Monday 23rd November 2009.

Economist Moore McDowell has criticised the proposal to introduce a single rate of tax relief for pensions and radically reduce the tax-free lump sum which is the only real encouragement to pension saving in the current system.

The criticism is contained in a paper on the taxation of pension contributions commissioned from McDowell by Irish Life – the country's largest pensions company.

There are increasing signs that the Government is moving to the introduction of a single rate of tax relief of 30% on pension contributions and to further limit the tax-free lump sum which is currently available on retirement.

McDowell's arguments include:

- **Contrary to common belief, the current tax reliefs encourage middle income earners to save for their pension much more than higher income earners**
- **Proposed reforms will run counter to EU policy on tax relief for pensions**
- **Critics of current system using a flawed argument**
- **Changes will discourage saving for pensions**

Moore McDowell was commissioned to study the proposed pension reforms in the context of the growing debate in Ireland about tax relief on pensions. Critics of the current scheme have argued that because tax relief is applied at the marginal rate of tax, higher income earners get greater relief than middle / low income earners. Critics have also suggested that the current scheme represents a State subsidy to the well-off.

McDowell defends the current system and argues that criticisms of it stem from a fundamental misunderstanding of the way in which the tax treatment of pensions works in practice; "A myth has grown which suggests that tax reliefs on pensions are net benefits to the taxpayer. They conveniently ignore the fact that pension funds are taxed at the point of *drawdown* **not at the point of** *contribution* **but the net effect for the exchequer and for the tax payer are broadly neutral under the current system. However under the reforms proposed, middle income earners will be disadvantaged by paying the marginal rate of tax on drawdown but enjoying less relief at the point of contribution."**

McDowell points out that contrary to popular belief, the main beneficiaries in most cases [ie: where the use of pensions is not simply a tax avoidance device by the very wealthy] from the present structure are not the very rich but those with middle incomes [€45,000 - €75,000].

The proposed change to a flat 30% rate of relief would in effect mean charging 11% income tax on contributions in the case of contributors paying the higher rate of tax [who will then be taxed at the higher rate when taking their pension out] while reducing the tax bill of those on the lower rate by 150% of their contributions. McDowell argues that such a change will mean that anyone earning over €35,000 will face a reduced incentive to make pension contributions;

McDowell also warns that the proposed move to a single rate of tax relief on pension contributions [of 30%] will ensure Ireland's pension is less attractive than that which applies in most of the EU15 countries and which has been explicitly endorsed by the EU Commission as the correct approach to taxing pensions.

McDowell warns that the move to a single rate of tax relief on pensions [30%] will result in a tax structure which discourages saving for pensions and which will ultimately work AGAINST the stated policy goals of the State to increase the level of provision people make for themselves.

Finally McDowell cautioned the Government against using the present budget crisis to introduce a "reform" that is simply a device to improve the Exchequer's cash flow position rather than to address the problem of inadequate pension provision - and in fact exacerbates it.

Welcoming the report, Gerry Hassett Chief Executive of Irish Life commented "Clearly the Government is facing extremely difficult decisions in the coming budget but pensions are a long-term issue which has very significant consequences for our society. There's a real risk here that the Government will take short-term action which will greatly damage the country in the long-run"

Hassett cautioned in particular against introducing a partial reform whereby the rate of relief for higher rate tax-payer is reduced but improved reliefs for standard rate players is deferred.