PROPOSED CHANGES TO PENSION LIMIT SYSTEM COULD SUBSTANTIALLY INCREASE MEDCIAL CONSULTANT'S PENSIONS

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We are pleased to provide you with an important Update following the publication on 18th September 2024 of a Review of the Standard Fund Threshold (SFT) by an independent expert appointed by the Minister for Finance, and the Minister's response to the Review.

If the key proposals are implemented, they could have a significant beneficial impact on the superannuation benefits of Medical Consultants, which in turn may impact on decisions of whether to move to the Public Only Consultant Contract, if you are not already on it, and when to retire

We welcome these proposed changes and believe they are long overdue. The lack of adjustment to the SFT since 2014 has meant that, allowing for the impact of wage inflation, the value of the maximum tax-efficient pension fell by over 39% in real terms during this time according to data from the CSO.

What is the Standard Fund Threshold limit?

The Standard Fund Threshold limit of €2 million, usually called the SFT, is a limit on the capital value of public and private pension benefits you can take, before a super tax of 40% kicks in at retirement on benefits taken in excess of the SFT limit. This super tax is called '*chargeable excess tax'* or *CET* for short and it is paid as follows:

- **On Private Pension benefits taken in excess of the SFT**: CET at 40% is deducted from the excess funds taken at retirement and paid over to Revenue Commissioners. The balance provides a lump sum and ARF or Annuity for you.
- **On public service superannuation benefits taken in excess of the SFT**: the CET is repaid by you in 240 equal monthly instalments taken from your gross monthly public service pension in retirement. If you die within the 20-year repayment period, the balance of CET repayments is written off.

The main impact of the SFT on Public Sector employees who crystallise benefits in excess of the SFT is to *reduce* their public service pension in retirement.

Chargeable Excess Tax Rate

The SFT has long been a major factor in decision making when clients are planning for their retirement. A chargeable excess tax (CET) of 40% applies immediately to the value of pension assets over the SFT. This excess may be taxed again as income when the pension is drawn, **leading to a combined tax rate of up to 71%.** The Review recommended a reduction in the CET rate to 10%. However the Minister has said that the rate will be maintained at 40% for the time being, subject to **a review of the rate "by 2030."**

What are the main recommendations in the Report?

The Report's main recommendations were that:

- The SFT limit be increased to €2.8m by 2029 and increased annually thereafter in line with growth in average industrial earnings. The increase from €2m to €2.8m will be in phases starting in 2026:

Date	Increase	Proposed SFT
2025	-	€2,000,000
2026	€200,000	€2,200,000
2027	€200,000	€2,400,000
2028	€200,000	€2,600,000
2029	**€200,000**	**€2,800,000**

- Subject to an 'independent valuation', for future retirees the factors used to value Defined Benefits pensions accrued after 1st January 2014 for the purposes of the SFT to be reduced substantially from its current level. For example, the current factor of 30 applying at retirement at age 60 would be reduced to 21, a significant reduction. *However, it is unclear whether the new lower factors will apply to retirements in 2025 or only from 2026 onwards.*

Age at retirement	Current Factor	Proposed New Factor	Reduction in factor
50	37	**25**	32.4%
55	33	**23**	30.3%
60	30	**21**	30.0%
65	26	**19**	26.9%
70	22	**16**	27.3%

Will Retirement Lump Sum limits increase in line with the Pension Limit?

Under current rules, a lifetime maximum tax-efficient lump sum of up to €500,000 can be accessed from all private pension arrangements. **The first €200,000 of such lump sums is tax free,** and the next €300,000 is taxed at the standard rate of income tax, currently 20%. Minister Chamber's confirmed that both elements of the tax-efficient pension lump sums will remain at the current levels and *not increase as future increases to the SFT are applied.*

Other recommendations

In addition to the changes announced above, the report sets out a number of further significant recommendations, including;

- A removal of the annual age and earnings related limits that apply to personal pension contributions on a phased basis.
- An allowance for CET liabilities for all pensions to be spread and paid over a 20-year period.

What do these changes mean for you?

The changes announced regarding the Standard Fund Threshold (SFT) are currently at a high level, with finer details expected to emerge after Budget 2025, when the relevant legislation will be published in mid-October.

Clients are advised to avoid making any irrevocable decisions about the maturity of private benefits until the Bill is published. We will then have a clearer understanding of the timetable for the planned changes to the SFT system.

This position is further strengthened by the proposed changes in the Review and wider recommendations. Unfortunately, the increases in the SFT aren't expected to become effective until 2026. For clients who were waiting to retire pension benefits in 2025 under a new limit, this does not help their position.

It is important to note that the specific implications and appropriate strategy will differ depending on each client's individual circumstances. We see the recommended SFT changes as a great opportunity for clients managing the accumulation and drawdown of their pensions to take action. It is also an Ideal time for clients to either revisit their existing financial plan, or to put one in place if they haven't yet.

In the short term, the only concrete changes to the SFT system appear to be the phased increase in the SFT to €2.8m, starting from 2026, and a reduction in the factors used to value defined benefit pensions accrued since January 2014.

I have a Personal Fund Threshold of €2.3m. Will it be increased?

One final point to note is for those clients who have a previous Personal Fund Threshold in place. Your PFT **<u>will be increased</u>** in line with increases in the Standard Fund Threshold. Take for example a PFT of €2.3m held today:

	Standard Fund Threshold	Personal Fund Threshold
2025	€2,000,000	€2,300,000
2026	€2,200,000	€2,530,000
2027	€2,400,000	€2,760,000
2028	€2,600,000	€2,990,000
2029	**€2,800,000**	**€3,220,000**

On the basis of the above figures an individual with a €2.3m Personal Fund Threshold Certificate who doesn't retire before 2029 will have a pension limit of over €3.22m at that point.

What impact would these two proposed changes have on my pension benefits?

The impact of the two proposed changes in the SFT level and the factors used to value pension accrued since 1st January 2014, differs in the main by the type of Contract you are on, the value of any private pension benefits you have, and when you will retire.

Take a **first example**[1] of a Medical Consultant on point 6 of Public Only Consultant Contract retiring at 65, on a projected salary of €286,151 and a fixed annual allowance of €11,348, i.e., total pensionable remuneration of €297,500[2], with the maximum 40 years reckonable service.

For comparison purposes, I have assumed the same pensionable remuneration and service for the Consultant retiring at 65 in each year, and ignored private pension benefits:

Example 1 - Medical Consultant - Public Only Consultant Contract – Retiring at 65

	Retiring in 2024	Retiring in 2026	Retiring in 2027	Retiring in 2028	Retiring in 2029
Pensionable remuneration	**€297,500**	**€297,500**	**€297,500**	**€297,500**	**€297,500**
Prospective Pension	**€134,280**	**€134,280**	**€134,280**	**€134,280**	**€134,280**
Prospective lump sum (before tax)	€446,250	€446,250	€446,250	€446,250	€446,250
Tax on lump sum	€49,250	€49,250	€49,250	€49,250	€49,250
Capital value of benefits	**€3,637,543**	**€3,047,579**	**€3,047,579**	**€3,047,579**	**€3,047,579**
Projected Chargeable Excess Tax	€605,767	€289,782	€209,782	€129,782	€49,782
Reduction in pension to pay chargeable excess tax	**€30,288**	**€14,489**	**€10,489**	**€6,489**	**€2,489**
***After* Chargeable Excess tax**					
Prospective pension (first 20 years)	€103,992	€119,791	€123,791	€127,791	€131,791
Prospective lump sum (after tax)	€397,000	€397,000	€397,000	€397,000	€397,000

You can see from the Example 1 Table above that the reduction in the factors used to value pension accrued since 1st January 2014 has the largest impact on the pension after chargeable excess tax, with the benefit of the increasing Threshold limit being less relevant the earlier the Consultant retires.

In this example, the combined maximum benefit of the increased Threshold and lower factors is pension of about €28,000 pa, assuming the Consultant retires in 2029.

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[1] Assumed: no private benefits, has an accrued pension at 1st January 2014 of €50,000, pa retires from public service at 65 in the year shown with maximum 40 years reckonable service, and is Class A PRSI. I have assumed no change in the State Pension from its current level and no change in the CET rate of 40%. Averaging of pensionable remuneration over 3 years where the Consultant retires with less than three years' service on POCC23 has been ignored in the example above, to allow a more transparent comparison of the impacting of retiring at different times.

[2] Based on the October 2023 salary and allowance levels for point 6 of the POCC scale, increased by the anticipated pay increased between January 2024 and June 2026.

The above is just one generic example, based on the assumptions stated.

We have also kept pensionable remuneration at the same level each year for comparison purposes.

The individual figures for each Consultant will vary depending on a number of personal factors including the Contract you are on, how long you have been on it, your pensionable allowances, the level of private benefits, if any, you have and if you have matured them, your service record, future pay increases, and when you propose to retire.

The following **second example** below assumes the Consultant is on Type B contract and also has €500,000 of private pension benefits which we assume they will encash under S787TA just before taking their public service benefits in the year shown. We also assume they have maximum 40 years reckonable service by retirement in each year shown.

Example 2 - Medical Consultant – Type B Contract – Retiring at 65

	Retiring in 2024	Retiring in 2026	Retiring in 2027	Retiring in 2028	Retiring in 2029
Private benefits taken first					
Encashed under S787TA	€500,000	€500,000	€500,000	€500,000	€500,000
tax @ 42%	€210,000	€210,000	€210,000	€210,000	€210,000
Net Encashment	€290,000	€290,000	€290,000	€290,000	€290,000
Public benefits taken next					
Pensionable remuneration	**€269,651**	**€269,651**	**€269,651**	**€269,651**	**€269,651**
Prospective Pension	**€120,356**	**€120,356**	**€120,356**	**€120,356**	**€120,356**
Prospective lump sum (before tax)	€404,477	€404,477	€404,477	€404,477	€404,477
Tax on lump sum	€40,895	€40,895	€40,895	€40,895	€40,895
Capital value of benefits	**€3,233,732**	**€2,741,240**	**€2,741,240**	**€2,741,240**	**€2,741,240**
Projected Chargeable Excess tax	€452,598	€175,601	€95,601	€15,601	€0
Reduction in pension to pay CET	**€22,630**	**€8,780**	**€4,780**	**€780**	**€0**
***After* Chargeable Excess tax**					
Prospective pension (first 20 years)	€97,726	€111,576	€115,576	€119,576	€120,356
Prospective lump sums (after tax)	€653,581	€653,581	€653,581	€653,581	€653,581

You can again see from the Example 2 Table above that the reduction in the factors used to value pension accrued since 1st January 2014 has the largest impact on the pension after chargeable excess tax, with the benefit of the increasing Threshold limit being less relevant the earlier the Consultant retires.

In this example the combined maximum benefit of the increased Threshold and lower factors is pension of about €23,000 pa, assuming the Consultant retires in 2029. **This is a generic example, based on the assumptions stated.**

The individual figures for each Consultant will vary depending on a number of personal factors including the Contract you are on, how long you have been on it, your pensionable allowances, the level of private benefits, if any, you have and if you have matured them, your service record, future pay increases, and when you propose to retire.

Will any of these two changes be backdated to Consultants who have already retired?

The Report does not make any recommendation to backdate any of the proposed changes.

The Increase in the Threshold will not start until 2026 and therefore will not apply to retirements before that date.

The recommendation to reduce the factor to value pensions accrued since 1st January 2014 refers specifically to '***future*** *crystallisations of defined benefit pensions*'. There is clearly no suggestion of backdating the lower factors to those who retired since 1st January 2014, even though the change in factors is in effect being backdated to 2014 for those who will retire in the future.

Retired Consultants, particularly those who retired in the recent past and suffered significant reduction in their public service pensions to pay for CET under the current SFT system, caused partially by the use of higher factors to value their post 1st January 2014 pension accrual, may therefore understandably feel hard done by.

What is a Section 787 Encashment Option

This is a special relief available only to those in the public service who also hold private benefits. The option involves **encashing that part of your private benefits which exceeds the Threshold** under s787TA TCA 1997 **subject to a fixed tax charge of 42%,** *before* you retire from public service.

By encashing under s787TA you suffer one tax charge only, i.e. 42%, because the amount encashed does **not** count against your Pension Threshold limit, hence leaving your full threshold limit available for your public service and residual private benefits. **Under the Sec 787 route your AVC / private pension benefits have to be encashed prior to your retirement from the Public Sector.**

The s787TA encashment therefore **avoids a double tax charge on your private benefits**, first 40% chargeable excess tax, and then higher rate tax + USC on taxable withdrawals from the balance transferred to an ARF, in total an effective tax rate of nearly 70% on your private benefits.

To be eligible to use the s787TA encashment option:

- You must be over age 60;
- You must have been employed in the public service on 8th February 2012;
- You must be currently employed in the public service; and
- You must have held at least one private pension plan/AVC as at the 8th February 2012

An application to revenue for Section 787 approval normally takes 12 to 16 weeks for approval, advance planning is recommended.

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