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Pensions update: Proposed Standard Fund Threshold changes require employer and trustee action

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Ireland

Dr Donal de Buitléir's excellent report on the Standard Fund Threshold (the "SFT"), published last month recommends a number of welcome changes to the operation of the SFT and related aspects of the pension system.

However, the phased nature of the Government response has created uncertainty for both employers and pension trustees

and requires careful consideration by both.

We comment on some key aspects of the report below.

Proposed increase of the SFT to €2.8 million

Dr de Buitléir recommends an immediate increase in the SFT to €2.8 million and the indexing of the limit to average earnings growth going forward.

However, the Government has indicated that it intends to phase in increases to the SFT in increments of €200,000 per year from 2026 to 2029.

This phased implementation approach creates planning issues for both employers and scheme trustees. For employers and trustees who have implemented opt-out arrangements in their pension schemes, permitting employees to cease pension accrual once they get close to the existing SFT, several questions arise, including:

- **At what point should any SFT opt-out triggers be re-set to the new anticipated limits?**
- **Should this be in line with the anticipated retirement ages of current scheme members?**
- **For employees who have previously opted out of the scheme, should they be facilitated in opting back into the scheme, and if so, when?**

There is also the vexed question of employees who may have already taken early retirement, based on the size of their pension pot, but are still in service.

Change to tax treatment of lump sums

Currently, where a lump sum in excess of the tax-free maximum of €200,000 is taken at retirement, the portion between €200,000 and 25% of the SFT is taxed at the standard rate of income tax.

Dr de Buitléir recommends that this link is broken once the SFT increases, so that the amount taxable at standard rate tax becomes a fixed monetary amount, not a percentage of the SFT. The Government has stated that it will implement this recommendation in 2025, and fix the amount chargeable at standard rate tax at €500,000 (ie the current limit) going forward.

Changes to the rate at which chargeable excess tax

is levied on amounts in excess of the SFT

Dr de Buitléir recommends a reduction in the rate of chargeable excess tax (“**CET**”) to 10% from the current rate of 40%.

The rationale is that this would still result in an effective rate of tax on pension assets/ benefits in excess of the SFT which is higher than the current marginal rate of income tax and USC. Dr de Buitléir states that the current rate of CET is “perverse”, and should not be retained.

The Government has not taken up this recommendation, but states that a specific review of the CET rate will take place by 2030.

For the moment therefore, avoiding a breach of the SFT threshold remains a priority for individual scheme members, as the tax consequences of such a breach remain penal, and in Dr de Buitléir’s words, perverse.

Changes to the valuation factors used to value defined benefit pensions for SFT purposes

Defined contribution pension pots are easy to value for SFT purposes. However, the value of a defined benefit (“**DB**”) pension must be converted into a capital sum. The conversion or valuation factor was originally a factor of 20 in all cases, but this was changed to age related factors, linked to the age at which the pension came into payment, for all DB accruals from 2014.

Dr de Buitléir recommends a reduction in the factors introduced in 2014, which would benefit DB members. This is based on his assessment of current market conditions. He also recommends that the valuation factors used to value DB pensions should be updated for market conditions every 5 years.

The Government has stated that an “independent evaluation” of the new factors proposed by Dr de Buitléir will be undertaken, in line with Dr de Buitléir’s own recommendation, but has not provided any timeline for this.

Spreading payment of CET liability over 20 years

One of the most egregious examples of differential treatment between public sector and private sector employees is that public sector employees who are members of un-funded public sector schemes and who have benefits in excess of the SFT can spread the payment of their CET liability on retirement over a period of up to 20 years. The CET liability is deductible from future pension payments over that period, without any interest rate or other charge being levied on the pensioner. In addition, if the pensioner dies during the 20-year period, any outstanding CET liability is forgiven.

The availability of this facility only to public sector workers and not to their private sector equivalents is a clear discrimination against private sector workers.

Dr de Buitléir recommends that the facility to spread forward a CET liability over 20 years be made available to all workers, not just those in the public sector.

The Government makes no specific comment on this recommendation, other than a general comment that an “*inter-agency group*” will

be formed to oversee the implementation of the remaining recommendations in the de Buitléir report.

Annual limits on employee pension contributions

Dr de Buitléir recommends that all annual limits on the amount of pension contributions which can be made by individuals should be removed.

The rationale for this is that the overall SFT limit addresses the issue of limiting the amount of tax relief available for contributions to pension schemes.

This is a radical proposal, and is not addressed specifically by the Government in its response. Therefore, it falls into the group of recommendations which " an inter-agency group" will be set up to implement, over an undisclosed timescale.

Conclusion

The de Buitléir report is a very clear-sighted report which makes a number of recommendations which are both radical and sensible. It is disappointing that the Government has deferred implementation of the proposed increase to the SFT limit, but employers and trustees need to be factoring these changes into their pension planning immediately.

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