● Finance

Making sense of Revenue pension limits

Ronan McGrath of Oakwood Financial Advisors gives consultants and GPs some expert advice on calculating their pension entitlements and making sure any tax bills on retirement are kept to a minimum

The thoughts of a hefty tax bill at retirement leads to sleepless nights for most people. A significant number of medical professionals (both HSE consultants and a smaller number of GP) are unaware of the potential tax bill that awaits them.

In the following article I highlight the main points in what has grown to be a very complex area requiring specialist advice.

Retrospectively penalised

The recent focus by the Revenue Commissioners on the medical profession has resulted in a large number of consultants being revenue-audited. For many, with dual earnings through their HSE employment and in a private capacity, they complied with Revenue tax rules. They funded (within these guidelines) their pension funds over their working careers. However, now they are shocked to find themselves being retrospectively penalised at retirement due to changes brought in over the past several years.

There has been a steady reduction in pension limits (Standard Fund Threshold), which has gone unnoticed by some in the medical profession. The potential knock-on effect of this, for many, will result in them receiving an unexpected tax bill when they come to draw down their pension benefits.

Standard Fund Threshold

The Standard Fund Threshold (SFT) is the maximum pension fund an individual is allowed at retirement for tax purposes without any claw-back of previous tax relief/exemptions. This is a lifetime limit and includes all pension benefits (both public and private) taken since December 7, 2005. At retirement, any amount over the SFT is subject to income tax at 40 per cent.

€2 million limit

Since January 2014, the limit an individual can have in their accumulated pension pot at retirement is €2 million (this has gradually reduced from €5.4 million in 2010). For those with defined benefit schemes (HSE consultants) all benefits accruing after this date are capitalised by a factor of 20 or greater depending on an individual's retirement age. Once you exceed the current limit of €2 million you are looking at a 40 per cent tax bill on pension benefits over this limit. While €2 million sounds like a hugely significant sum, the revised revenue capitalisation factors that apply mean that a consultant on a modest pension (relative to their working salary) can easily find themselves exceeding the SFT.

Example

Take a simplified example of a HSE Consultant with a prospective public service pension of €100,000 p.a. (€5,000 assumed to be accrued after January 1, 2014), a related gratuity of €300,000, private pension benefits of €500,000 and a current PFT of €2,000,000. Currently this member has a prospective chargeable excess on retirement at age 65, assuming all benefits are taken together, of:

HSE Pension accrued before January 1, 2014	€95,000 x 20	€1,900,000
+ Pension accrued after January 1, 2014	€5,000 x 26	€130,000
+ Public Service (gratuity) lump sum		€300,000
+ Private benefits		€500,000
Total Pension Benefits		**€2,830,000**
- Personal Fund Threshold		€2,300,000
Chargeable excess		**€530,000**
Chargeable excess liability (tax due)	**€530,000 x 40%**	**€212,000**
Less Credit for Standard rate tax deducted from gratuity		- €45,000
Total tax due		**€167,000**

Allowing for the additional PAYs, the PFT can increase up to €2.3 million, which immediately reduces the potential tax liability by €120,000. The projected chargeable excess liability (in 2016) is €530,000 x 40% = €212,000, less a credit for €45,000 for standard rate tax deducted from the gratuity and 25% lump sum from private benefits, leaving a net chargeable excess liability of €212,000 - €45,000 = €167,000.

Offsetting taxes

However, any taxes on the lump sum paid out from your pension on retirement can be offset against the 40 per cent liability, which can mean that the actual tax-efficient pension fund value at retirement can increase to €2.15 million.

Personal Fund Threshold

For Individuals whose existing funds already exceeded SFT, each time the limit was reduced they were entitled to apply to retain their existing higher fund value at the relevant reduction date. The higher amount is called the individual's Personal Fund Threshold (PFT).

Missed opportunity

Unfortunately, due to lack of awareness, a significant number of consultants missed this opportunity, and as a result can now apply only under the current SFT limits. Revenue, however, do allow an option to review upwards any existing SFT or PFT when Professional Added Years (PAYs) are applied at retirement for medical consultants. I'll touch on this in more detail later.

For many HSE consultants in their 50s the reduced SFT can be of particular concern. Often, they have built up private pension benefits in addition to their HSE pension. Moreover, they may have pension benefits from abroad which leads to further confusion. A significant number of Irish doctors are entitled to UK pension benefits.

Foreign pensions

The good news is that foreign pension entitlements are not taken in to account when assessing an individual's Personal Fund Threshold in Ireland. In recent years some financial advisers, due to lack of knowledge, have encouraged their clients in the medical profession to transfer their benefits, from abroad, back to Ireland. This can have the dangerous consequence of potentially pushing individuals above the Standard Fund Threshold.

For the majority of consultants this is not advisable as it will bring their benefits closer to the revenue cap. It is far more provident to draw these benefits from abroad at retirement. Then separately, receive the local pension entitlement benefits in Ireland.

Professional Added Years

It is also important to be aware that PAYs can push a consultant closer to, or over, the revenue limits. HSE consultants may have an entitlement to additional credited service for retirement benefits. This is only activated on reaching retirement age between age 60 and 65.

For example, many HSE consultants will be entitled to sufficient PAYs to bring their service up to 40 years (the maximum allowable) on retirement from 60 onwards. If the PAYs bring you over the SFT, then this will lead to tax being due on the amount the limit is exceeded.

However, there is an option to review upwards any existing SFT or PFT when PAYs are applied at retirement for medical consultants. If dealt with correctly this will allow you to receive a higher PFT and reduce or negate any potential tax liability.

GPs & the GMS

Far fewer GPs will be affected by the reduction in the SFT. However, if a GP has built up a large GMS practice, in conjunction with any private pension benefits, they may possibly find themselves exceeding the SFT also.

Yet calculating a GP's current funding level isn't always straightforward. Some work is required due to the structure of the GMS and how returns are calculated:

- Each year a return is declared to each GP's account that is a percentage of the average amount standing of their fund through the year.
- The return is calculated by reference to the gains and losses on investments over a four-year period.
- In addition, this is further complicated by the fact that a GP's individual values are only updated once a year (typically around Easter time), which compounds the difficulty in getting accurate figures.

How GPs draw their benefits is crucial. With annuity rates at 40-year lows the Approved Retirement Fund option has proved a far more attractive route since being introduced in 2014. But the ARF option isn't without its risks, and while it allows you a greater level of control in retirement, you need to understand the risks that go with this.

AVCs: a good idea?

Additional Voluntary Contributions (AVCs) are in the main always a good idea for higher-rate tax payers. For HSE Consultants, however, who will over time come close to or pass the 30-year service mark, this may not be the case.

AVCs are a simple and tax-efficient way for pension scheme members to save for their retirement. AVCs are extra contributions made by members of group pension schemes in order to increase their benefits when they retire, and they can plug any income shortfall. These pension contributions that are made while working may be eligible for tax relief (within Revenue limits).

For each individual, a clear outline of their expected years of service and potential retirement benefits are needed before making this decision. An outline of one's expected retirement benefits can be requested from one's hospital HR department for HSE consultants or Mercer in the case of the GMS scheme.

Under the GMS scheme, a GP's obligation is to make the standard contribution of 5 per cent of capitation fees. You do not have to add AVCs to the scheme. You have the choice to do your AVCs privately outside the GMS scheme should you like to do so, which diversifies your funds.

Over time a GP will have significant exposure to the GMS main scheme fund, as they have their 5 per cent contribution plus the HSE 10 per cent contribution to the fund. Making an AVC contribution, external to the GMS scheme, allows for a greater diversification through a wider range of fund choices and clarity on charges.

Reducing your tax bill

The good news is there is some scope to reduce your tax liability if you do exceed the Standard Fund Threshold:

1. Tax on any pension lump sum (up to €200,000 paid out tax free with a balance up to €500,000 taxed at 20%) can be offset against the tax due on exceeding the limit.
2. For HSE employees the tax liability can be paid as an interest-free deduction from their HSE pension over 20 years (no impact on spouse death in retirement entitlement and no recovery on early death) – in essence this is an interest-free loan.
3. One can use a little-known encashment option on any personal pension benefits at age 60 before taking HSE benefits. This option is only available to those in the public service.
4. Retire your benefits on a staggered basis, drawing your private pension initially in order to crystallise their value now so that any further growth will not impact on your PFT limit. A plus for individuals, with both HSE (or a GMS pension) and private pension benefits is that you don't have to retire in order to draw down your private pension benefits.
5. Take early retirement in order to keep under the €2 million limit.

Which option to consider needs careful consideration before making a decision. Expert advice from an experienced adviser, familiar with this area, is essential.

Planning Tips

A significant number of consultants that contact us initially have no clear understanding of their expected pension entitlements at 60 or 65. Knowing those projected benefits is a key requirement in order to put an informed, prudent financial plan in place.

You need to be aware of where you are at from an overall limits perspective. Otherwise you may pay on the double at retirement. The right advice has never been more important for GPs and HSE Consultants with regard to their most beneficial retirement planning.

Minimise your risk

There are a couple of strategic steps that you can take in order to ensure that you minimise the risk with regard to being in an over-funded position:

1. Request a breakdown of your current values and expected pension benefits from your pensions provider, or in the case of HSE employees their relevant department. Most hospitals have a contact person for such queries.
2. Gather together the information (or request your financial adviser to do so) and get an experienced financial adviser/ pension specialist to review your figures.
3. Ask your adviser if they have the necessary experience to provide the right advice. The majority would lack familiarity with both the GMS and HSE pension schemes.
4. Putting the correct plan in place is critical. Each individual's circumstances will vary, depending on their years of service, salary level and private pension values.

Getting the right advice on your retirement planning is very important. It gives you peace of mind.

You will know that no unexpected tax bills from Revenue are going to emerge and will be able to relax and enjoy the well-earned benefits from your years of hard work.

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