Pensions Notice – Changes to the Standard Funding Threshold

Budget 2014 introduced changes to the taxation of pensions. This has been affected by making changes to the Standard Funding Threshold (SFT). ***Generally, the changes introduced with effect from 1st January 2014 will only potentially have implications for higher earners who will retire with pensions that deliver an income of €60,000 per annum or more.***

Set out below are (i) the purpose of the SFT, (ii) the method of calculation under Budget 2011 and (iii) the changes introduced under Budget 2014. Finally, the steps which may need to be taken by individuals whose pension benefits exceed the reduced threshold of €2m on 1st January 2014 are outlined below.

Standard Funding Threshold

The SFT is an overall limit or ceiling on the total capital value of pension benefits that an individual can draw in their lifetime from tax-relieved pension arrangements. This applies to all benefits which have come into payment for the first time since 7th December 2005. Originally the limit was set at €5.4m and has been reduced in Budget 2011 to €2.3m and in Budget 2014 to €2m. The SFT is calculated by placing a capital value on defined benefit pension benefits such as your DIT pension and then adding on the value of any additional pension benefits held by an individual. Additional pension benefits may be in the form of another occupational pension – either defined benefit or defined contribution, an AVC, a PRSA, an ARF etc. When the capital value of pension benefits in payment exceeds the SFT the excess (called a "chargeable excess") is subject to a tax charge at 41% when the benefit comes into payment. A more detailed explanation of the operation of the SFT is below at Appendix 1.

Calculations under Budget 2011

At retirement DIT's Pensions Section completes an assessment of the potential tax liability of all retiring staff members. For example, if a DIT staff member retired at age 65 in 2012 with an annual pension of €60,000 and a lump sum of €180,000 the capital value of this pension would be calculated by multiplying the annual pension by a capitalisation factor of 20 and adding the lump sum. In this example the capital value would be €1.38m [i.e. (€60,000*20)+€180,000]. The capitalisation factor used in all cases was 20, regardless of the age at which the staff member retired. In this example the staff member will not exceed the SFT on the basis of their DIT pension alone. The individual would need to have additional pension benefits external to DIT with a capital value of €920,000 before s/he will exceed the SFT.

Calculations under Budget 2014

Budget 2014 made two main changes to the Standard Funding Threshold (SFT). Firstly the threshold has been reduced to €2m with effect from 1st January 2014. Secondly, a range of age-related capitalisation factors have been introduced to establish the capital value of defined benefit arrangements. In this case in order to calculate the capital value of the DIT pension, we must split the pension benefits into the proportion accrued before and after 1st January 2014. The capitalisation factor of 20 will apply to the proportion accrued before 1st January 2014 whereas the age-related capitalisation factors will apply to the proportion accrued after 1st January 2014.

To illustrate†,

- If a DIT Lecturer has 30 years of service on 1st January 2014, s/he would have accrued benefits comprised of an annual pension of €29,664.75 and a lump sum of €88,994.25 equating to a capital value of €682,289.25 [i.e. (€29,664.75*20)+€88,994.25]. The value of the DIT pension alone does not exceed the SFT. The individual would have to have additional pension benefits external to DIT in excess of €1,317,710.75 before s/he will exceed the SFT.
- If the Lecturer subsequently retires in 10 years time, s/he will have 40 years service. Assuming there have been no changes to the SFT, salary etc the total pension will be €39,553 (i.e. €29,664.75 accrued up to 1st January 2014 and €9,888.25 accrued after) and the total lump sum will be

€118,659. The staff member is retiring at age 65; therefore a capitalisation factor of 26 will be used for the proportion of the pension accrued after 1st January 2014. The capital value of the DIT pension is €969,048.50 [i.e. (29,664.75*20) + (9,888.25*26) + 118,659]. Again the value of the DIT pension alone does not exceed the SFT. The individual would have to have additional pension benefits external to DIT in excess of €1,030,951.50 before s/he will exceed the SFT.

- Note in the previous example if the Lecturer has retired at age 60 a capitalisation factor of 30 would have been used in the calculations and the capital value of the DIT pension would have increased to €1,008,601.50 [i.e. (29,664.75*20)+(9,888.25*30)+118,659]. Again the value of the DIT pension alone does not exceed the SFT. The individual would have to have additional pension benefits external to DIT in excess of €991,398.50 before s/he will exceed the SFT. This shows the impact of using the age-related factors. The full range of capitalisation factors is set out at Appendix 1.

[† The calculations above are based on a Lecturer who pays D Rate PRSI, is entitled to an uncoordinated pension and receives an annual salary of €79,106]

Further information on the above is available online in the Budget 2014 Annexes: http://budget.gov.ie/Budgets/2014/Documents/Taxation%20Annexes%20to%20the%20Budget%202014%20Measures.pdf

Individuals who exceed the Standard Funding Threshold

If you have accrued significant pension benefits external to DIT and in addition to the benefits accrued under DIT's pension scheme on 1st January 2014, it is possible to apply to Revenue for a Personal Funding Threshold (PFT) certificate. The purpose of the PFT is to allow individuals to avail of a higher limit than the SFT. There are several points to note in this regard:

1. To establish the capital value of your various pension arrangements you should contact the relevant pension administrators. Queries on DIT benefits can be directed to me by return or to pensions@dit.ie.
2. The PFT can only be claimed in respect of the capital value of all accrued benefits on 1st January 2014. If your accrued pension benefits do not exceed €2m on 1st January 2014 you do not need to apply for a PFT.
3. Affected staff members may already have applied for and received a PFT in 2011 when the limit was reduced to €2.3m and if so they will not need to do so again. For avoidance of doubt, you should double check that your existing PFT remains valid with Revenue. If you have not previously applied for a PFT the maximum PFT which can be applied for now is €2.3m.
4. Applications should be made to Revenue. An online application system has been developed and is available at http://www.revenue.ie/en/online/personal-fund-threshold.html
5. The deadline for applications for a PFT is **before 2nd July 2015**.

Further details are available at Appendix 1. Revenue's website should be consulted for updates on an ongoing basis.

Pensions Manager
25/09/2014

APPENDIX 1 - TAXATION & PENSIONS

Budget 2011 & subsequently Budget 2014 introduced several changes to the taxation of pensions. The vast majority of the Institute's staff members are not affected by these tax changes.

The ***Standard Funding Threshold (SFT)*** is a limit to the total amount of tax relieved pension funds that an individual can take from all pension arrangements. Benefits taken in excess of SFT are taxed at the marginal rate (i.e. the excess is taxed at 41%). The threshold is as follows:

With effect from 07.12.2005	€5,418,085
With effect from 07.12.2010	€2,300,000
With effect from 01.01.2014	€2,000,000

In this regard pension arrangements are considered to be any arrangements entered into for the purpose of supplementing retirement benefits. This is taken to include benefits from any or all of the following:

- defined benefit occupational pension scheme
- defined contribution occupational pension scheme
- Retirement Annuity Contract (RAC)
- Personal Retirement Savings Account (PRSA)
- Additional Voluntary Contributions (AVC)

This list is not exhaustive and you may have additional pension arrangements which it will be necessary to declare. Benefits from the Department of Social Protection are not included for the purpose of calculating the SFT and do not have to be declared. Similarly, benefits which came into payment on or before 6th December 2005 do not have to be declared.

Frequently Asked Questions

Source: http://www.revenue.ie/en/practitioner/law/bills/finance-no2-bill-2013/changes-sft-regime.pdf.

What is the Standard Funding Threshold (SFT) Regime?
The SFT regime imposes a limit or ceiling on the total capital value of pension benefits that an individual can draw in their lifetime from tax-relieved pension arrangements, where those benefits come into payment for the first time on or after 7 December 2005.

The limit was set at €5 million when first introduced on 7 December 2005 and was subsequently reduced to its current level of €2.3m on 7 December 2010. In certain cases, individuals could avail of a higher limit or threshold (called a "personal fund threshold" or PFT). This arose if the individual's pension rights on 7 December 2005 or 7 December 2010 exceeded the SFT applying at those dates.

How does the SFT regime work?
On each occasion that an individual becomes entitled to receive a benefit under a pension arrangement for the first time (called a "benefit crystallisation event" or BCE) they use up part of their SFT or PFT, as the case may be. At each BCE, a capital value has to be attributed to the benefits that crystallise and the value is then tested against the SFT or the individual's PFT, as appropriate, by the pension scheme administrator.

When the capital value of a BCE, either on its own or when aggregated with earlier BCEs, exceeds the SFT, or an individual's PFT, the excess (called a "chargeable excess") is subject to an immediate tax charge at 41% (called "chargeable excess tax"). Any chargeable excess tax due has to be paid upfront by the pension fund administrator and recovered from the individual.

In addition, when the remainder of the excess is subsequently drawn down as a pension (or, for example, by way of a distribution from an Approved Retirement Fund or vested Personal Retirement Savings Account) it is subject to tax at the individual's marginal rate. The effective income tax rate on a chargeable excess can, therefore, be as high as 65%, excluding any liability to USC and PRSI.

What changes are being made in the Finance (No. 2) Bill 2013?

Section 18 of the Finance Bill makes a number of changes to the SFT regime. The most important of these are:

- firstly, the absolute value of the SFT is being reduced, with effect from 1 January 2014, from €2.3m to €2m. However, as on previous occasions, an individual who has pension rights in excess of this new lower SFT limit on 1 January 2014, may claim a PFT from the Revenue Commissioners.
- secondly, the valuation factor to be used for establishing the capital value of an individual's defined benefit (DB) pension rights at the point of retirement (i.e. at a BCE), where this takes place after 1 January 2014, is being changed from the current standard valuation factor of 20 to a higher age–related valuation factor that will vary with the individual's age at the point at which the pension rights are drawn down. The age–related valuation factors are set out in the table below and range from 37 for DB pension rights drawn down at age 50 or under, to a factor of 22 where they are drawn down at age 70 or over.
- thirdly, in calculating the capital value of a DB pension at the point of retirement, a "split" calculation will apply where part of the pension had already been accrued at 1 January 2014 so that the part accrued up to that date (referred to in the legislation as the "accrued pension amount") will be valued at a factor of 20 and the part accrued after that date valued at the appropriate higher age-related valuation factor.
- finally, the reimbursement options, introduced in Finance Act 2012, for public servants affected by chargeable excess tax are being amended and extended (see below).

***[Note:** The Bill was enacted at the end of 2013 - No. 41/2013: Finance (No. 2) Act 2013]*

How is a PFT calculated?

The PFT is the sum of the capital values of all of an individual's "uncrystallised" pension rights on 1 January 2014 i.e. pension rights that the individual is building up on that date but has not yet become entitled to. This would include rights under DB and defined contribution (DC) occupational pension schemes, AVCs, retirement annuity contracts and PRSAs. If the individual has already become entitled to pension benefits from any pension arrangements since 7 December 2005 (called "crystallised rights") the capital value of those rights have to be included in the PFT calculation. Where, on 1 January 2014, the overall capital value of an individual's pension rights exceeds the SFT of €2 million, that higher amount will be the individual's PFT, subject to it not exceeding the previous SFT of €2.3m.

An individual who holds a PFT issued in accordance with the legislation as it applied before Finance (No.2) Bill 2013 is passed into law retains that PFT and there is no need to make a new application to Revenue.

How are pension rights determined?

In the case of rights arising under DC arrangements, the capital value for PFT purposes remains, as before, the value of the assets in the arrangement that represent the member's accumulated rights on that date i.e. the value of the DC fund on that date.

Because members of DB arrangements do not have an individual "earmarked" fund, the capital value of pension rights arising under such arrangements has to be determined using a simple formula. Basically, you establish from the pension fund administrator the gross annual pension you would be entitled to under the rules of the DB arrangement if you retired on 1 January 2014 at your salary and service on that date and on the assumption that you had attained normal retirement age on that date. The gross annual pension is then multiplied by 20 (the standard valuation factor) to arrive at the capital value of your DB pension rights for PFT purposes.

If your DB arrangement provides for a separate lump sum entitlement (otherwise than by way of commutation of part of the pension) e.g. most public service schemes, the value of the lump sum entitlement (calculated on the same assumptions as above) is added to the capital value of the DB pension to arrive at the overall capital value. It is important to note that the higher age–related valuation factors being introduced for determining the capital value of DB pension benefits at the point of retirement must not be used for PFT purposes.

The following simple examples illustrate the above concepts.

Example 1

Paul is a member of a DC pension arrangement. The value of his pension fund on 1 January 2014 (i.e. his uncrystallised pension rights) is €1m. He had not become entitled to any pension rights since 7 December 2005. As the value of Paul's uncrystallised rights on 1 January is below the SFT of €2m, he cannot claim a PFT and the maximum allowable pension fund for tax purpose that Paul can build up is €2m.

Example 2

John is a member of a private sector DB pension arrangement. His pension fund administrator has indicated that, under the rules of the scheme, his accrued pension rights at 1 January 2014 would entitle him to a gross annual amount of pension (before any commutation for a lump sum) of €60,000, based on his salary and service on that date and on the assumption that he had attained normal retirement age on that date. The capital value of John's uncrystallised pension rights on 1 January 2014 is, therefore, €60,000 multiplied by the standard valuation factor of 20, i.e. €60,000 x 20 = €1.2m. He had not become entitled to any pension rights since 7 December 2005. As the value of John's uncrystallised pension rights on 1 January 2014 is below the SFT of €2m, he cannot claim a PFT and the maximum allowable pension fund for tax purpose that John can build up is €2m.

Example 3

Mary is a member of a DB pension arrangement. Her pension fund administrator has indicated that her accrued pension on 1 January 2014 based on her salary and service on that date and on the assumption that she had attained normal retirement age on that date, is €95,000 before any commutation for a lump sum. Mary also has DC pension arrangements with a value on 1 January 2014 of €300,000. The capital value of Mary's uncrystallised pension rights on 1 January 2014 is, therefore, €2.2m i.e. DB rights of €95,000 x 20 = €1.9m + DC rights of €300,000. She had not become entitled to any pension rights since 7 December 2005. Mary can apply to Revenue for a PFT of €2.2m and that represents the maximum allowable pension fund for tax purpose that Mary can build up. Any future accrual of pension benefits by Mary in her DB arrangement and any future increase in the value of her DC arrangement, either through further contributions or fund growth, will give rise to a chargeable excess and be subject to chargeable excess tax.

Example 4

Jean is a member of a DC pension arrangement the value of which is €1.8m on 1 January 2014 (i.e. her uncrystallised rights). Jean had already drawn down pension benefits under a separate scheme on 1 July 2009 which had a capital value for BCE purposes of €0.7m at that date (i.e. her crystallised rights). The combined value of Jean's crystallised and uncrystallised pension rights on 1 January 2014 is, therefore, €2.5m. This exceeds the SFT of €2m, so Jean is entitled to make a PFT application. However, Jean's PFT will be restricted to a maximum of €2.3m (the current SFT limit). Jean's maximum allowable pension fund at retirement is, therefore, €2.3m. The pension benefits she drew down in July 2009 have already used up €0.7m of her PFT leaving her with a PFT balance of €1.6m for use against her uncrystallised rights when she draws them down. Whether Jean ultimately has a chargeable excess will depend on how her remaining DC pension arrangement performs up to the point when she takes her benefits. On the assumption that the value of her uncrysatllised pension rights remains at €1.8m, she would have a chargeable excess at retirement of €200,000 (i.e. €1.8m - €1.6m).

How is the capital value of a BCE determined?
The approach is similar to that for calculating a PFT.

For DC pension arrangements, the capital value of pension rights when they are drawn down after 1 January 2014 is simply the value of the assets in the arrangement that represent the member's accumulated rights on that date. For example, in the case of an annuity, it is the value of the assets used to purchase the annuity while in the case of a retirement lump sum it is the value of the lump sum (before excess lump sum tax, if any).

In the case of DB pension arrangements, the capital value of such rights drawn down after 1 January 2014 is determined by multiplying the gross annual pension that would be payable to the individual (before commutation of part of the pension for a lump sum) by the appropriate age-related valuation factor. If the DB arrangement provides for a separate lump sum entitlement (otherwise than by way of commutation of part of the pension) e.g. most public service schemes, the value of the lump sum is added to the capital value of the DB pension to arrive at the overall capital value.

However, where part of the DB pension has been accrued at 1 January 2014 and part after that date, transitional arrangements allow the capital value of the pension at retirement to be calculated by way of a "split" calculation, so that the part accrued up to 1 January 2014 (called the "accrued pension amount") will be valued at a factor of 20 and the part accrued after that date valued at the appropriate higher age-related factor. A condition of applying the "split" calculation is that the administrator concerned is satisfied from information and records available to the administrator that an accrued pension amount arises in relation to the DB pension in question.

The following simple examples illustrate the above.

Example 5
Michael is a member of a DC pension scheme. He has no PFT. Michael retires on 1 July 2015. The value of his DC fund on that date is €1.5m. As this is below the SFT of €2m no chargeable excess arises.

Example 6
Jim is a member of a private sector DB scheme. He retires on 1 February 2020 aged 65. The relevant age-related valuation factor applying to Jim is, therefore, 26. The annual amount of pension that his scheme would pay him on retirement (before any commutation of part of the pension for a lump sum) is €75,000. Jim's pension fund administrator is aware that €50,000 of this pension had already been accrued at 1 January 2014 (i.e. the accrued pension amount). The administrator calculates the capital value of Jim's pension rights at retirement for BCE purposes as follows:

€50,000 x 20 = €1m (i.e. accrued pension amount x the standard valuation factor)
€25,000 x 26 = €0.650m (pension accrued after 1 January 2014 x age-related factor)
Capital Value = €1.65m.

As the capital value of Jim's retirement benefits based on the "split" BCE calculation is less than the SFT, no chargeable excess arises.

Example 7
Lucy retires at age 60. She does not have a PFT. Her annual DB pension at retirement is €90,000 (before commutation for a lump sum). The relevant age-related valuation factor applying to Lucy is, therefore, 30. Lucy's pension fund administrator is aware that €45,000 of her pension had already been accrued at 1

January 2014 (i.e. the accrued pension amount). The administrator calculates the capital value of Lucy's pension rights at retirement for BCE purposes as follows:

€45,000 x 20 = €0.900m (accrued pension amount x the standard valuation factor)
€45,000 x 30 = €1.350m (pension accrued after 1 January 2014 x age-related factor)
Capital Value = €2.250m
Less SFT = €2.000m
Chargeable excess = €0.250

As Lucy has a chargeable excess of €250,000, she is liable to chargeable excess tax of €102,500 (i.e. €250,000 @ 41%). The pension fund administrator must pay this tax to Revenue upfront and recover it from Lucy.

What are the procedures for making a PFT application?

In the past the PFT application procedure was paper based. However, on this occasion a new electronic based application process is being developed by Revenue under which the relevant PFT information will have to be provided. For the purposes of the application an individual will be required to provide basic identifying information about him or herself and the various pension arrangements he or she is a member of. In addition, the individual will have to obtain from the administrator of each pension arrangement of which he or she is a member, a statement certifying the amount of the individual's pension rights on 1 January 2014 relating to that arrangement, calculated in accordance with the provisions of the legislation. In the case of a DB arrangement, the individual will also have to indicate the annual amount of pension accrued at 1 January 2014 underpinning that calculation as certified by the administrator. Full details of the application requirements will be reflected in the electronic system when it is made available.

Is there a deadline for a PFT application?

The time limit for making a PFT application is 12 months after the date on which the electronic system is made available. So if the system is made available by, say, 1 February 2014, an individual will have until end-January 2015 to make an application.

The exception to this is where a person is entitled to a PFT and is retiring after 1 January 2014 and before the electronic application system comes on stream. In such cases, the existing paper based application process must be used and the application must be made in advance of retirement, otherwise the administrator is required to apply the SFT limit of €2m.

How does the administrator recover chargeable excess tax paid in the case of DB pension arrangements?

In the case of private sector DB pension arrangements, the legislation provides for the administrator to recover any chargeable excess tax paid either by way of an actuarial reduction in the individual's pension rights or by arranging to be directly reimbursed by the individual.

In the case of public sector DB pension arrangements, a range of reimbursement options were introduced in Finance Act 2012 and these are being amended and extended in Finance (No.2) Bill 2013. Under the new arrangements the following options will be available.

Where the chargeable excess tax paid does not exceed 20% (previously 50%) of the net retirement lump sum (i.e. after excess lump sum tax, if any):

- by recovering it from the net lump sum, or
- by payment by the individual of a sum equivalent to the tax to the administrator, or
- by any combination of the above, or
- solely by way of a reduction in the gross pension payable to the individual over a period not exceeding 20 years (this is a new option).

Where the chargeable excess tax paid exceeds 20% (previously 50%) of the net retirement lump sum (i.e. after excess lump sum tax, if any):

- by retaining not less than 20% of the net lump sum, or
- by payment by the individual of a sum not less than 20% of the net lump sum to the administrator, or
- by any combination of the above, and
- by recovering any balance by reducing the gross pension payable over a period not exceeding 20 years (previously 10 years), or
- solely by way of a reduction in the gross pension payable to the individual over a period not exceeding 20 years (this is a new option).

Offset of excess lump sum tax against chargeable excess tax.
Under current rules, where an individual is faced with paying chargeable excess tax on his or her retirement benefits and standard rate tax on an excess retirement lump sum, the administrator is required to offset the excess lump sum tax against the chargeable excess tax. For example, if Sean has to pay chargeable excess tax of, say, €50,000 and also faces tax of €10,000 on his retirement lump sum, the administrator offsets the €10,000 excess lump sum tax against the chargeable excess tax so that Sean only has to pay net chargeable excess tax of €40,000 (i.e. €50,000 - €10,000). Overall, Sean's tax liability is now €40,000 net chargeable excess tax and €10,000 excess lump sum tax. The facility to offset excess lump sum tax against chargeable excess tax is unchanged.

However, it should be noted that while under current arrangements the first €200,000 of a retirement lump sum is paid tax free, the amount of a lump sum in excess of that tax–free amount is taxed at a ring-fenced rate of 20% up to €575,000 and at the individual's marginal rate on any amount above €575,000. The €575,000 cut-off point is, effectively, defined in the legislation as being 25% of the SFT. Therefore, as a consequence of the SFT being reduced to €2m from 1 January 2014, the cut-off point will automatically change to €500,000 on that date. As a result, while the tax-free amount of €200,000 remains unchanged, the 20% rate of tax will apply to amounts between €200,000 and €500,000 and marginal rate tax on amounts above €500,000.

Are there any sanctions for failing to comply with the legislation?
The Finance Bill introduces a fixed penalty of €3,000 for each failure on the part of a person to comply with any of the obligations imposed on the person by the legislation (Chapter 2C and Schedule 23B of the Taxes Consolidation Act 1997), for example failing to retain records for the required 6 year period.

Table of Relevant age-related valuation factors

Age	Factor
50 (and below)	37
51	36
52	36
53	35
54	34
55	33
56	33
57	32
58	31
59	30
60	30

Age	Factor
61	29
62	28
63	27
64	27
65	26
66	25
67	24
68	24
69	23
70+	22

These Q&As may be supplemented from time to time, and will be posted on Revenues website.

Additional Questions:
Source: Department of Public Expenditure & Reform Circulars

What happens in the case of an individual whose pension is subject to a pension adjustment order? Does the portion of the pension being allocated to the other party form part of the latter's SFT/PFT?
No. Under the requirements of the legislation where an individual is a member of a relevant pension arrangement which is, or becomes, subject to a pension adjustment order (PAO), then in calculating the capital value of the PFT or any subsequent Benefit Crystallisation Event (BCE) the benefits designated to the other party under the PAO are to be included in the calculations as if the PAO had not been made. This is the case whether the benefits under the PAO are to be paid, in due course, by way of a designated benefit from the individual's pension scheme or whether a transfer amount has been applied to provide the other party with an independent benefit in accordance with the Family Laws Acts. The corollary is that the PAO benefits are not included in any PFT/BCE calculations in respect of the other party.