Funding Into Your Pension – Key Benefits

A pension is simply a retirement savings fund with your name on it, used to pay for your retirement. Funding into a pension in Ireland comes with several benefits with the main one being the tax relief allowed on the premiums and also the tax-free growth. Please see a summary below:

1. **Tax Relief**: Contributions to your pension are eligible for tax relief at your highest rate of income tax (currently 40%), which can significantly reduce your tax bill.
2. **Tax-Free Growth**: The investment growth within your pension fund is not subject to tax, allowing your savings to grow more efficiently over time.
3. **Retirement Income**: Pensions provide a source of income when you retire, supplementing the State pension, which is currently €277.30 per week.
4. **Lump Sum**: You may take a portion of your pension as a tax-free lump sum upon retirement, giving you financial flexibility when you need it most.
5. **Compound Interest**: The power of compound interest allows your retirement savings to increase exponentially over time, as the returns themselves earn further returns.
6. **Control and Flexibility**: You have control over how your pension is managed and invested, with a range of investment funds and growth potential.
7. **Portability**: Certain pension plans, like a Personal Retirement Savings Account (PRSA), can be carried with you if you change jobs, maintaining continuity in your retirement savings.
8. **Long-term Security**: Pensions are designed to provide financial security in your later years, ensuring you can maintain your standard of living after you stop working.

It is important to consider these benefits in the context of your personal financial situation and retirement goals.

Tax relief on pension contributions

The main benefit of pension funding as mentioned above is the tax reliefs available. Unlike a regular savings account, money invested in your pension can earn important tax breaks.

Tax relief on your pension is based on the rate of income tax that you pay, this will be 40% for a higher rate taxpayer or 20% for a standard rate taxpayer. For example, for €100 invested in a regular savings policy will cost you €100. Putting the same amount into a pension will cost you €80 (20% tax relief) if you are a standard rate taxpayer or €60 (40% tax relief) if you are a higher rate taxpayer.

PRSA FAQ:

What is a PRSA?

A Personal Retirement Savings Account is a highly flexible, tax-protected pension account that anyone can open. You can get income tax relief on your contributions and can start, or stop your contributions at any point. On top of that, the charges are capped by law, and you can bring your account with you when you change jobs.

Do I need a PRSA?

A pension will replace your salary when you stop working, rather than relying on the State pension alone. PRSAs are the simplest kind of pension in some ways, with several different types available which we cover on page 3.

What is difference between a PRSA and a Pension?

A PRSA is just one of several pension types in Ireland. It is well-known because anyone can get one, and the investment options are fairly simple. There are other kinds of pension which can be more appropriate if you want to retire early, move a pension from an old job.

What happens a PRSA when I retire?

Typically, when you retire, you can take up to 25% of your pension as a lump sum. The first €200,000 of the lump sum is tax-free, and the rest is taxed at 20%. The remaining three-quarters of your pension is usually invested (in an Approved Retirement Fund, or ARF, or sometimes an annuity) to pay you an income in retirement.

What are the benefits of a PRSA?

A PRSA is useful because it offers a simple investment range, clear charges, and your employer can pay in to it too. What is more, you can take a PRSA with you when you leave your job, and you get all the normal tax benefits of a pension: income tax savings on the money you add, tax-free investment growth, and a lump sum on retirement.

How does a PRSA work?

A PRSA can be set up individually or an employer will typically set up your pension for you. You, and your employer, can pay in a fixed amount each month, and add lump sums if you have additional funds available. The money is usually invested in assets with scope for long-term growth, to provide you with an income in retirement.

How much should I put into my PRSA?

Putting as much as you can reasonably afford will save tax and increase your income later in life. But getting started is the key part. Then over time you can increase payments or add funds if available and benefit from the tax relief available and tax-free growth. See page 4 for additional information on tax reliefs.

Can I take money out of my PRSA?

Once money is invested in a PRSA, it is not possible to withdraw it until retirement. Typically, you cannot take money out of a PRSA until age 60. There are exceptions for situations of extreme ill health, but for most people, it is not possible to access the money earlier. Also, if you move abroad it may be possible to access your pension earlier depending on the rules of the jurisdiction you move to.

When can I cash in a PRSA?

The earliest age you can cash in a PRSA is generally 60. Of course, the earlier you start to draw down the benefits, the longer the period you will have to spread it out over. Most people cash in pensions when they retire from their job – perhaps at the same time as the State pension (i.e. age 66 or older).

What is the latest I can cash in a PRSA?

You must draw down a Personal Retirement Savings Account before your 75th birthday.

What is the best PRSA for me?

For most of us, a pension that invests into a passive global investment funds which is appropriate for the level of risk you are comfortable with is the best PRSA option. In general, PRSAs from a mainstream investment provider, at a good-value charge, are best. But there are many options, and everyone is situation is different, so it is worth finding out what is right for you.

What is a Standard PRSA?

A Standard PRSA is a kind of pension with limits on charges and investment options. Standard PRSAs have a maximum charge of 5% on the money paid in, and a maximum charge of 1% per year on the funds itself. Investments are only allowed in pooled investment funds.

What is a Non-Standard PRSA?

A Non-Standard Personal Retirement Savings Account differs from a Standard one in that there are no limits on charges, and no limitations on the funds into which you can invest?

What is a Self-Directed PRSA?

A Self-Directed PRSA is a type of Personal Retirement Savings Account that offers individuals in Ireland the opportunity to have greater control over their retirement investments. This type of PRSA may be particularly suitable for experienced investors who wish to take a more hands-on approach to managing their pension fund investments.

What are the risks of a PRSA?

The main risk with any pension is that it fails to provide enough income for you when you come to retire. That is where we sit down with you to review the investment fund option that is appropriate for your circumstances, and guide you on how much you should put in. There are a range of fund options available however we do recommend a traditional investment approach centred around equities (the great companies of the world).

Can I transfer a PRSA if I change job?

Yes. PRSAs are very flexible in this way. You can move your account into a new work pension if you change job. You can move old pensions into your PRSA, or consolidate many pensions into a single one, or indeed split your pension into several PRSAs, for example to stagger lump sums in retirement.

Who can start a PRSA?

Almost anyone can start a PRSA. You can pay into it yourself (and receive income tax relief on the money you put in), and your employer can also add money.

Do I need a job to start a PRSA?

You do not need to have a job to start a Personal Retirement Savings Account. But if you do not have an income, you will be missing one of the key benefits: saving income tax on the money you put in at your top rate of tax.

What is the maximum amount I can pay I personally and receive Tax Relief on?

Income tax relief is available on payments up to a certain percentage of your net relevant earnings, subject to an earnings limit of €115,000* per year. The percentage changes depending on your age. You can only claim income tax relief within this limit. Entitlement to income tax relief is not guaranteed.

Age during tax year	Tax Relief Limit per annum *
Under 30	15% of Net Relevant Earnings
30 – 39	20% of Net Relevant Earnings
40 – 49	25% of Net Relevant Earnings
50 – 54	30% of Net Relevant Earnings
55 – 59	35% of Net Relevant Earnings
60 or over	40% of Net Relevant Earnings

Earnings refers to a person is total taxable remuneration. An earnings cap applies to pension contributions for tax relief purposes. The earnings cap is currently €115,000, however this figure may change in the future. Contributions paid above age related percentages are treated as Benefit in Kind (BIK).

Please note: Future legislative and tax changes may affect the benefits payable from a pension or investment.

INVESTMENT RISK

Investment risk has many definitions with the most basic being a permanent loss of capital. A loss of capital might not be permanent in and of itself but if it happens when you need the money it effectively is.

Is any loss of capital measured in nominal or 'real' terms? A fall of 15% in monetary terms might really be 30% having taken account of inflation just as a 'gain' of 15% might actually represent a loss of purchasing power.

'Real' assets such as equities (company shares) and property are less likely to lose value due to inflation than financial assets such as bonds (other than those linked to inflation). If financial theory is correct, equities and property should also produce higher returns – they are riskier – and they have done so over the long term. However, the share of the portfolio which can be allocated to such assets is constrained by considerations of risk and, in the case of property, liquidity.

One commonly used proxy for investment risk is the degree to which the investment return may fluctuate from one period to the next, known as **Volatility**. While long-term investors should be more concerned about the possibility of having less than they need when the time for encashment arrives, volatility has emerged as the most widely accepted measure of risk.

Future experience may be quite different and the measure should be used with considerable care: it may usefully be looked at in conjunction with **Maximum Drawdown** - the greatest possible loss over a given historical period.

ASSET CLASSES EXPLAINED

EQUITIES

These are also referred to as stocks or shares. They represent ownership of a company is assets and earnings. In the past, equities have earned higher returns than bonds or cash investments. However, they have also experienced periods of high volatility where investors have lost a significant portion of their original investment, so they are considered to be higher risk than cash or bonds.

Equities (company shares) are clearly high risk both intuitively and in terms of volatility. The rationale for their inclusion is as follows:

- *Historically global equities have produced the best returns (> 5% annualised return over inflation since 1900)*
- *Equities have produced better returns than bonds or cash in over 70% of periods of five years or more; the longer the time period the greater the frequency with which equities outperform cash or bonds*

- *In general the dividend yields from equities are attractive relative to the yields available from bonds and those dividends have the capacity to grow*
- *The real value of equities tend to suffer less than nominal bonds in periods of higher inflation*

Equities can suffer sharp falls e.g. 2007/09 during which most equity market indices halved. They can also suffer prolonged periods of poor performance (e.g. an investor in the *FTSE World Index* made no return between *September 2000* and *March 2013*).

Although the case for long term investors to commit heavily to equities is very strong, we have limited the allocation to 45% recognising that global equities have already performed very strongly in recent years. The scale and composition of the equity exposure also takes into account the degree of correlation with equities which has been shown by the two 'absolute return' funds. The equity content

ALTERNATIVES

This refers to investments that are expected to have the same level of expected return and risk as equities. However, alternatives will generally rise and fall in value at different times and for different reasons than equities which makes them a good addition to a well-diversified investment fund. Alternatives may refer to investments like commodities (gold, oil, sugar and so on) or emerging-market equities (investments in China, Brazil, India and so on).

PROPERTY

Property investment involves investing in commercial properties such as shops, offices and industrial properties. The returns from property investment can come from rental income and capital appreciation. However, property can experience periods of low or negative returns and may take a long-time to buy and sell. For these reasons it is considered to be a higher risk than cash or bonds.

CASH

Cash is generally considered to be the safest investment. However, in exchange for this security, you can expect to earn relatively lower returns or potentially negative returns.

BONDS

A bond is a type of loan given to a company or the government (Govt.). Say for example the government wants to raise money, they can issue a bond. If you loan money to a government you get your money back after a set time- frame and you will also receive a fixed interest rate (known as a coupon).

Bonds are considered to be a lower-risk investment than equities but run the risk that the borrower will not pay all of the interest or return the full value that was borrowed. Because of this extra risk, bonds tend to offer a higher return than cash.

Index-linked bonds are a particular type of bond that provide interest and capital payments linked to changes in inflation, providing some protection against the effects of future inflation.

Warnings:

Past performance is no guide to future performance, they are not a reliable guide to the future performance of your funds.

The funds outlined are not guaranteed.

If you invest in these funds you may lose some or all of the money you invest.

The value of your investment may go down as well as up.