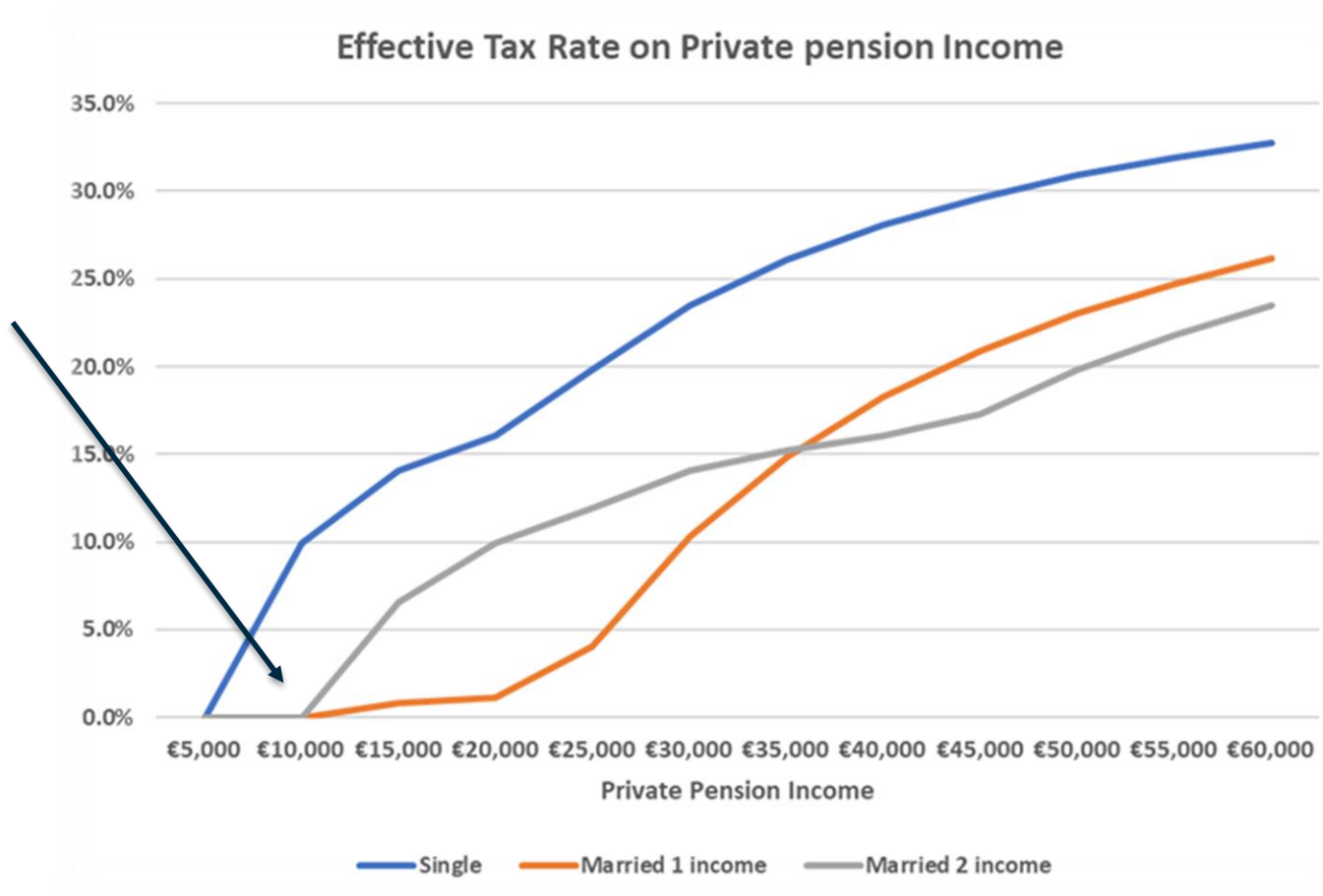
USC exemption below €13,000

Reduced USC rate for over 70's



Taxation of private pension income > 65


Tax free zone



Assuming only income is State Pension + private pension income



When does private pension income become liable to tax?

	Private retirement income is tax free below this level	Effective tax rate of 15% applies to private pension retirement income	Effective tax rate of 30% applies to private pension retirement income
Single	€5,308 pa	€16,930 pa	€46,260 pa
Married one income	€13,000 pa 	€35,144 pa	€77,360 pa
Married two incomes	€10,610 pa	€33,860 pa	€92,560 pa



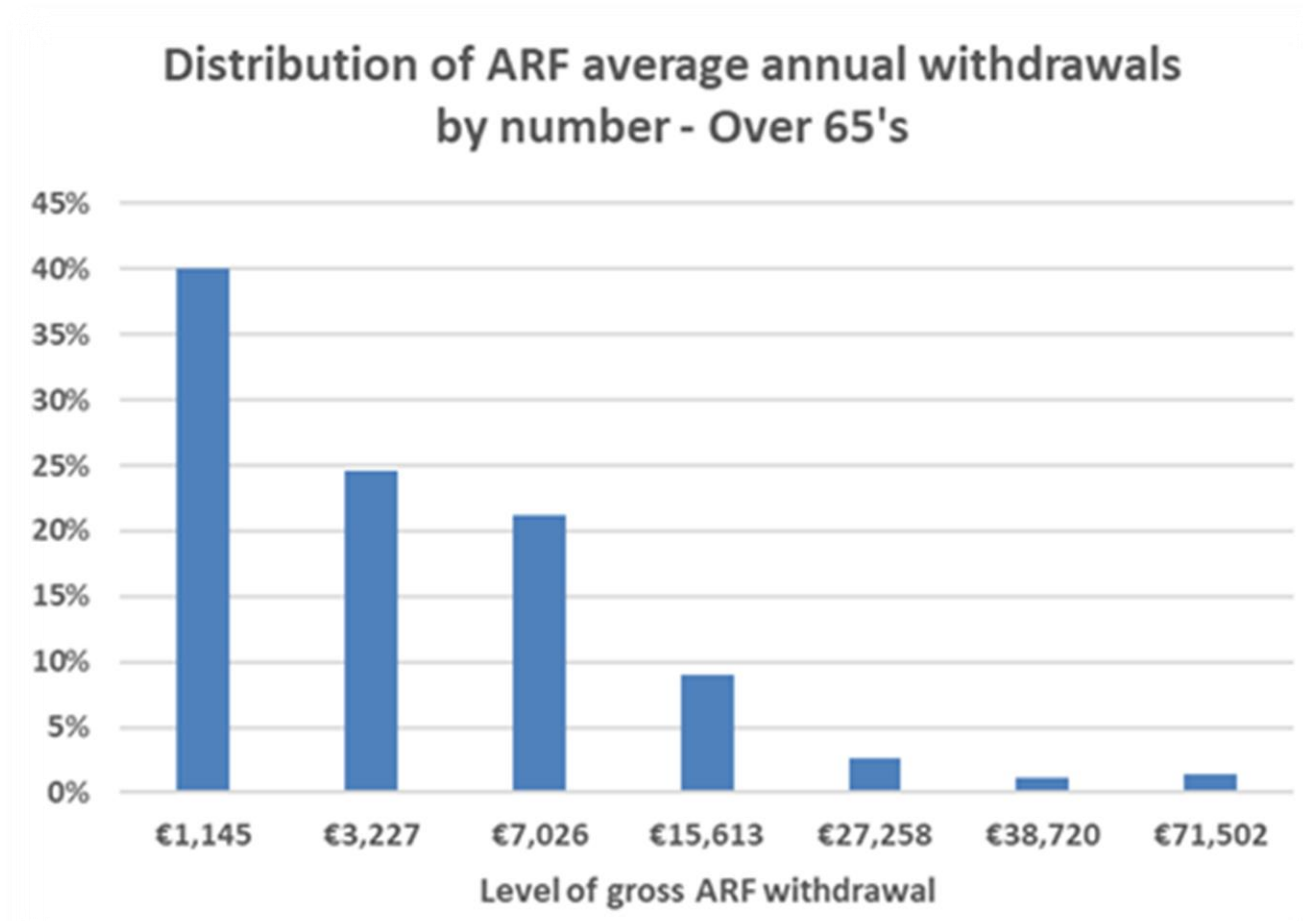
ARF size	% number		% Value	
0-€50k	40%		7%	
€50-100k	25%	86%	13%	43%
€100-250k	21%		23%	
€250-500k	9%		22%	
€500-750k	3%	14%	11%	57%
€750-€1M	1%		7%	
€1M+	2%		17%	

ARFs

Median: €70k Average: €142k



ARF income



86% have an average ARF income of €3,000 pa

14% have an average ARF income of €25,000 pa



	Single Person	Married one State Pension	Married two State Pensions
Income tax exemption limit	€18,000	€36,000	€36,000
Less State Pension (Contributory)	€12,695	€12,695	€25,390
Available exemption limit for ARF income withdrawals	€5,305	€23,305	€10,610

86% have an average ARF income of €3,000 pa
14% have an average ARF income of €25,000 pa

ARF holders



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Cost of private pension tax relief



Qualifications on 'cost'

Assumes no change in behaviour

Gross of tax recoveries

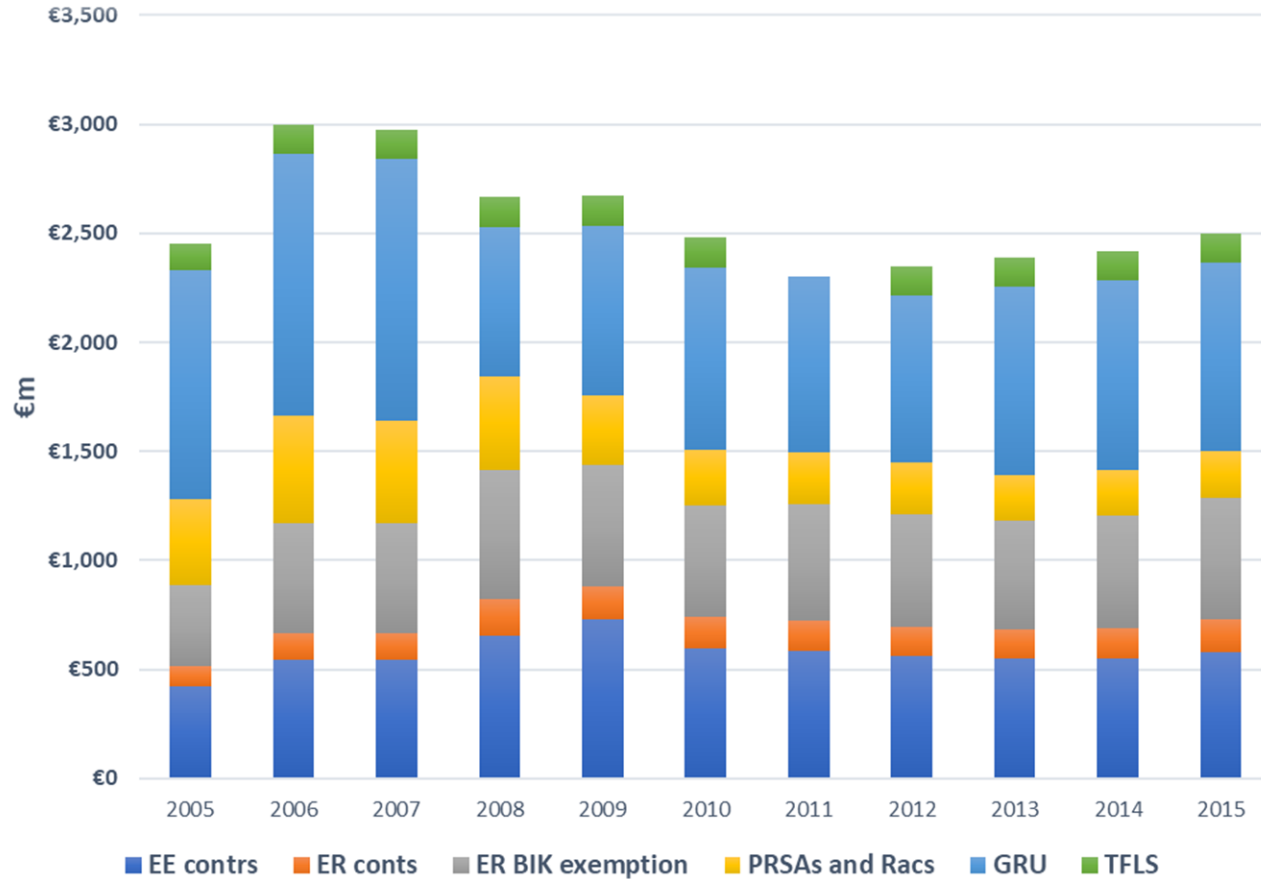
Based on some speculative assumptions

Excludes cost of BIK exemption of notional public service employer contribution

*This data shows the estimated **cost** in terms of revenue forgone as well as the numbers who availed of tax credits and the main reliefs and deductions*



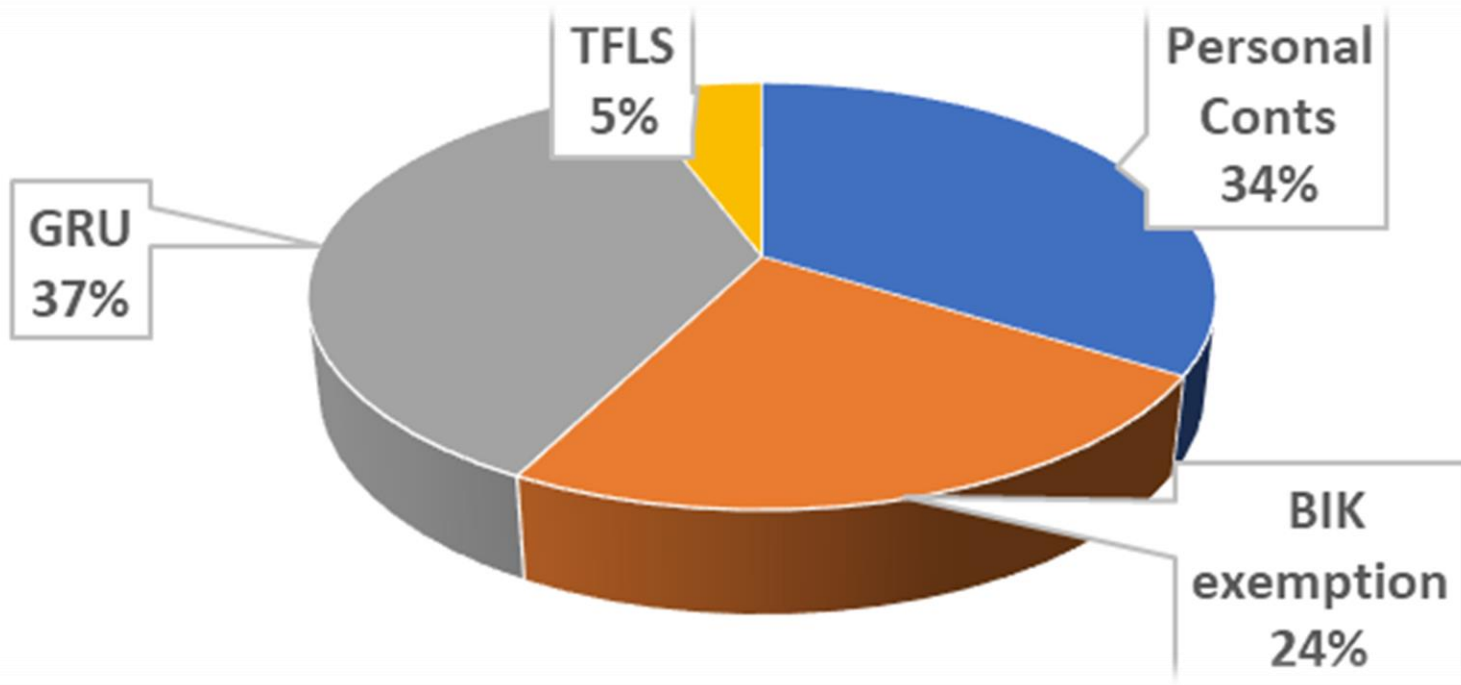
Cost of private pension tax relief (€m)



Source: Revenue Commissioners Costs of Tax Expenditures (credits, allowances and reliefs) 2005-15

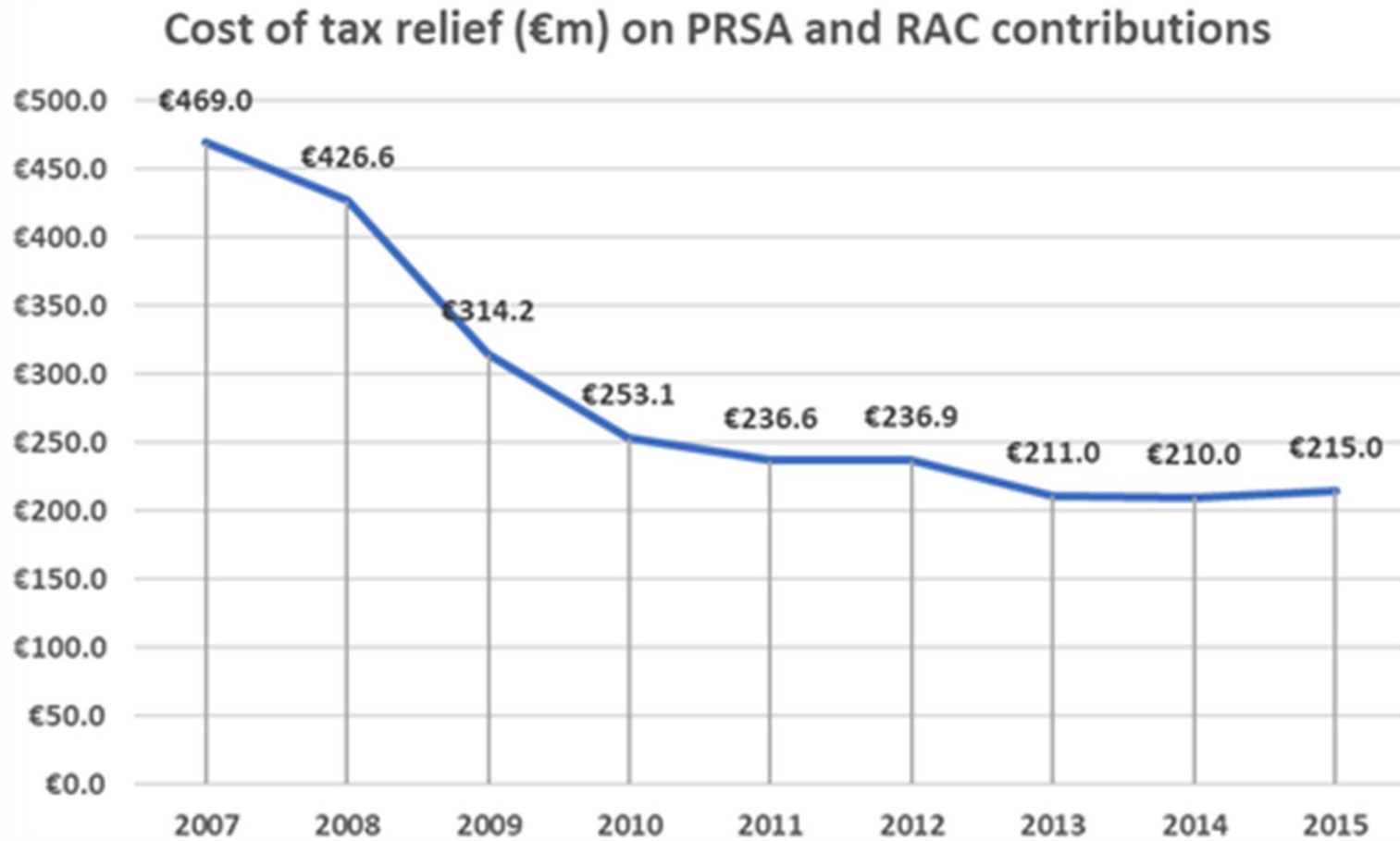


Split of total EET cost 2015





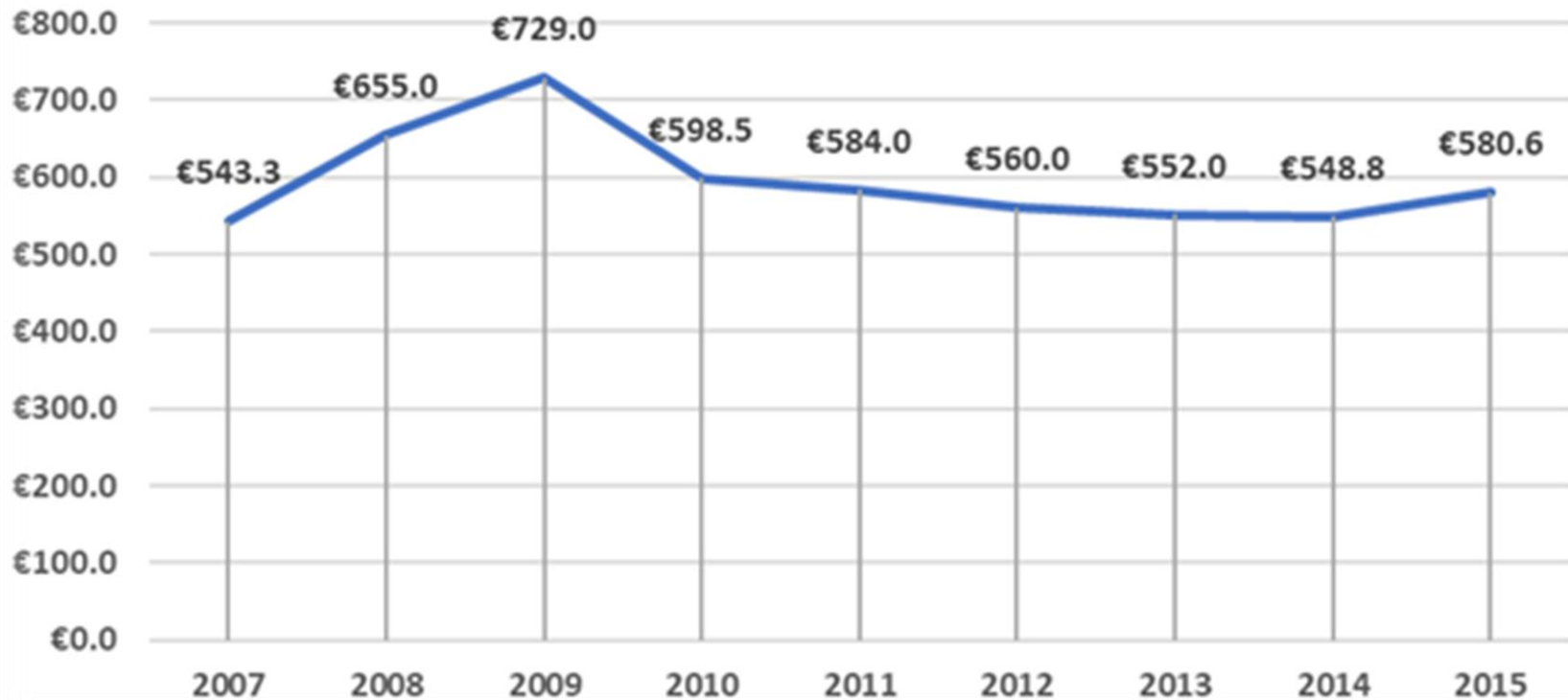
Cost of income tax relief (€m) – PRSAs & RACs





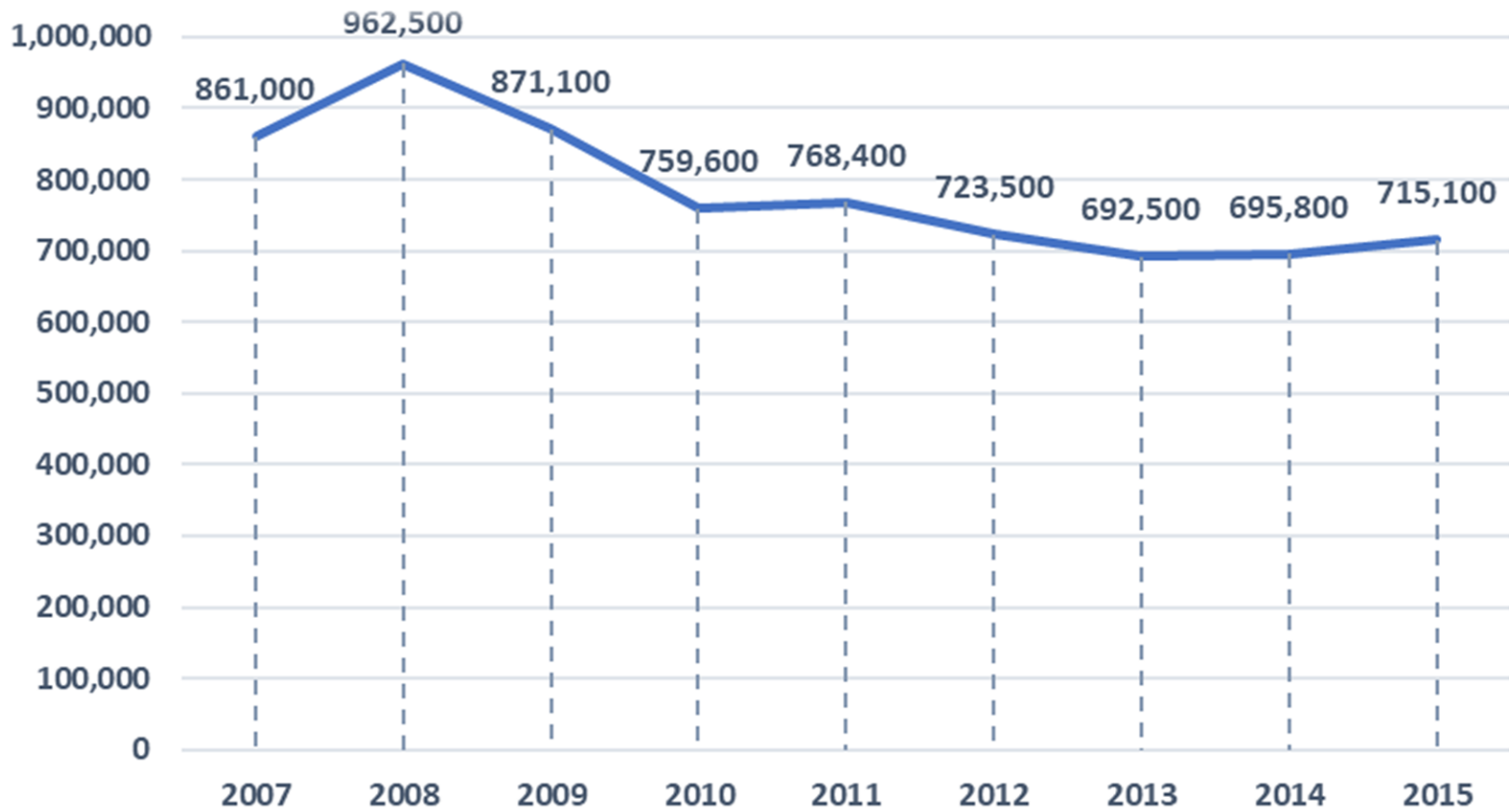
Cost of income tax relief (€m) – OPS employee contributions

Cost of tax relief (€m) on employee OPS contributions
(Public + Private Sector)



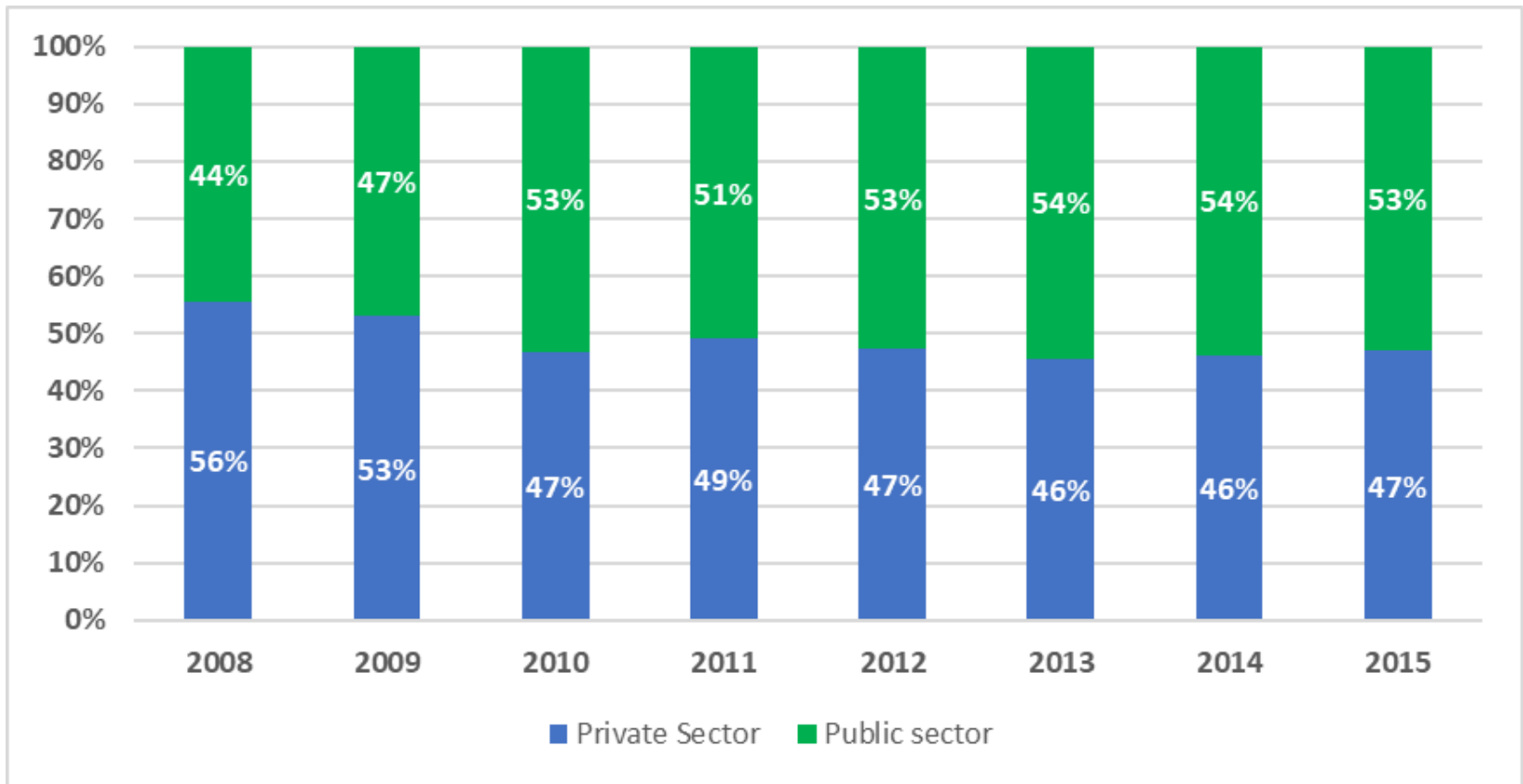


Numbers claiming income tax relief on personal contributions (public + private)



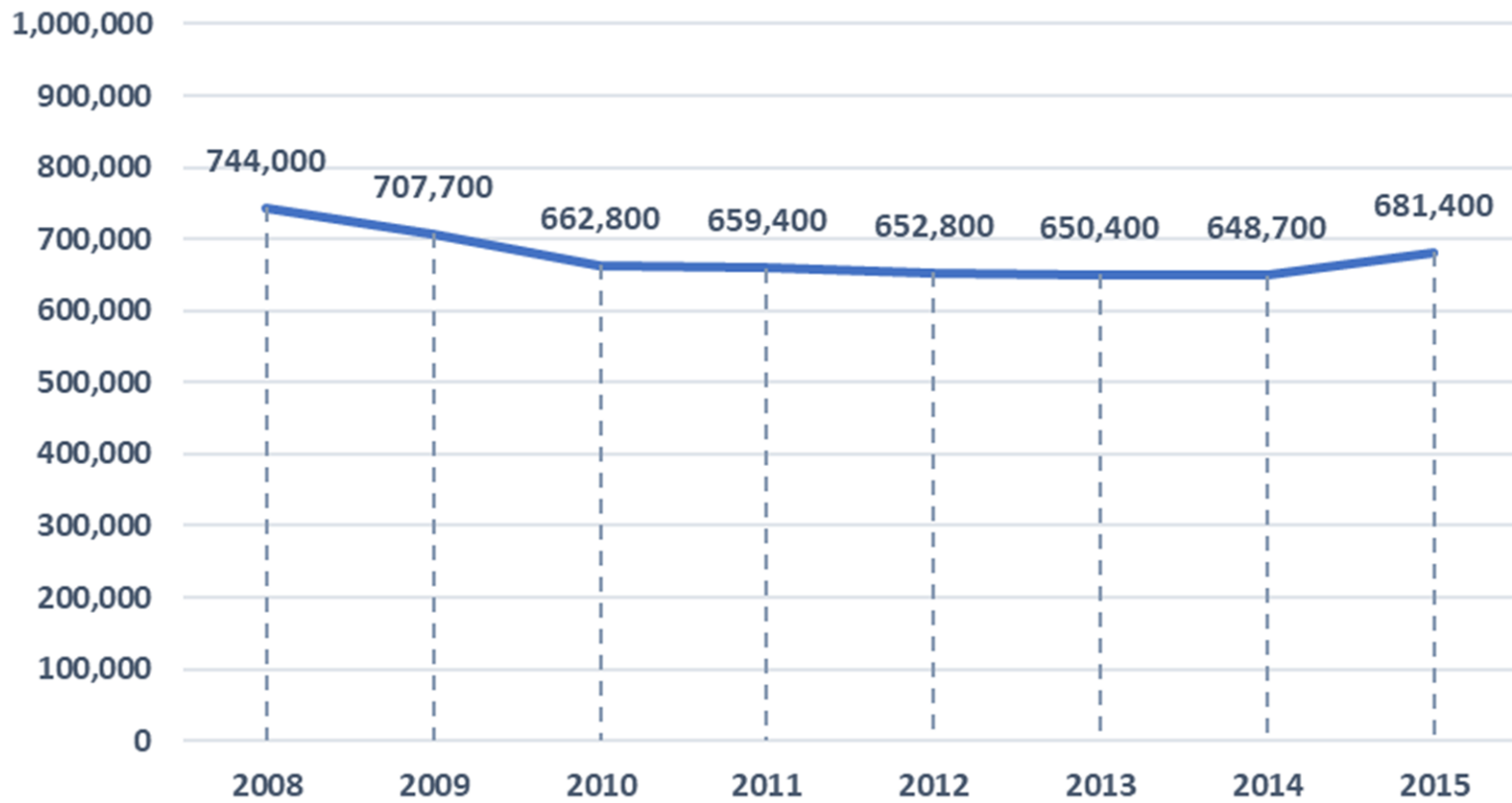


Numbers claiming income tax relief on personal contributions



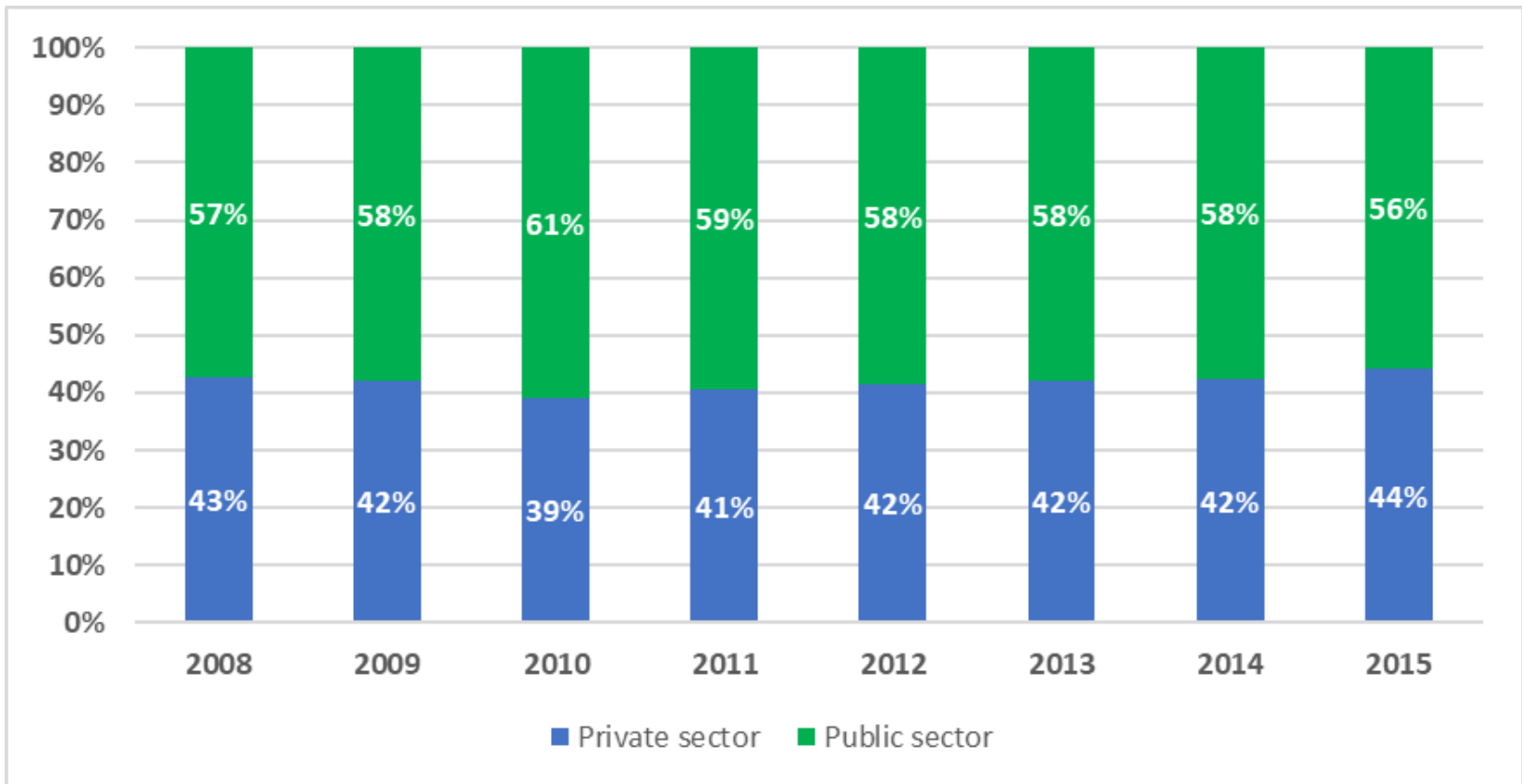


Numbers benefitting from employer contributions (public+ private)



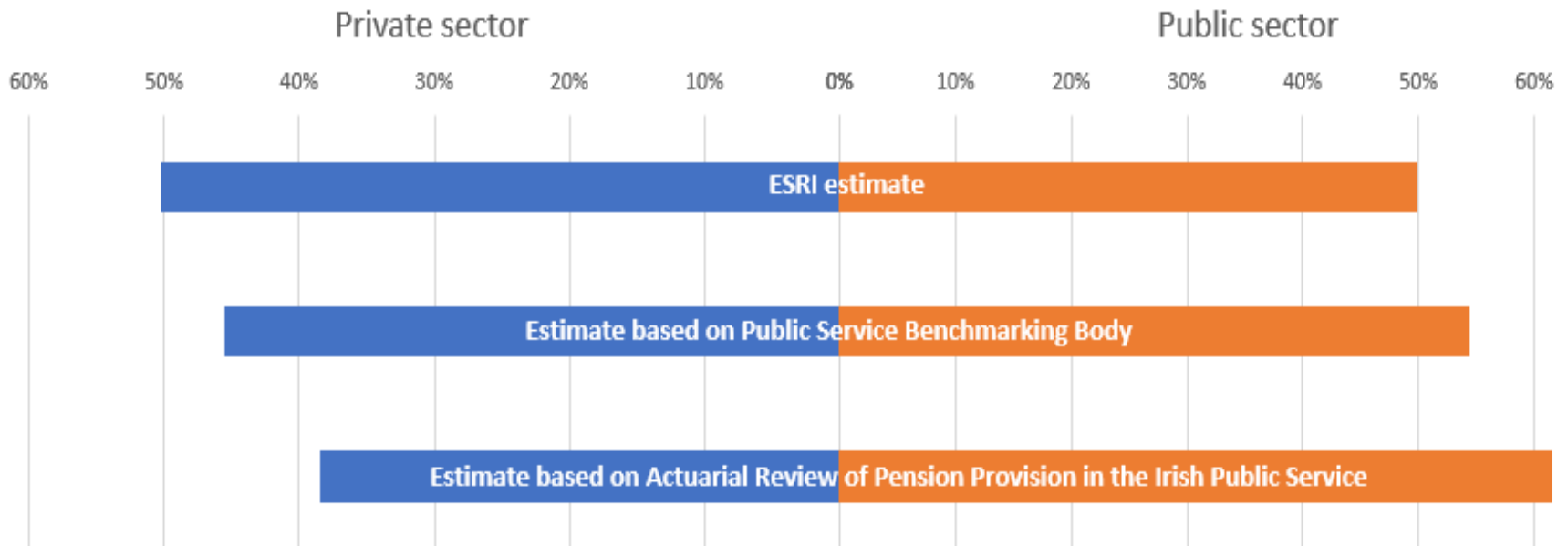


Numbers benefitting from employer contribution





Adding in cost of relief on notional public service employer contribution rate



Total cost increases to circa €3.5bn pa



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Findings

Roma Burke



Who benefits most?

- OECD (2013) : *“Tax deductions give the greatest incentive to save for retirement to those with the highest level of income, while those most in need get the lowest incentive.”*
- ESRI (2018): *“higher earners benefit more from tax relief on pension contributions than lower earners. The top four deciles of the income distribution gain between 3-4.5% of disposal income due to tax relief on pension contributions...most of the gains from tax relief on contributions are concentrated in the upper half of the income distribution”.*



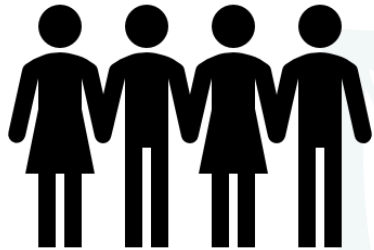
Who benefits most?

	With private pension	No private pension
Coverage	Public sector: 100% (DB) Private sector: 30% (25% DC 5% DC)	Public sector: Nil Private sector: 70%
Numbers	Public sector: 396,000 Private sector: 495,200 Total : 891,200	Public sector: Nil Private sector: 1,171,000
Salary (full-time)	Median €54k pa Lower quartile €41k pa Upper quartile: €72k pa	Median €21k pa Lower quartile €28k pa Upper quartile: €39k pa
Profile of contributor	Standard rate: 29% Higher rate: 71%	Likely to be mainly standard rate
Average employer contribution	Public sector (pre 2013): 29%* Public sector (2013+): 9%* Private sector DB: 22% Private sector DC: 7% Self employed: 0%	
Deferreds	Public sector: pay parity Private sector DB: revaluation	
Limits	Caps in place	

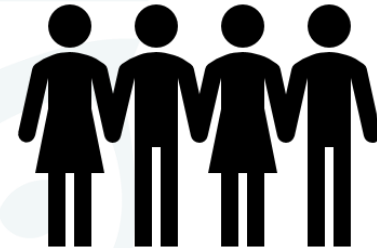


Different viewpoints

Change the System!



Leave it as it is!





Change the system!

Marginal rate income tax relief on personal contributions is inequitable.

Yes, but

- **not as much as expected: gap is 14%, not 20%**
- **71% are higher rate taxpayers (salary of 34,500 pa +)**
- **What if people who need to save, save less?**
- **Other inequities in the EET system are more significant**



Change the system!

A small number of high earners benefit disproportionately from the relief.

Not really:

- **900,000 benefited from relief in some way in 2017**
- **Relief used primarily by “middle income earners”**
- **681,400 benefited from employer contributions**
- **50% + of whom are public sector workers**
- **Median income of those benefitting is €54k pa (full-time)**
- **75% had income less than €72k pa**
- **Highly effective overall limits in place**



Change the system!

The cost of the relief €2.5bn is poor value for money.

- **Is it accurate?**
- **It doesn't include €0.7bn - €1.4bn for notional public sector employer contributions**
- **Doesn't include the T from EET**
- **€2.5bn was higher (€3bn in 2007)**
- **Spread over a large number of people...900,000**
- **Benefits private and public sector employees**



Change the system!

The relief has failed to produce significant private pension coverage in the private sector and the quality of the coverage is on average poor

Yes, but

- **Not everyone needs a private pension?**
- **If exclude low earners, coverage increases to 47%**
- **Affordability may be the key issue not the design of incentives under EET, particularly for lower earners**
- **Message may not be right (Pensions Levy)**



Change the system!

There is a substantial deadweight cost of the relief (ie higher earners would save anyway)

Little analysis done, but

- **75% with cover earning less than €72k pa**
- **Only 9% have incomes more than €100k**
- **HWI limited by the SFT and frequently have low income anyway**
- **And..**



Change the system!

Green Paper on Pensions:

“the removal of the reliefs would represent a fundamental adjustment to the current balance of the tax system and would have very significant implications in terms.. of the economic and behavioural impacts which would ensue. These impacts would be difficult to model in advance”



Maintain the status quo!

The relief encourages private pension provision which is good for society.

Yes:

- **TILDA has shown higher income positively correlated with better quality of life**
- **Reduces reliance on the State Pension**
- **Reduces reliance on public healthcare systems**



Maintain the status quo!

Pension tax relief granted is substantially a deferral of tax, as tax is paid in retirement on taxable retirement benefits.

Not really:

- **Low funding and age tax package means many pay little or no tax in retirement**
- **Even with higher funding, age concessions mean (potentially) lower effective tax rate in retirement**
- **Leakage: lump sums, overseas transfers**



Maintain the status quo!

Middle income earners benefit most from private pension tax relief and reducing tax relief now on personal contributions would impact most on this group, including many in the public sector

Yes:

- **715k availing of relief on contributions, 50%+ in public sector**
- **75% earn less than €72k pa**
- **75% of full-time self-employed earn less than €63k pa**



Maintain the status quo!

There has already been a substantial number of measures introduced since 2009, cutting back the scope for private pension tax relief, particularly for higher earners.

Yes, definitely

- **€2.0m SFT limit**
- **Kicks in well before limit reached; not a limit on contributions**
- **NRE: €115k**
- **Lump sum: €200k + 300k @20%**



Society of Actuaries in Ireland

Reform

Roma Burke



Disclaimer

We are not advocating any of the options referred to in the following and indeed, some may have significant negative potential financial consequences for some individuals and could lead to undesirable changes in behaviour in relation to private pension provision.





Options for reform – **Public sector**



Consider

- Replace pay-parity with CPI
- Fast accrual for some grades
- Credited years (Professional Added Years)
- Use a realistic capitalisation factor
- Review approach to collecting chargeable excess




Options for reform – Private sector

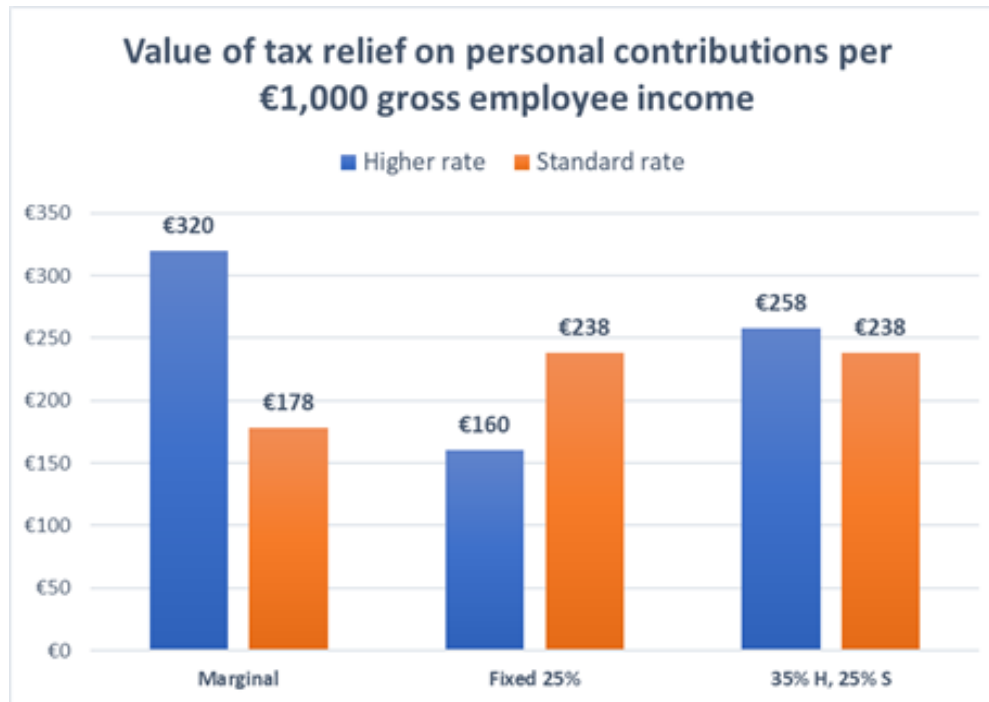
Consider

- Limit to 2/3rds including State Pension
- Reduce fast accrual opportunity from 10 to 20 years
- Make max TFLS available after 40 years, not 20
- Set TFLS at max 25% for DC savers
- Limit employer BIK exemption to age related and €115k NRE 
- Increase imputed distribution 



Options for reform – Public and Private

- Set tax relief to 25% for personal contributions for everyone 
- Adjust tax relief by -/+5% for higher/standard rate taxpayers





Options for reform – **Public and Private**

- Apply relief to 75% of contributions
- Reduce NRE limit from €115k
- Disallow age income tax limits i.r.o. private pension income
- Introduce minimum withholding tax on private pension retirement income
- Align income tax exemption age with State Pension age
- Don't index reliefs
- Reduce tax-free element of lump sum



Getting people to save more

- Strong correlation between private pension coverage and earnings, therefore:
 - Fixed 25% AES relief will benefit lower earners
 - For higher rate tax payers – allow them to claim additional relief in their year-end return if part of AES
- Multiple systems avoids a one-size fits all approach
- Special considerations for the self-employed



Q & A



Society of Actuaries in Ireland

Private Pension Tax Relief

Roma Burke & Tony Gilhawley

15th November 2018
