

## CHAPTER 5

### FUNDING & INVESTMENTS

#### General

##### 5.1

The tax advantages of *exempt approved schemes* are controlled by the imposition of limits on benefits. The other important control is to ensure that excessive funding does not take place. The basic requirement is that scheme assets should not amount to more than what is required to provide the benefits which the scheme has a commitment to pay.

#### Actuarial Reports

##### 5.2

It is the duty of scheme trustees and *administrators* to monitor the scheme's funding. In the case of self-administered schemes, appropriate actuarial advice should be obtained at commencement and at regular intervals thereafter. Actuarial reports are not required for insured schemes where contributions are invested exclusively in a policy or policies that provide benefits according to a predetermined scale of premium rates. Particular attention should be paid to employee's additional voluntary contributions.

#### Surpluses

##### 5.3

There is no objection to a scheme holding a reasonable reserve. In any case, where a valuation discloses a surplus in excess of 10% of the value of the fund assets, the matter should be brought to the attention of the Pensions Business Unit. Cases will be reviewed on an individual basis. It is important to protect the Revenue interest by prohibiting the build-up of monies in a tax-exempt fund that could not be used for the purposes of providing relevant benefits.

Normally, a scheme surplus should be disposed of by augmenting benefits within approvable limits or by reducing or suspending contributions to the scheme. In exceptional cases, part of the surplus might have to be refunded to the employer, and taxed as a trading receipt.

#### Investments

##### 5.4

The sole Revenue interest in scheme investments is to ensure that schemes are "bona fide established for the sole purpose of providing relevant benefits", Section 772(2)(a). Certain investments may prevent approval or prejudice ongoing Revenue approval. These could include investments used for tax avoidance purposes and assets not used to provide "relevant benefits".

Specific investment rules for Small Self-Administered schemes are detailed in **Chapter 19**.

### **Transactions deemed to be pensions in payment**

Certain transactions made by an Approved Retirement Fund, as detailed in 23.5, are deemed to be a distribution from the ARF. A similar provision now applies to pension schemes. When certain transactions occur, the use of scheme assets are treated as a pension payment from the scheme. Any amount treated as a pension payment is no longer regarded as a scheme asset. The transactions are:

- Loan made to the beneficial owner or connected person.
- Acquisition of property from the beneficial owner or connected person
- Sale of ARF asset to the beneficial owner or connected person
- Acquisition of residential or holiday property for use by the beneficial owner or connected person
- Acquisition of property which is to be used in connection with any business of the beneficial owner, or of a connected person. The distribution arises on the date such use commences. The distribution is the amount of the value of the ARF assets used in connection with the acquisition and any expenditure on improvement or repair of the property
- Acquisition of shares in a close company in which the beneficial owner, or connected person, is a participator.

A close company means a company under the control of 5 or fewer participators, or of participators who are directors. Please refer to Sec.430, Taxes Consolidation Act, 1997, for a complete definition.

A participator in relation to any company, means a person having a share or interest in the capital or income of a company. Please refer to Sec.433, Taxes Consolidation Act, 1997 for a complete definition.

Definitions of “connected persons” and “relative” are contained in Sec.10, Taxes Consolidation Act, 1997.

### **Borrowing** **5.5**

Section 16 Finance Act 2004 inserted Section 772 (3E) into the Taxes Consolidation Act,1997, and provides that:

“A retirement benefits scheme shall neither cease to be an approved scheme nor shall the Revenue Commissioners be prevented from approving a retirement benefits scheme for the purposes of this Chapter because of any provision in the rules of the scheme which makes provision for borrowing by the scheme”.

The following rules apply to scheme borrowing:

1. Only assets purchased by borrowing may be used to provide security to the lender.
2. Assignment of rental income to the lender is not permitted
3. Life cover on the amount of the debt may only be provided outside the scheme.

4. No cross collateralisation.
5. Interest only loans and loans for a period of more than 15 years are not permissible. The loan should be repaid in full prior to normal retirement age.
6. Use of other scheme assets to clear residual debt is not permissible.

### **Geared Property Investment Vehicles.**

#### **5.6**

In relation to investments made via geared investment funds and unit trusts, it is possible to link a scheme investment to a particular property, within a collective investment fund, provided the arms length rules apply. In other words, all acquisitions, disposals and lettings must be on a totally arms length basis.

### **Calculation of Maximum Contributions**

#### **5.7**

In order to standardise benefit and funding calculations, the following methodology and capitalisation factors should be used. Current annuity rates form the basis for the calculation. Both the factors and the methodology have been determined following consultation with The Society of Actuaries in Ireland. The capitalisation factors will be reviewed on a regular basis.

The methodology to obtain the maximum ordinary annual contribution to be paid by or on behalf of an individual employee (combined employer and employee) is as follows:

$$\text{Contribution} = \frac{B \times CF - (\text{value of assets plus retained benefits})}{\text{Term in years to normal retirement date, minimum 1 year}}$$

$$\text{Or} \quad = \frac{N/60\text{ths pension} \times CF - \text{value of assets}}{\text{Term in years to normal retirement date, minimum 1 year}}$$

whichever is the greater.

B is the revenue maximum pension based on current remuneration but with service to normal retirement date.

CF = Maximum benefit capitalisation factor as detailed in the table below.

N/60ths pension is the pension that can always be provided from a scheme regardless of retained benefits.

This maximum ordinary annual contribution includes administration costs but not the cost of death in service benefits. The cost of death-in-service benefits may be added to amount calculated using the above formula.

The maximum ordinary annual contribution for a group scheme would be the sum of the individual maximum allowed contributions

Tax relief in respect of contributions in any one tax year is subject to the limits for employee contributions, as detailed in Chapter 3. Relief for employer contributions is subject to the rules in Chapter 4. The limits on Tax Relieved Pension Funds also apply, please see Chapter 25. Care must be taken to ensure that overfunding does not occur as surplus funds may have to be refunded to the employer and taxed as a trading receipt. Details of maximum retirement benefits are contained in Chapter 6.

Additional Voluntary Contributions AVCs can be made if the total of employer Contributions and employee normal contributions do not exceed the above limits and the total employee contribution limits as outlined in Chapter 3.

In the case of defined benefit plans where the value of pension assets are not readily available or earmarked at an individual level the following formula would be applicable

$$\text{Contribution} = \frac{B \times CF - (\text{SchB} \times \text{SchCF plus retained benefits})}{\text{Term in years to normal retirement date, minimum 1 year}}$$

SchB is the scheme pension based on current remuneration but with service to normal retirement.

SchCF is the Scheme benefit capitalisation factor.

### Example 1

A male employee with a dependant spouse has a salary of €100,000 and has 15 years to go to retirement at age 60. He has accumulated assets of €1,000,000 in his pension plan. The maximum normal annual contribution the employer and employee can pay in total is

$$\frac{2/3 \times €100,000 \times 32.4^* - (€1,000,000)}{15} = \frac{€1,160,000}{15} = €77,333 \text{ or } 77.3\% \text{ of salary.}$$

\* This factor is taken from the Table 1, line 1.

### Example 2

A male employee has 20 years to go until retirement at age 65. His gross salary is €60,000, his pensionable salary is €50,000 and he has an AVC fund of €120,000. His scheme provides a 50% spouse's pension and fixed increases of 3% per annum.

	Salary/ pensionable salary	Benefit	Pension	Capitalisati on factor	Value of benefits	
Revenue maximum benefits	60,000	66.66%	40,000	28.4*	1,136,000	A
Scheme benefits	50,000	66.66%	33,333	22.6**	753,326	B
Current AVC fund plus value of retained benefits					120,000	D
Maximum benefit to be funded by AVCs					262,674	E=A-B-D

Maximum AVC rate as % of salary	21.9%	$\frac{(E/20)}{60,000}$
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\* This factor is taken from Table 1, line 6.

\*\* This factor is taken from the Table 5, allowing for a 50% spouse's pension and 3% pension increases.

### Example 3

A married, male civil servant will have forty years' service on retirement at age 60 and also has 20 years' to go until retirement and has €100,000 AVCs accumulated. The public sector scheme provides a spouse's pension of 50% and parity increases.

	Salary/ pensionable salary	Benefit	Pension	Capitalisati on factor	Value of benefits	
Revenue maximum benefits	60,000	66.66%	40,000	32.4*	1,296,000	A
Scheme benefits	60,000	50%	30,000	28.3**	849,000	B
Gratuity					90,000	C
Current AVC fund plus retained benefits					100,000	D
Maximum benefit to be funded by AVCs					257,000	E=A-B-C-D
Maximum AVC rate as % of salary					21.4%	$\frac{(E/20)}{60,000}$

\*The factor 32.4 is from Table 1, line 1.

\*\* The factor 28.3 is from Table 5 for a scheme providing 50% spouse's pension and the earnings indexed figures are used as the public sector scheme provides parity increases

### Table 1: Capitalisation Factors

The capitalisation factors to be used are as follows:

NRA	Female no spouse	Female w spouse	Male No Spouse	Male w spouse
60	27.5	30.0	24.4	32.4
61	26.8	29.2	23.6	31.6
62	26.0	28.4	22.8	30.8
63	25.3	27.5	22.0	30.0
64	24.6	26.7	21.2	29.2
65	23.8	25.9	20.4	28.4
66	23.1	25.1	19.6	27.6
67	22.4	24.3	18.9	26.8
68	21.6	23.5	18.1	26.0
69	20.9	22.6	17.4	25.2
70	20.2	21.8	16.7	24.4
71	19.5	21.0	16.0	23.6
72	18.9	20.2	15.4	22.8
73	18.2	19.4	14.8	22.0

74	17.5	18.6	14.2	21.2
75	16.9	17.8	13.7	20.5

**Table 2: Sample Maximum Contribution Rates**

Applying the above factors produces the following table for maximum annual contribution rates, assuming no pre-existing retirement benefits and an NRA of 60.

Current age	Female no spouse	Female with spouse	Male no spouse	Male with spouse
30	61%	67%	54%	72%
35	73%	80%	65%	86%
40	92%	100%	81%	108%
45	122%	133%	108%	144%
50	183%	200%	163%	216%

**Table 3: Pension Increases**

The formulae are easy to apply when there is a fixed rate of pension increase. If increases are in line with an earnings index the figures can also be taken from the table. However quite often increases are related to CPI (Consumer Price Index) but with such increases being capped at a fixed amount or uncapped. The table below shows the fixed increase to be used where the scheme provides increases linked to CPI.

Increases CPI subject to Annual Cap of	Fixed Increase
Under 1.5%	The Actual Cap
2%	1.50%
3%	1.50%
4%	1.75%
5% or over	2.00%

**Table 4: Scheme Factors for females**

Intermediate factors can be derived by interpolation:

Female	0% spouse					Earnings index
NRA		0%	1%	2%	3%	
	60	17.0	19.3	22.1	25.5	27.5

	61	16.8	19.0	21.6	24.9	26.8
	62	16.5	18.6	21.1	24.2	26.0
	63	16.2	18.2	20.6	23.6	25.3
	64	15.9	17.9	20.2	23.0	24.6
	65	15.7	17.5	19.7	22.3	23.8
Female	50% spouse					
NRA		0%	1%	2%	3%	Earnings index
	60	17.5	19.9	22.9	26.5	28.7
Female	100% spouse					
NRA		0%	1%	2%	3%	Earnings index
	60	18.1	20.6	23.8	27.7	30.0
	61	17.8	20.3	23.3	27.0	29.2
	62	17.5	19.9	22.8	26.3	28.4
	63	17.3	19.5	22.2	25.6	27.5
	64	17.0	19.1	21.7	24.9	26.7
	65	16.7	18.7	21.2	24.2	25.9
	61	17.2	19.5	22.4	25.8	27.9
	62	17.0	19.2	21.9	25.2	27.1
	63	16.7	18.8	21.4	24.5	26.3
	64	16.4	18.4	20.8	23.8	25.5
	65	16.1	18.0	20.3	23.1	24.8

**Table 5: Scheme Factors for males**

Male	0% spouse					
NRA		0%	1%	2%	3%	Earnings index
	60	15.9	17.7	20.0	22.8	24.4
	61	15.5	17.3	19.5	22.1	23.6
	62	15.2	16.9	18.9	21.4	22.8
	63	14.9	16.5	18.4	20.7	22.0
	64	14.5	16.0	17.8	20.0	21.2
	65	14.2	15.6	17.3	19.3	20.4
Male	50% spouse					

NRA	0%	1%	2%	3%	Earnings index
60	17.3	19.6	22.5	26.1	28.3
61	17.0	19.2	22.0	25.4	27.5
62	16.7	18.8	21.5	24.7	26.7
63	16.4	18.4	21.0	24.0	25.8
64	16.1	18.0	20.4	23.3	25.0
65	15.7	17.6	19.9	22.6	24.2

Male 100% spouse

NRA	0%	1%	2%	3%	Earnings index
60	18.8	21.7	25.2	29.7	32.4
61	18.6	21.3	24.7	29.0	31.6
62	18.4	21.0	24.3	28.4	30.8
63	18.1	20.7	23.8	27.7	30.0
64	17.9	20.3	23.3	27.0	29.2
65	17.6	20.0	22.8	26.4	28.4