FINANCIAL UPDATE - MAY 2007

Technical Services – Irish Life Retail

Approved Retirement Funds – Imputed Distribution Requirement

Key Facts

- From 31/12/2007 an ARF fund will be deemed to have made a 1% withdrawal which will be liable to income tax in the same way as if an actual ARF withdrawal had been made.
- % will increase to 2% from 31/12/2008 and 3% from 31/12/2009 onwards.
- Income tax and PRSI rate will depend on individual's own circumstances.
- ARF distribution doesn't apply to AMRF, or to ARF where the individual is under age 60.
- Any actual income taken from the ARF during that year will reduce the imputed distribution amount.

Quick Example - 2007 Tax Year with no income distribution taken

ARF value at 31/12/2007:		**€1,000,000**
1% of ARF value as at 31/12/2007:	€10,000	
Less actual income distributions in 2007:	€0	
Imputed distribution: (Income tax and PRSI will be calculated on this amount)	€10,000	
Income tax due on imputed distribution: (assuming 41% tax, 2% PRSI)		**€4,300**
ARF value after 31/12/2007:		€995,700

Frequently Asked Questions about the ARF Imputed Distribution requirement

When was the Imputed Distribution requirement introduced?

The Finance Act 2006 introduced a new taxation requirement on ARFs designed to encourage people to take a regular income from their ARF. The first year this applies is the 2007 tax year. If clients do not take an income of up to 1% from their ARF before the end of 2007, an imputed distribution will take place based on the value of the ARF as at 31 December 2007.

Who does this effect and who is exempt?

The charge will apply to ARFs taken out on or after 6 April 2000. It does not apply to Net ARFs, that is ARFs taken out before 6 April 2000.

The imputed distribution requirement applies to ARF holders aged 60 or over **for the whole of a tax year.**

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Example:

John Smith reaches age 60 on 1 September 2007 and takes his pension benefits. He takes his maximum tax free lump sum entitlement. As he already has sufficient guaranteed income he invests the balance of his pension fund in an ARF. There is no imputed distribution required on 31 December 2007, as John was not aged 60 or over for the whole of 2007.

If John does not take an income during 2008, then an imputed distribution will apply on 31 December 2008

Example:

Ann Murphy reaches age 65 on 1 December 2007. She takes her maximum tax free lump sum entitlement. As she already has sufficient guaranteed income she invests the balance of her pension fund in an ARF. If Ann does not draw down sufficient income from her ARF before 31 December 2007, then an imputed disruption will be made based on 1% of the value of the fund as at 31 December 2007, as she was aged 60 or over for the whole of 2007.

There is no allowance or adjustment to the imputed distribution calculation even though the ARF has only been taken out recently.

Does this charge effect AMRFs?

The imputed distribution requirement will not apply to Approved Minimum Retirement Funds. But remember, an AMRF becomes an ARF when the individual reaches age 75. From that point on, if sufficient income is not taken, income tax will be deducted on an imputed distribution.

The first imputed distribution income tax deduction is made on 31st December following the client attaining 75.

Example:

Tom McCarthy reaches age 75 on 30th December 2008. His AMRF becomes an ARF on that day. If no income was taken during the year, then on 31st December 2008 the QFM must calculate the amount of income tax due on 1% of the fund value. There is no adjustment for the fact that the plan has only been an ARF for 1 day.

In this example the plan only becomes an ARF very close to the calculation date for the imputed distribution. If the client had taken an actual income distribution from the AMRF in 2008 then this would be set against the imputed distribution requirement. However, assuming the client had not taken any income from the AMRF he would need to take an actual income distribution immediately to avoid the imputed distribution requirement.

Does this change effect funds held in PRSAs post-retirement?

The imputed distribution requirement does not apply to the balance of funds held in a PRSA post-retirement. That is, it does not apply to the balance of funds remaining in a PRSA after the contributor takes his Tax Free Lump Sum.

Under current regulations, a client can take up to 25% of his PRSA fund on a tax-free lump sum basis. For a PRSA AVC the tax free lump sum will be calculated based on the client's final salary and service. The balance of the fund can be used to provide one or more of the following options:

1. stay invested in his PRSA and draw down an income at his discretion, subject to certain restrictions and appropriate income tax deductions; or
2. buy an annuity (pension for life) which is subject to income tax; or
3. invest in an Approved Retirement Fund (ARF) /Approved Minimum Retirement Fund (AMRF) from which an income may be drawn down at his discretion, subject to certain restrictions and appropriate income tax deductions; or
4. take in cash, subject to income tax and certain restrictions.

If a client chooses option 1, to keep the balance invested in his PRSA, the fund can remain invested and there is no imputed distribution requirement. On death, the value remaining in the PRSA is treated exactly as if it was held in an ARF.

On the other hand, if the client chooses option 3, to invest in an ARF and AMRF, the imputed distribution requirement will apply.

On this basis it is an advantage to clients who do not wish to draw an income from their pension funds post-retirement to stay in a PRSA rather than taking out an ARF. Clients may also want to consider transferring to a PRSA pre-retirement, and then availing of this option. Legislation may be changed in the future to remove this anomaly.

How will the Imputed Distribution requirement work in practice?

As a transitional measure, the relevant percentage for the imputed distribution calculation will be phased in over 3 years.

- 1% based on the value as at 31 December 2007
- 2% based on the value as at 31 December 2008
- 3% based on the value as at 31 December 2009 onwards

The deduction the QFM takes from the ARF will not be 3% of the value. The amount deducted will be the income tax and PRSI due on 3% of the value.

The best way to understand this is to look at some examples of

- What happens if I don't take an actual income distribution during the year?
- What happens if I take an income of more than the Imputed Distribution amount?
- What happens if I take an income of less than the Imputed Distribution amount?

All the following examples are based on an assumed income tax rate of 41% and assumed PRSI rate (health levy portion) of 2%. Actual income tax and PRSI rates will depend on each individual's own circumstances.

What happens if I don't take an actual income distribution during the year?

Example 1:

(assuming 41% income tax and 2% PRSI)

December 2007

ARF value at 31/12/2007:	€1,000,000
Actual income distribution from ARF in 2007:	€0
1% of ARF value as at 31/12/2007:	€10,000
Less actual income distributions in 2007:	€0
Imputed distribution:	€10,000
Income tax due on imputed distribution:	€4,300
ARF value after 31/12/2007:	€995,700
After tax amount client received from ARF:	€0

January 2008

Actual income distribution request on 2/1/2008:	€5,700
Income tax/PRSI Due:	€2,451
After tax amount client received from ARF:	€3,249
ARF value after 2/1/2008:	€990,000

Total for December 2007 and January 2008

ARF value reduced by:	€10,000
Total income tax and PRSI deducted:	€6,751
After tax amount client received from ARF:	€3,249

What happens if I take an income of more than the Imputed Distribution amount?

If a client withdraws more than 1% of the fund (based on the fund value as at 31/12/2007) between 1 January 2007 and 31 December 2007, then the imputed distribution will be zero, and no further income tax or PRSI will be due as at 31 December 2007.

Example 2:

(assuming 41% income tax and 2% PRSI)

December 2007

ARF value at 30/12/2007:	€1,000,000
Actual income distribution on 30/12/2007:	€10,000
Income tax/PRSI due:	€4,300
ARF value at 31/12/2007:	€990,000
1% of ARF value as at 31/12/2007:	€9,900
Less actual income distributions in 2007:	€10,000
Imputed distribution:	€0
Income tax due on imputed distribution:	€0
ARF value after 31/12/2007:	€990,000
Total income tax and PRSI deducted:	€4,300
After tax amount client received from ARF:	€5,700

January 2008

Actual income distribution request on 2/1/2008:	€0
Income tax/PRSI Due:	€0
After tax amount client received from ARF:	€0
ARF value after 2/1/2008:	€990,000

Total for December 2007 and January 2008

ARF value reduced by:	€10,000
Total income tax and PRSI deducted:	€4,300
After tax amount client received from ARF:	€5,700

Compare this with example 1 above where the client took no income withdrawal in 2007. In both examples the client reduced his ARF value to €990,000. In example 1, the client who waited until January 2008 to take his income received €3,249 and paid tax of €6,751. In example 2, the client who took his income in December 2007 received €5,700 and paid tax of €4,300, a saving of €2,451. This shows the advantage of taking an income each year at least equal to the imputed distribution percentage.

What happens if I take an income of less than the Imputed Distribution amount?

Example 3:

(assuming 41% income tax and 2% PRSI)

December 2007

ARF value at 30/12/2007:	€1,000,000
Actual income distribution request on 30/12/2007:	€5,000
Income tax/PRSI due:	€2,150
ARF value at 31/12/2007:	€995,000
1% of ARF value as at 31/12/2007:	€9,950
Less actual income distributions in 2007:	€5,000
Imputed distribution:	€4,950
Income tax due on imputed distribution:	€2,129
ARF value after 31/12/2007:	€992,871
Total income tax and PRSI deducted:	€4,279
After tax amount client received from ARF:	€2,850

January 2008

Actual income distribution request on 2/1/2008:	€2,871
Income tax/PRSI Due:	€1,235
After tax amount client received from ARF:	€1,636
ARF value after 2/1/2008:	€990,000

Total for December 2007 and January 2008

ARF value reduced by:	€10,000
Total income tax and PRSI deducted:	€5,514
After tax amount client received from ARF:	€4,486

Comparing this example 3 with examples 1 and 2 on previous page, the client has done better than example 1 where no income was taken in 2007, but has not done as well as in example 2 where he took an income at least equal to the imputed distribution amount.

Example 4:

(assuming 41% income tax and 2% PRSI)

During 2007

ARF value at 1/04/2007:	€1,000,000
Actual income distribution request on 01/04/2007:	€10,000
Income tax/PRSI due:	€4,300
ARF value at 02/04/2007:	€990,000
ARF value at 31/12/2007:	€1,020,000
1% of ARF value as at 31/12/2007:	€10,200
Less actual income distributions in 2007:	€10,000
Imputed distribution:	€200
Income tax due on imputed distribution:	€86

Example 4 highlights one of the issues which has been mentioned as a potential problem on imputed distributions. In this case the client took an income during the year of 1% of his fund value. However, growth on the fund during the rest of the year meant that the actual income withdrawal was not sufficient to meet the imputed distribution requirement based on the value at the end of the year.

To avoid this problem Revenue agreed in January 2007 that if an individual is in receipt of an actual distribution of 3% (1% for 2007, 2% for 2008) during the year then no deemed distribution will arise even if timing differences mean that the amount received is less than 3% calculated by reference to 31st December.

What counts as an actual income distribution?

In calculating if you have already taken 1%, 2% or 3% of your fund the following will be included:

- Any income distributions taken from that ARF during that year.
- Any income distributions taken from any ARF with the same QFM during that year.
- Any income distributions taken from an AMRF with the same QFM during that year.
- Where a QFM has been appointed as a Nominee QFM, any income distributions taken from any ARF with the Other QFM during that year.

The following will not count towards meeting the 1%, 2% or 3% distribution:

- Transfers to another QFM to be invested in an ARF with them.
- Income from a pension i.e. income from a Compulsory Purchase Annuity.
- Any previous imputed distribution deduction.
- Transactions on ARF assets that are deemed to be distributions and subject to tax. For example, making a loan to the ARF holder or a connected person, selling an asset in an ARF to the ARF holder or a connected person, or purchasing a property to be used by the ARF holder or a connected person as a residence or a holiday property.

When will the QFM deduct this tax and remit it to Revenue?

In practise the QFM will not deduct tax from the ARF on 31 December each year. While the tax is calculated by reference to the value at 31 December, it is treated as a payment made at the start of the following tax year. The QFM has until the end of February to account for the distribution.

What Income Tax rate and PRSI rate will apply?

The rate of Income Tax and PRSI that will apply to an imputed distribution are the same as would apply to an actual income distribution from the ARF. So income tax and PRSI rates will depend on individual's own circumstances.

An imputed distribution is treated as a distribution made at the start of the following tax year. So if a client does not take an actual income distribution in 2007, an imputed distribution will be calculated based on the value as at 31/12/2007. This will be treated as a distribution at the start of 2008 and 2008 tax rates and thresholds will apply.

If the QFM has received a Certificate of Tax Credits and Standard Rate Cut-Off Point from Revenue, then we will deduct income tax in accordance with that statement. If the QFM has not received such a notification from Revenue, they are obliged to deduct income tax at the higher rate.

How will clients reclaim any overpayment of Income Tax or PRSI?

If a client thinks there might have been an overpayment of Income Tax then he should contact his local inspector of taxes and confirm the income he received and tax paid during that tax year.

If the client wants Revenue to issue a Notifcation of Tax Credits and Standard Rate Cut-Off Point to Irish Life he should contact his local inspector of taxes and ask him to issue such a notice to Irish Life, quoting Irish Life's tax reference number 4820009C.

For overpayments of PRSI the client should contact
Customer Service Section
Office of the Collector-General
Sarsfield House
Limerick
Lo-Call: 1890 203070

What is a "Nominee" QFM and an "Other" QFM?

A Qualifying Fund Manager (QFM) means an institution that is authorised to manage ARFs and AMRFs. Where an ARF holder has more than one ARF which are not all with the same QFM then the ARF holder may appoint one of the QFMs for the purposes of operating the new provisions. The appointed QFM is referred to in legislation as the "Nominee" QFM, while the other QFMs are imaginatively referred to as the "Other" QFMs.

In those circumstances, the nominee must act as if all of the ARFs were managed by the nominee. The nominee must then account for any tax due on an imputed distribution, taking into account the value of all the client's ARFs and taking into account any actual distributions taken from those ARFs.

How is a Nominee QFM appointed and how are the ARFs treated after that?

The procedure set out in the legislation for appointing a Nominee QFM is as follows:

- The individual appoints a QFM as the nominee.
- The individual informs the Other QFMs of the appointment for the purpose of returning the specified distribution amount to Revenue.
- The individual also informs the Other QFMs of the full name and address of the Nominee QFM.

The procedure at the end of each year is that the Other QFMs shall provide the Nominee QFM with a certificate for the year of assessment stating

- the relevant value
- the relevant distribution

The Nominee QFM will then be responsible for the imputed distribution for the total ARFs held by that client.

The Other QFM must provide the Nominee QFM with a certificate within 14 days of the end of the year of assessment. If the Nominee QFM does not receive such a certificate from the Other QFM then each QFM will be responsible for the relevant distribution separately. The Nominee QFM must retain such certificates for 6 years.

Will Irish Life act as Nominee QFM?

No, due to the manual communication that will be required between QFMs, Irish Life will not be acting as Nominee QFM. Revenue confirmed in March 2007 that there is no obligation on the QFM to accept such a nomination.

Will Irish Life be communicating with ARF clients about this requirement?

Yes, we will be contacting all effected clients over the coming months to let them know about the introduction of this new potential tax charge, and also to let them know the possible consequences of not making regular income withdrawals from their ARF in the future.