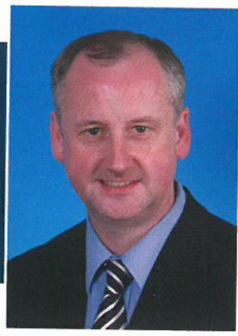
Aiming for a prosperous retirement?

The many tax benefits of pensions can be mobilised to get you there!



Kevin Fitzsimons, Pensions Development Manager, Irish Life

Targeting a million euro pension fund may sound grandiose in this recessionary climate, but leveraging the tax benefits attached to private pension funding makes reaching a €1 million retirement fund, far more achievable than most business people realise. This is especially true for company directors. Of course, in many instances, even a €1 million fund will be insufficient to meet income needs in retirement, and individual advice will be required in any event. It's also important to be cognisant of inflation over the next 20 to 25 years, which will erode the purchasing power of a €1 million fund **(see notes at the end for present day values of future funds).**

There are essentially 4 tax advantages (5 if you include death benefits!) attaching to pensions and these tax benefits, if properly mobilised and leveraged, can be used to steer an investment in the direction of your retirement goals. Such tax advantages can also be used to dramatically reduce tax on the fund, at, and into retirement, if prudent tax planning, along with regular reviews are carried out. The one downside to pension funding of course, is that benefits can only be accessed at retirement age.

Pension contributions not only attract income tax relief at the marginal rate or corporation tax relief if a company contribution,(subject to Revenue limits) but any investment growth within the fund accumulates tax free as well (a temporary Government levy currently applies).To be eligible to claim income tax relief, your income must be taxable either Schedule E or Schedule D (case I or II) and income tax relief is not guaranteed. Pension income in retirement is subject to income tax at your highest rate on withdrawal, Universal Social Charge, PRSI (if applicable) and any other taxes or levies applicable at that time. On maturity, part of the pension fund can be availed of tax free, and currently married couples and couples in civil partnerships over the age of 65 can enjoy an income of up to €36,000 tax free under a lower exemption limit in the tax code. This income can emanate in full or in part from a private pension scheme. Social welfare pensions are also taxable, although from 2028 the old age pension will only be payable from age 68, assuming no further changes in the meantime.

A 45 year old married male planning to retire at age 65 (a 20 year term) would require a level monthly contribution of €2,643 (€31,716 per annum) to build a retirement fund to a €1 million at 65 **(see notes below for specific pension contract and values in today's terms)** based on an estimated growth rate of 5.4% (not guaranteed). If this client was a company director, the entire contribution could be funded by his company from company profits, and could then be fully written off as a business expense. Such a contribution would also be fully exempt from Benefit-in-Kind. In order for this monthly contribution to be within Revenue limits, this client would only require an annual salary of at least €34,000 assuming no other pensions accumulated to date.

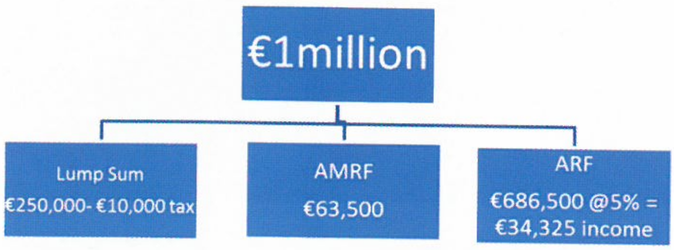
At age 65, if the assumptions are borne out in practice, the €1 million fund will be achieved and this fund would break down as follows, if it were maturing today **(see chart opposite).**

25% of the value (€250,000) could be availed of as a retirement lump sum. Only €200,000 of this lump sum could be availed of tax free, with a flat 20% income tax liability on the remaining €50,000. This €10,000 tax on the excess only represents 4% of the overall retirement lump sum. The next €63,500 would need to be invested in an Approved Minimum Retirement Fund (AMRF) if the client did not have a guaranteed income for life of €12,700 per annum, and the full balance of €686,500 could be invested in an Approved Retirement Fund (ARF). The client would need to take a minimum drawdown of 5% from this ARF, as he would be taxed on this amount in any event; giving an initial annual income of €34,325 which would be entirely tax free if this was the client's sole income (the Universal Social Charge and PRSI may apply) under the lower exemption limit, already mentioned (Important to note that the old age pension will also be counted as income for tax purposes too, when it comes into payment, resulting in a different tax calculation).

It's interesting to note that a €34,325 tax free income represents in nominal terms, a 50% pension of a €68,650 pre-retirement salary or a 66.67% pension of a €51,487 pre-retirement salary , albeit that this income will not be guaranteed for life in an ARF, and ARFs can bomb out.

For a sole trader, the pension tax reliefs are not quite as generous as those for company directors. However, over a 25 year term, a sole trader could achieve an estimated million euro fund with a level monthly contribution of €1,871 (€22,452) **(see notes below for details of the pension contract along with values in today's terms).** In this example, the €1 million fund would have a net cost to the client of just €331,167 over the 25 year term (assuming 41% income tax relief) based on a 5.4% growth rate (not guaranteed). The net cost of this fund, for a standard rate tax payer would be €449,040. Such funding would require Net Relevant Earnings in his/her forties of €90,000 as the limit for income tax relief is 25% of Net Relevant Earnings. Most clients will have no idea that the tax advantages of pensions can fast track a million euro fund, and if that wasn't enough, it is often possible to minimise income tax, if not eliminate income tax on the pension income depending on circumstances. In a recovering economy, you could do worse with your hard earned cash!

Breakdown of a €1 million pension fund in 2014.



*Based on the Irish Life Complete Solutions 1 bullet payment contract with 100% client allocation and a 1% Annual Management Charge.

- €1 million in 20 years is valued at €553,568 in today's terms using a 3% inflation rate for the 20 year term.
- €1 million in 25 years is valued at €477,532 in today's terms using a 3% inflation rate for the 25 year term

Warning: These figures are estimates only. They are not a reliable guide to the future performance of this investment

Warning : The income you get from this investment may go down as well as up

This article is based on current pension rules which are subject to change. Pension Plans should be reviewed regularly. Independent advice should always be sought on pension planning. To claim income tax relief, you can apply to your Inspector of Taxes to adjust your tax credits. Contribution deducted from salary will receive immediate tax relief. If you are self-employed, you must include your pension contributions in your self assessment tax returns in order to obtain income tax relief. Irish Life is regulated by the Central Bank of Ireland.