SPOTLIGHT

The National Pensions Framework generates shift in focus to alternative business structures for pension funding.

Kevin Fitzsimons MPMI, MIIPM, QFA, FLIA. Pensions and Area Development Manager, Canada Life

Now that the dust is beginning to settle on the National Pensions Framework, we at least now have a detailed insight into Government thinking on the likely future structure of pension provision in Ireland. The framework proposes personal contributions will be matched by a state top up payment equivalent to 33% income tax relief. It seems possible also that we will also see an end to PRSI relief on pension contributions as the Commission on Taxation recommended last year that PRSI along within the health levy and recently introduced income levies should be amalgamated into one Universal Social Contribution. If this Universal Social Contribution operates like the current income levies, there will be no relief for personal pension contributions.

For sole traders and workers in non pensionable employment, the pension regime appears to be tightening all the time with limits on the pension contributions they can make. Since 2009 a limit of €150,000 on the earnings they can apply the relevant percentage to, and now possibly from 2014, an effective reduction in the tax relief from 41% to 33%.

This will bring sharp focus onto employer contributions where on a positive note, the framework sees no need to adjust the tax treatment of employer contributions made on behalf of employees and directors. The Commission on Taxation report identified the Pension Fund Cap as their preferred mechanism for controlling employer contributions. They would like to see this cap at a level which reflects the maximum pension permitted on the current earnings cap, which if implemented, would produce a Pension Fund Cap of approximately €3 million. The current Pension Fund Cap is €5.4 million. In short, there is no proposal to cut corporation tax relief on employer contributions to exempt approved pension arrangements

All of this will oblige us to explore more advantageous business structures for pension funding for our clients, where full use can be made of ‘employers’ pensions contributions, such as limited companies, spousal employment, service companies, and unlimited companies.

Spousal employment may seem like it’s not the most exciting idea in the world but remember that there is already an income tax break for an employed spouse. He/she can earn up to €27,400 p.a. and up to this limit, the income is subject to income tax at standard rate only, irrespective of what the other spouse earns. It is noteworthy that this tax advantage exists whether the spouse with the main income is a director or a sole trader.

Assuming a spouse will have 10 years paid service completed before he or she reaches Normal Retirement Age, a pension of 2/3rds of final salary is permitted under an employer sponsored scheme. If this final salary is say €27,400 a pension of €18,267 is permitted. The cost of such a pension and lets say that it’s a level, non escalating single life pension for a female at age 60 would be approximately €349,273 (using an annuity rate of 5.23%) but such a pension could, under current rules be funded over a relatively short period. If it was feasible to fund it over say 3 years, this would mean a tax write off of €116,424 per annum for 3 years.

Pension planning and business structure reviews are now more important than ever in the context of what the National Pensions Framework is telling us and in this regard, clients need appropriate advice more than ever.

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Canada Life™

Canada Life House, Temple Road, Blackrock, Co. Dublin
Tel: 01 210 2000 **Fax:** 01 210 2020 **Web:** www.canadalife.ie

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