Budget 2011 – Advisory Services Update

This update provides commentary and summary of the main changes announced in the Budget on Tuesday 7th December 2010.
This is not a customer document and is intended for financial advisors only.

Pensions Overview

Key Points:

- Employees considering making pension contributions personally may wish to consider making such contributions before the end of 2010 in order to avail of the additional PRSI and Health Levy relief that is currently available.
- Individuals at retirement age who are entitled to a lump sum in excess of €200,000, and who have not yet taken their benefits, may wish to consider taking benefits before the end of 2010, and may also consider topping-up their pension funds with a further contribution prior to taking benefits.
- For clients intending to make a contribution before the 31st October 2011 pay and file tax deadline, and backdate the relief against 2010 earnings, the annual earnings limit for the year of assessment 2010 will be deemed to be €115,000. Individuals in this position with earnings in excess of €115,000 may wish to consider making their contribution before the end of 2010, in order to avail of the current €150,000 earnings limit.

Employee PRSI on pension contributions

Currently employees making pension contributions can claim PRSI relief and Health Levy relief, along with income tax relief. Employers also receive employers PRSI relief in respect of employee contributions where these contributions are deducted from salary under the net pay arrangement.

From 1 January 2011, employee contributions to occupational pension schemes (including AVCs), PRSAs and Personal Pensions will no longer qualify for relief for employee PRSI and the Universal Social Charge. *Employees considering making pension contributions personally may wish to consider making such contributions prior to 31 December 2010 in order to avail of the additional PRSI and Health Levy relief, currently available.*

The following table shows the effect of this change for the employee, based on the net cost of a contribution of €100

	Current Net Cost of €100	**Net Cost of €100 from 1 January 2011**	**Reduction in relief**
Standard Rate Tax Payer (Income from €26,000 up to income tax standard rate threshold, for example €36,400 for a single person with no dependants)	€72	€80	€8
Higher Rate Tax Payer (Income from standard rate threshold, up to €75,036)	€51	€59	€8
Higher Rate Tax Payer (Income above €75,036)	€54	€59	€5

Even with this change, the retention of income tax relief at marginal tax rate is positive, and saving for retirement using a pension plan remains attractive.

The treatment of employer contributions to a PRSA going forward is unclear. Currently employer contributions to a PRSA are treated as BIK. Employer PRSA contributions are subject to income tax, PRSI, the Health Levy and the Income Levy. The individual employee can then immediately receive relief on income tax, PRSI and the Health Levy within the same limits as if they had paid the contribution themselves. This currently leaves the income levy (2% on incomes below €75,036) as the only charge applying to the individual in respect of the employer PRSA contribution.

Irish Life

Assuming the same treatment applies going forward then the charge for an individual will go from typically 2% of the employer PRSA contribution up to 11%. This would be a significant disadvantage for PRSAs when compared to the treatment of employer company pension contributions, which do not generate any BIK liability for the individual employee. The PRSI change will be legislated for in the upcoming Social Welfare Bill and we will know the full details at that stage. However, the Universal Social Charge FAQ released by the Revenue Commissioners indicates that an employee will have to pay this charge on a PRSA contribution by the employer.

In addition to the changes for the employee, the current employer PRSI exemption for employee contributions to occupational pension schemes and other pension arrangements will be reduced by 50% from 1 January 2011. The employer PRSI rate is typically 10.75%, so the employer PRSI saving will go from 10.75% of the employee's contribution, to 5.375% of the employee's contribution.

The above PRSI and Health Levy relief changes do not affect the self-employed, as PRSI relief and Health Levy relief is not currently available to them.

Retirement lump sums

Pension tax free lump sums in excess of €200,000 are to be taxed from 1 January 2011 at the standard rate of income tax (currently 20%). This move is not unexpected as it has previously been indicated in the Commission on Taxation Report and the National Pensions Framework.

The following example of a Personal Pension client with €1 million of a fund would be affected by only a reduction of €10,000. So in this example, tax of €10,000 on a lump sum of €250,000 is equivalent to a tax rate of 4%.

	Current Position	**Proposed Position**
Total Fund	€1,000,000	€1,000,000
Tax Free Lump Sum	€250,000	€200,000
Balance of Lump Sum (after tax at 20%)	N/A	€40,000 (after €10,000 tax)
Balance to ARF/AMRF or annuity	€750,000	€750,000

Tax free lumps sums taken on or after 7 December 2005 will count towards using up the new tax free amount so that if an individual has already taken tax free retirement lump sums of €200,000 or more since 7 December 2005, any further retirement lump sums paid to the individual on or after 1 January 2011 will be taxable.

In addition the existing maximum lump sum limit from all pension plans is being reduced from €1.3 million (approx) to €575,000 (this is, 25% of the reduced Standard Fund Threshold of €2.3m). The excess of retirement lump sum payments over that amount will be taxed at the taxpayer's marginal rate of income tax.

Individuals at retirement age who are entitled to a lump sum in excess of €200,000, and who have not yet taken their benefits, may wish to consider taking benefits before 31 December 2010.

These limits do not apply to lumps sums paid on death.

Maximum allowable pension funds

The maximum allowable pension fund on retirement for tax purposes (known as the Standard Fund Threshold (SFT)), is to be reduced from €5.4 million (approx) to €2.3 million with effect from 7 December 2010.

A higher personal fund threshold (PFT) may apply if, on 7 December 2010, the value of the individual's pension is greater than €2.3 million. The value of any pension benefits already taken (since 7 December 2005) will also be included. Individuals will have a period of 6 months from Budget Day to send details of their pension schemes to the Revenue Commissioners in order for the PFT to be certified. The maximum PFT that will be certified by Revenue is the current SFT of €5.4 million.

The capitalisation factor for use in determining the value of Defined Benefit pension rights for the purposes of an individual's SFT is 20 times the pension payable.

Individuals who already have a PFT under the existing arrangements will retain that PFT

Contribution limit

The annual earnings limit which (along with age-related percentage limits) determines the maximum tax-relievable contributions for pension purposes is being reduced from €150,000 (2010) to €115,000 for 2011.

For clients intending to make a contribution before the 31st October 2011 pay and file tax deadline, and backdate the relief against 2010 earnings, the annual earnings limit for the year of assessment 2010 will also be deemed to be €115,000. *Individuals in this position with earnings in excess of €115,000 may wish to consider making their contribution before the end of 2010, in order to avail of the current €150,000 earnings limit.*

Approved Retirement Funds

The annual imputed distribution which applies to the value of assets in an Approved Retirement Fund (ARF) each year is being increased from 3% to 5% in respect of 2010 and future years.

A 5% rate of drawdown increases the risk that ARF values could reduce to the point where it is incapable of providing a reasonable income in retirement if a client lives a long time.

This change appears to be effective immediately, which gives very little time for the increase to be implemented for ARF drawdowns due in December 2010. We will be seeking clarity regarding when this change applies, and push that this applies from 2011 at the earliest to give clients and the industry time to adapt.

There is no mention that this compulsory imputed distribution is being introduced for PRSAs at this stage.

Extension of flexible options on retirement

As indicated in the National Pensions Framework, all members of Defined Contribution pension arrangements will have access to ARF options on retirement, subject to certain conditions.

- The AMRF option is being retained but the requirement will now be about €120,000, which is 10 times the maximum rate of State Pension (Contributory) as compared with €63,500 at present. If the remainder of the pension fund after taking the tax-free lump sum is less than this than the full amount will be set aside in an AMRF.

- The specified or guaranteed income limit of €12,700 per annum is being increased to 1.5 times the maximum rate of the State Pension (Contributory) bringing the “specified income” limit to close to €18,000 per annum.

As currently, where the AMRF route is taken the capital invested in the AMRF cannot be used by the individual until he or she reaches 75 whereupon the AMRF automatically becomes an ARF. However, in a proposed change, if the guaranteed income requirement is satisfied at any time after retirement, the AMRF becomes an ARF at that time. As a transitional measure for existing AMRF holders, the current guaranteed income requirement of €12,700 per annum will continue to apply for a 3 year period. If they satisfy the existing requirement within 3 years (of the 2011 Finance Bill becoming law) their AMRF becomes an ARF. After this 3 year period, the new higher guaranteed income test referred to above will have to be satisfied.

This ARF option for members of DC schemes will be provided for in the Finance Bill in early 2011. In the meantime the option introduced in December 2008 to allow the deferral of annuity purchase on retirement for defined contribution scheme members is to be extended. Employees (non-5% directors) who are currently approaching retirement may wish to consider if they defer their retirement until the publication of the Finance Bill, when full details will be available.

This will require careful consideration, and individuals will need advice in this area. As was stated by the Government in the Budget measures “it should be borne in mind that the option to invest in an ARF or AMRF as opposed to purchasing an annuity on retirement may not be appropriate for everyone.

Taxation Changes

Income Tax

There have been no changes to the income tax rates of 20% and 41%. But the standard rate bands have been reduced by approximately 10% from 1 January 2011. This means that earners will move on to the higher income tax rate quicker. For a single person any income over €32,800 will now be charged at 41%. For a married couple with one income the 41% rate will apply to income over €41,800.

The income tax credits have also been reduced by approximately 10%. This has the effect of widening the tax base to those on lower incomes. A single PAYE worker earning over €16,500 will now be subject to income tax. Previously no income tax would have been paid on income up to €18,300.

PRSI

PRSI rates for employees remain at 4%. However the PRSI ceiling is to be removed. This means that employees will pay 4% PRSI on their total earnings from 1 January 2011. Up until now PRSI was only paid on earnings up to €75,036 per annum.

The PRSI rate for self employed individuals and company directors is to be increased from 3% to 4% from 1 January 2011.

Health, Income Levies and the Universal Social Charge

Both the Health and Income levies are to be abolished from 1st January 2011 and replaced with a new Universal Social Charge (USC). The USC will apply on a similar basis to the Income Levy.

The new USC will be applied at the following rates

Income up to €10,036	2%
Between €10,036 and €16,016	4%
Income over €16,016	7%

Those earning less than €4,004 per annum (€77pw) will be exempt from the USC. Once an individual's earnings exceed €4,004 a year the USC will apply to the entire income. The USC will be capped at a maximum of 4% for individuals aged 70 and over.

The tables below clearly show how these changes will affect a single PAYE earner and their net income.

Table 1: 2010 Income Tax, PRSI, Health Levy and Income Levy Rates

Gross Income	Income Tax	PRSI	Health Levy	Income Levy	Net Income	Effective Tax Rate
€25,500	€1,440	€756	€0	€510	€22,794	10.6%
€40,000	€5,096	€1,336	€1,600	€800	€31,168	22%

Table 2: New 2011 Income Tax, PRSI and Universal Social Charge (USC)

Gross Income	Income Tax	PRSI	USC	Net Income	Effective Tax Rate
€25,500	€1,800	€756	€1,104	€21,840	14.35%
€40,000	€6,212	€1,336	€2,119	€30,333	24%

Tax on Life Assurance and Bank Savings and Investments

Deposit interest retention tax and life assurance and investment funds exit tax

The rate of DIRT that applies to deposit interest, together with the rates of tax that apply to life assurance policies and investment funds, are being increased by 2% to 27% and 30% respectively. The increased rates will apply to payments, including deemed payments, made on or after 1 January 2011.

Capital Acquisitions Tax

The minister announced that the current group tax free thresholds are being reduced by 20%. This reduction applies in respect of gifts or inheritances taken from midnight on 7 December 2010.

Group 1 €332,084	Where the person receiving the property is a child or a minor child of a deceased child of the disponer.
Group 2 €33,208	Where the person receiving the property is a lineal ancestor, descendant, a brother/sister, or child of a brother/sister of the disponer.
Group 3 €16,604	All other cases.

Capital Gains Tax

It was proposed as part of the National Recovery Plan that the base for CGT would be broadened while the level of reliefs and exemptions would be reduced. There was no mention of any changes to the current CGT system and therefore we await further clarification on these proposed changes.

Stamp Duty

Transfers of residential property
There is a reduction in rate for transfers of residential property to 1% on properties valued up to €1 million, with 2% applying to amounts over €1 million, in respect of instruments executed on or after 8 December 2010.

The abolition of various reliefs and exemptions, in respect of instruments executed on or after 8 December 2010, as follows:

- First time buyer relief
- Exemption for new houses over 125 sq m in size
- Relief on new houses over 125 sq m in size
- Consanguinity relief for residential property transfers
- Exemption for residential property transfers values under €127,000
- Site to child relief

There have been no proposed changes to the rate of stamp duty on commercial property.

Corporation Tax

There has been no change to the current rate of Corporation Tax. An extension has been announced to the existing scheme which provides a three year exemption from tax on the income and gains of new start up companies to include companies who commence trading in 2011.

National Solidarity Bond

It is proposed to introduce a new, four-year, National Solidarity Bond to complement the ten-year National Solidarity Bond which was launched last year and which has been very successful. The bond will pay a coupon each year and a bonus for those who hold the bond to maturity.
The bond will be sold by An Post on behalf of the NTMA. Further details will be announced by the NTMA in the New Year.

Abolition of Reliefs

The abolition of a number of reliefs will apply from 1 January 2011 unless otherwise stated. Some of these are noted below.

- Rent Relief to be phased out over 8 years; the same timeline as previously announced for Mortgage Interest Relief.
- Tax relief for Trade Union Subscriptions.
- Approved Share Options Scheme, effective from the launch of the National Recovery Plan on 24 November 2010
- A restriction of the tax-free element of ex-gratia termination payments (redundancy payments) to €200,000 so that payments above this amount will be subject to tax at the marginal rate.

Income Tax, PRSI and other information

Standard Rate Bands	2011	2010
Single / Widowed		
No dependant children	€32,800	€36,400
With dependant children	€36,800	€40,400
Married – one income	€41,800	€45,400
Married – two incomes	€65,600	€72,800
Max transferable between spouses	*(€41,800)*	*(€45,400)*

Income Tax Credits	2011	2010
Personal		
Single	€1,650	€1,830
Married	€3,300	€3,660
PAYE / Employer Credit	€1,650	€1,830
Incapacitated child	€3,300	€3,660
Blind Person – single	€1,650	€1,830
- married (both blind)	€3,300	€3,660

Income Exemption Limits	2011	2010
Single / Widowed (aged 65+)	€18,000	€20,000
Married (aged 65+)	€36,000	€40,000

PRSI Rates	A1	S1
Employee All Income (earnings less than €352pw exempt)	**4%** First €127 pw exempt	**4%** On all Income
Employer All income	10.75%	Nil

Universal Social Charge

The Universal Social Charge replaces both the Health Levy and Income Levy from 1 January 2011.

Income up to €10,036	2%
Between €10,036 and €16,016	4%
Income in excess of €16,016	7%

The Universal Social Charge exemption threshold is €4,004.

This levy is paid on gross income, before deduction of capital allowances or pension contributions.
It does not apply to social welfare payments, including contributory and non – contributory social welfare pensions.
Income earners over 70 are capped at 4%

Savings and Investment Tax	2011	2010
DIRT	27%	25%
Life Assurance Policies	30%	28%
Wrapper Products	50%	48%

Social Welfare Benefits

The following table sets out the main changes in Social Welfare benefits

Social Welfare Benefits	Weekly 2011	Weekly 2010
State Pension (Contributory + Transition)		
Personal Rate	€230.30	€230.30
Personal + Adult dependant (over 66)	€436.60	€436.60
Widow / Widowers Contributory Pension (under 66)	**€193.50**	€201.50
State Pension (Non-Contributory)		
Personal Rate	€219.00	€219.00
Personal + Adult dependant (under 66)	€363.70	€363.70
Widow/ Widowers Non Contributory Pension	**€188.00**	€196.00
Invalidity Pension		
Personal Rate (under 65)	**€193.50**	€201.50
Personal + Adult dependant (under 66)	**€331.60**	€345.30
Illness Benefit		
Personal Rate	**€188.00**	€196.00
Personal + Adult dependant	**€312.80**	€326.10
Jobseeker's Allowance		
18 to 21 years of age		
Personal Rate	€100.00	€100.00
Personal + Adult dependant	€200.00	€200.00
22 to 24 years of age		
Personal Rate	**€144.00**	€150.00
Personal + Adult dependant	**€268.80**	€280.10
Over 25 years of age		
Personal Rate	**€188.00**	€196.00
Personal + Adult dependant	**€312.80**	€326.10
Where a person aged 18 to 24 has a dependant child the basic personal rate (€188) applies.		
Increase for each dependant child	€29.80	€29.80

Child Benefit (Children's Allowance)	2011	2010
First and second child	**€140.00**	€150.00
Third and subsequent child	**€167.00**	€187.00
Fourth and subsequent child	**€177.00**	€187.00

Contact Details

Life Advisory Services:

Caitriona Gaffney: (Manager) — 01 856 3160 — Caitriona.Gaffney@irishlife.ie

Edel Hughes: (Specialist) — 01 856 3150 — Edel.Hughes@irishlife.ie

Pensions Advisory Services:

Patrick O'Shea: (Manager) — 01 856 3166 — Patrick.O'Shea@irishlife.ie

Marie Ann Reidy: (Specialist) — 01 856 3171 — MarieAnn.Reidy@irishlife.ie