Feature Personal Finance

Pension limits – a major cause of concern for hospital doctors

Following a significant increase in queries from HSE hospital consultants concerned at the impact of pension limits on their entitlements after a recent High Court ruling, **Ronan McGrath** of Oakwood Financial Advisors offers advice and guidance on getting the best outcome

The 2018 High Court win resulted in the reinstatement of pre-2010 and 2013 salary cuts for Health Service Executive (HSE) hospital doctors. However, the knock on effect of this was the potential for a significant tax bill at retirement due to the 2014 reduction in pension limits (see 'Impact of recent High Court victory for consultants' pension limits' *IMT* 14/12/2018).

Ramifications

With the higher salary and pension limits this has led to many consultants now having significantly higher tax liabilities to pay on drawing down their pension benefits at retirement. It has also led to some hospitals trying to force consultants to pay any liability over shorter time periods.

Ombudsman's beneficial ruling favours consultants

A recent Ombudsman ruling against a large Dublin city hospital is a significant win for those with a tax liability. The hospital tried to force the consultant to repay the tax on her pension benefits over a 10-year period. The Ombudsman upheld the complaint against the hospital and, in a legally binding ruling, determined that the consultant can write-off her tax liability over a 20-year period.

Mitigate tax liability

In our 2018 article we were concerned that too many doctors are leaving the HSE because of potential tax charges on their pensions.

Ronan McGrath, Oakwood Financial Advisors

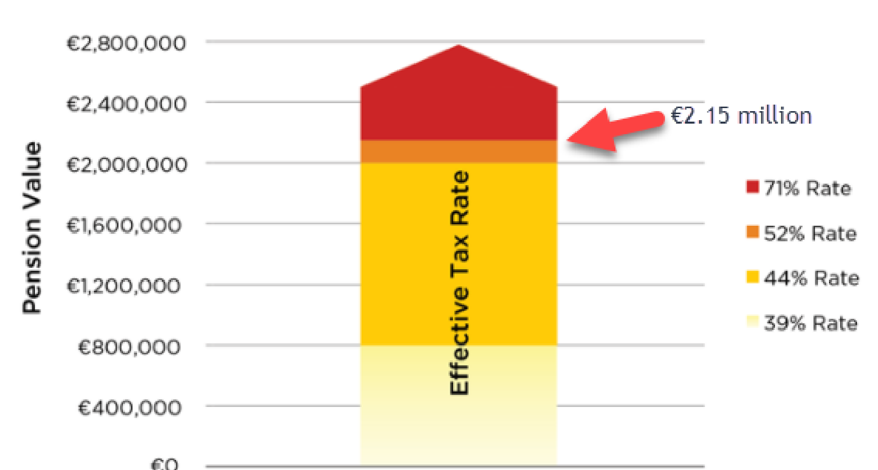
This is because they are not fully aware of the options available to mitigate the tax and the wider ramifications on their overall financial circumstances. Our concern has proved to be well-founded.

Improved revised pension limit available for some

Revenue have advised that those individuals who have been issued with a Personal Fund Threshold (PFT) Certificate in December 2010 and January 2014 may be eligible to reapply for a revised PFT at a higher limit:

- Consultants who have already been issued with a PFT as of December 7, 2010 may be eligible to apply on a 'look-back' basis for a revised PFT.

Tax rate on pension assuming 52% tax on income drawdown



	25% Lump Sum *	Balance After Lump Sum	Chargeable Excess Tax	Combined Effective Tax Rate
€2.15m +	Assumed none	52% x 100%	40% x 100%	71%
€2m - €2.15m	Assumed none	52% x 100%	0% x 100%	52%
€800k - €2m	20% tax x 25%	52% x 75%	Nil	44%
€0 - €800k	0% tax x 25%	52% x 75%	Nil	39%

* Lump sum based on salary multiple of up to 1.5 times final salary may lead to higher overall tax liability.

- Consultants who have already been issued with a PFT as of January 1, 2014 may be eligible to apply on a 'look-back' basis for a higher PFT as of December 7, 2010.
- Consultants who were not previously eligible to apply for a PFT in either 2010 or 2014 may now be eligible to apply on a 'look-back' basis.

Current allowable limit — €2 million

Since January 2014, the Standard Fund Threshold (SFT) limit an individual can have in their accumulated pension pot at retirement is €2 million (this has reduced from €5.4m in 2010). For those with Defined Benefit schemes (HSE consultants employed pre-2013) all benefits accruing after this date are capitalised by a factor of 20, or greater, depending on an individual's retirement age. For some, there is scope to stretch the limit to €2.15m, depending on their individual circumstances.

This limit can be easily exceeded

While €2m sounds like a hugely significant sum, the revised revenue capitalisation factors which apply mean that a consultant on a modest pension (relative to their working salary) can easily find themselves exceeding the SFT. The table to the left illustrates the point.

It may be advisable to cease future pension contributions

Pension contributions are one of the most tax-efficient means of saving. However, for many doctors who are members of the pre-2013 pension scheme with the HSE, this may not make sense. A chargeable excess tax of 40 per cent applies to pension assets over the SFT of €2m. At retirement, this portion of the assets may be taxed again at higher income tax, Universal Social Charge (USC) and potentially Pay Related Social Insurance (PRSI) when drawn as income of up to 52 per cent. This leads to a combined effective rate of up to 71 per cent on the excess amount (i.e., 100% – [40% * 52%]). It is not efficient to continue making pension contributions once assets have reached the threshold (or are projected to reach the threshold).

Professional Added Years (PAY) — correct procedure

While PAY can push you over the Revenue limit they may also allow you to apply for a retrospective increase in your PFT as a result. If dealt with correctly, this may allow you to receive a higher PFT and reduce or negate any potential tax liability.

How to avoid paying double tax

You need to be aware of where you are from an overall limit. Otherwise, you may pay on the double at retirement. The right advice has never been more important for HSE consultants regarding their options towards retirement planning.

Investment strategy review

Once your pension assets are valued above the SFT you need to weigh up the risk versus

Example

Take a simplified example of an HSE consultant looking at retirement in 2021 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 individual 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 Pension / Additional Voluntary Contributions (AVCs) benefits		€500,000
Total Pension benefits		**€2,830,000**
Chargeable excess		**€830,000**
Chargeable excess liability (tax due)	€830,000 x 40%	€332,000
Less credit for standard rate tax deducted from gratuity		- €45,000
Total tax due		**€287,000 ***

If eligible for Professional Added Years, the PFT can increase up to €2.3m, which reduces the potential tax liability by €120,000 immediately.

* The projected chargeable excess liability (in 2020) is €830,000 x 40% = €332,000, less a credit for €45,000 for standard rate tax deducted from the gratuity and 25% lump sum from private benefits.

In summary, leaving a net chargeable excess liability of €348,600 - €45,000 = €287,000.

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reward. You are taking on risk where any growth is taxed at a minimum of 52 per cent and up to 71 per cent, while there continues to be full exposure to loss. Level of risk will be dependent on several factors including time horizon and risk appetite.

How to reduce your potential tax bill

The good news is that there is some scope to reduce your tax liability if you do exceed the SFT:

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 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 the encashment option under Section 787 Taxes Consolidation Act, 1997. Any AVC or Private Pension benefits can be encashed from age 60 before taking HSE benefits. This option is only available to those in the Public Service.
4. Retire your benefits on a phased basis drawing your Private Pension initially 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 General Medical Services [GMS]) Pension and Private Pension benefits is that you do not have to retire in order to drawdown your Private Pension benefits.
5. Take early retirement to keep under the €2m limit – but be aware of losing ancillary benefits as a result.

How to minimise your risk

There are a couple of strategic steps which you can take in order to ensure that you minimise the risk of a significant tax liability when in an overfunded position.

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

Incorrect submissions have detrimental results on benefits

We pointed out previously, due to the sheer volume of requests being submitted to the various HSE pension sections across the country, there has been an increase in incorrect projections of pension benefit statements. Issues such as applying incorrect salary, or revenue multiples to calculate benefits, or years of service being omitted, are common. These lead to substantial losses.

Missed tax relief opportunity – Spouses' and children's lump sum

When retiring, a deduction may be made from your lump sum on the arrears due for spouses' and children's contributions. Undercurrent Revenue provisions, income tax relief is allowable on contributions towards the Spouses' and Children's Scheme, whether paid by deduction from salary or by deduction from retirement lump sum or death gratuity.

Phased retirement approach

For some doctors with both Private Pension and HSE Pension benefits, the phased drawdown of benefits may be an option. This may be particularly beneficial for those who have total pension benefits in excess of the SFT or their PFT:

- This facilitates the split of larger Private Pension pots into smaller pension accounts which can be drawn over different times.
- This can then facilitate the maximum tax-efficient amount only is drawn at the earliest possible time with the excess above this amount deferred, to a maximum age of 75.
- It reduces the mandatory taxable withdrawal if choosing the Approved Retirement Fund (ARF) option.
- Defers the timing of the chargeable excess tax due on exceeding the SFT.
- The potential of improved death benefits from an estate planning perspective.

Working past age 65 — pros and cons

For pre-2013 HSE employees who have a shortfall in years of service and currently buying back years, another option to consider is working past age 65. If the intention is to work on past age 65 then these years will more than likely qualify for additional years' service to age 65 (this can be checked by reviewing the applicable scheme rules). In some cases, it may mean the purchase of notional service is not necessary.

Benefit by being aware of your options

Too many doctors are making decisions without knowing their complete options or looking at their overall financial picture. While you could face additional tax charges by staying in the HSE Pension scheme, if you leave early you may miss out on ancillary benefits, which may mitigate the possible tax charges.

Critical that you have a clear understanding

It is difficult enough to have a clear understanding of expected pension entitlements at 60 or 65 due to the various elements and rules involved. Now with salary reinstatement it is become even more complicated for some consultants. Knowing these projected benefits is a key requirement to put an informed, prudent financial plan in place.

Peace of mind is assured if you have expert advice

Getting the right advice on your retirement planning is very important. Very few financial advisors or accountants have the technical knowledge to advise on the most efficient ways to mitigate any tax liability on HSE Pension benefits especially if coupled with AVC or Private Pension benefits. Which option to consider needs careful review before deciding. Expert advice from an experienced advisor, familiar with this area, is essential. Make sure you are getting the right advice to give you peace of mind. IMT

Information

Oakwood Financial Advisors are specialist financial advisors to the medical profession with a unique understanding of both the GMS Pension scheme and also the HSE Pension benefits.

For more information please contact Ronan at:
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Sláintecare

It may have slipped under the radar with current focus on Covid-19 measures but the recent Government proposal under Sláintecare in the October Budget to appoint 500 new medical consultants on a "Public Service-only" contract of €250,000 p.a. would normally be a headline grabbing soundbite. The proposal for new consultants joining under the Single Public Service Pension Scheme would also have an impact with the current Revenue pension limits on retirement resulting in a significant tax liability.

Significant loss if €2m is not increased

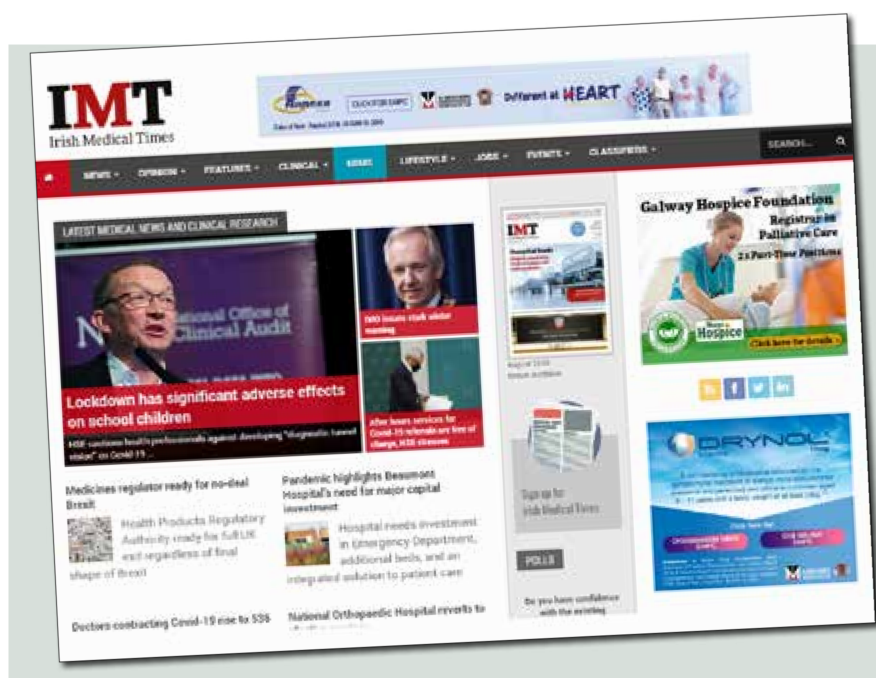
A new appointee who works for 30 years in the Public Service and retires at 65 may lose about one-third of their Public Service Pension in chargeable excess tax at retirement, if the current SFT of €2m is not increased.

Experienced consultants may be lost

If the Government wants to recruit and retain highly paid specialists like consultants, they will have to at least turn back on indexation of the current SFT. Otherwise, experienced consultants may be incentivised to leave Public Service early before their chargeable excess tax bill starts to build quickly.

Switching contracts can have disastrous outcomes

Existing consultants who may wish to switch to the new Public Service-only contract may have an even worse pension outcome. This could result in an even higher chargeable excess tax bill at retirement because they have a combination of pension benefits under the old scheme and the new Single Public Service Pension Scheme.



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