

Brokers Ireland Pre Budget 2024 Submission

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Executive Summary

Our pre-Budget 2024 submission makes the following recommendations:

- **Proposed Exit Tax Incentive Scheme for Responsible Investment Products.**
- **Remove the 1% Life Assurance Premium Levy.**
- **Link the life assurance exit tax (LAET) rate to the Capital Gains Tax rate of 33%** to ensure consistency and equality in the taxation of returns from investment in risk assets between life assurance and collective investment funds and direct investment in such assets.
- **Index the pensions earnings limit for tax relief on personal pension contributions of €115,000 in line with growth in average earnings over the previous year, starting on 1st January 2024.**
- **Recommence indexation of the Standard Fund Threshold limit in line with growth in average earnings over the previous year, starting on 1st January 2024.**
- **Allow salary/service lump sum option on taking retirement benefits from a PRSA, in addition to the 25% fund option.**
- **Allow PRSA retirement benefits to be taken on ill health early retirement at any time, using the same Revenue Practice definition as currently applies to schemes.**
- **Retain current taxation of ARF balances on death.** We urge the retention of the current 30% flat tax rate on ARF inheritances taken by adult children of the deceased.

Proposed Exit Tax Incentive Scheme for Responsible Investment Products

We set out here the proposed basis for a scheme for a reduced rate of exit tax on personal unit-linked investments which are confined solely to funds complying with ESG¹ criteria, as defined under Articles 8 and 9 of the *Sustainable Finance Disclosure Regulation*. We believe it would stimulate the greater adoption of ESG investment among the Irish public, while its fiscal cost should be modest.

Background

It is widely recognised that responsible investment has an important role to play in furthering climate change policy objectives, and in promoting broader environmental, social and governance (ESG) standards for society. The UN's adoption in 2005 of its *17 Sustainable Development Goals* and associated six *Principles for Responsible Investment (UNPRI)* was a critical milestone along this road. Since then, almost 4,000 institutional investors and service providers have become signatories to the UNPRI.

In recent years the EU has led the way in the introduction of measures to stimulate responsible investment, and in particular investments which are consistent with the reduction of greenhouse gas emissions. In 2021 the *Sustainable Finance Disclosure Regulation (SFDR)* was introduced, imposing disclosure requirements of a 'comply or explain' nature on participants in investment markets. On January 1st, 2023, SFDR enhanced disclosure standards came into force, which oblige investment providers to back up their claims to Article 8 or Article 9 status with specific data.

Product providers internationally, and especially in Europe, have been proactive in launching funds which meet ESG criteria. Recent research from Morningstar² suggests that inflows to sustainable funds in Europe accounted for 43% of total fund inflows in Q1 2023, and through the course of 2022 sustainable fund flows remained positive even while total fund flows were negative.

The insurance-linked fund sector plays a leading role in Ireland's long-term household savings market. Until recently, it was something of a laggard in European terms with respect to promoting sustainable investment products, but it is catching up. We estimate that, in the sphere of investment bond (i.e., non-pension) products, the sector currently offers 103 funds with SFDR Article 8 or Article 9 designations, out of a total number of approximately 250. So, anyone wishing to follow responsible investment criteria has a good range of options to choose from.

Meanwhile, changes to the Insurance Distribution Directive (IDD) effected in August 2022 mandate that the customer's sustainability preferences be placed on the agenda of every conversation with their financial

¹ *Environmental, Social and Governance*

² *"Global Sustainable Fund Flows - Q1 2023 in Review" – Morningstar Research, 25 April 2023*

broker. Coupled with the greater fund choices on offer, the ground is now fertile for a measure to nudge investors in the direction of sustainable funds.

Proposed Scheme

Brokers Ireland would like to propose an incentive scheme for personal investments, where if they are made exclusively into funds qualifying as 'ESG' or equivalent, they would attract a reduced rate of exit tax at 25%. We propose this in tandem with the proposal that the standard exit tax rate would be reduced to 33%.

To participate in the scheme, life assurance companies would be required to offer a separate category of 'ESG' investment bond policies. The investor in an ESG policy would be permitted to select only from the set of ESG funds on offer from the provider, and switches during the life of the policy could only be made within that group. The only exception to this that we suggest is to permit the inclusion of a cash fund in the eligible mix, as investors should be allowed the option of temporarily de-risking their positions without making an encashment from the policy.

The disclosures mandatory under SFDR make the question of defining which constitutes an 'ESG' fund straightforward. We suggest that eligibility for this scheme be restricted to funds which have classifications of Article 8 or Article 9.

Costs and Benefits

The proportion of the insurance-linked fund market accounted for by taxable (i.e. non-pension) investments is quite small. For example, Brokers Ireland estimates that it accounted for just 9.5% of total unit-linked annual premium income in 2021 (expressed in Annual Premium Equivalent terms). The fiscal cost of the proposed scheme, at least as far as insurance-linked products are concerned, should be correspondingly modest. Furthermore, in so far as future investment returns from today's starting point are likely to be lower than those enjoyed over the past decade, the tax revenue foregone will be correspondingly less. Indeed, if the measure stimulates some greater flows from low-yielding cash deposits into funds, it could be close to revenue neutral.

On the other hand, by stimulating greater interest from the public in responsible investment products, we would expect the scheme to help accelerate the adoption of ESG investment in the much larger pensions segment – a societal benefit which would come at no cost to the taxpayer.

Remove the 1% levy on life assurance premiums

A stamp duty levy of 1% was introduced on life assurance premiums in the April 2009 Supplementary Budget.

The Tax Strategy Group Report of September 2020 states, in this regard:

“The levy was introduced as one element of the Government's concerted effort to raise revenue necessary to help address the serious decline in the public finances evident in 2009. It was understood that in common with other taxation measures, the operation of the levy would be kept under review.”

We suggest that the 1% levy on life assurance premiums be abolished from 2024 onwards for the following reasons.

- It increases the cost to individuals of protecting themselves and their families through life assurance and serious illness cover, as the levy increases their premiums by 1% over what they would otherwise pay.
- It amounts to a 1% confiscation of savings and investments made only through life assurance policies. It distorts the domestic savings and investment market by not applying to deposits, direct investment in property, stock and shares, or collective investment funds. There is no logical reason to apply a 1% tax through savings and investments structured using a life assurance policy and not on identical savings and investments made through other collective investment structures.
- Unlike the general insurance levy, the levy on life assurance premiums was not introduced to pay off deficits in life assurance companies. No life assurance company has failed. So why is there a 1% ‘levy’ on life assurance premiums?
- It compounds the inequity of the exit tax rate of 41% applying to realised gains on life assurance savings and investment policies, as opposed to a 33% Capital Gains Tax rate applying to direct investment. Savers and investors in life assurance policies are hit twice, once with a 1% tax on investment and then again with a higher tax rate on gains.

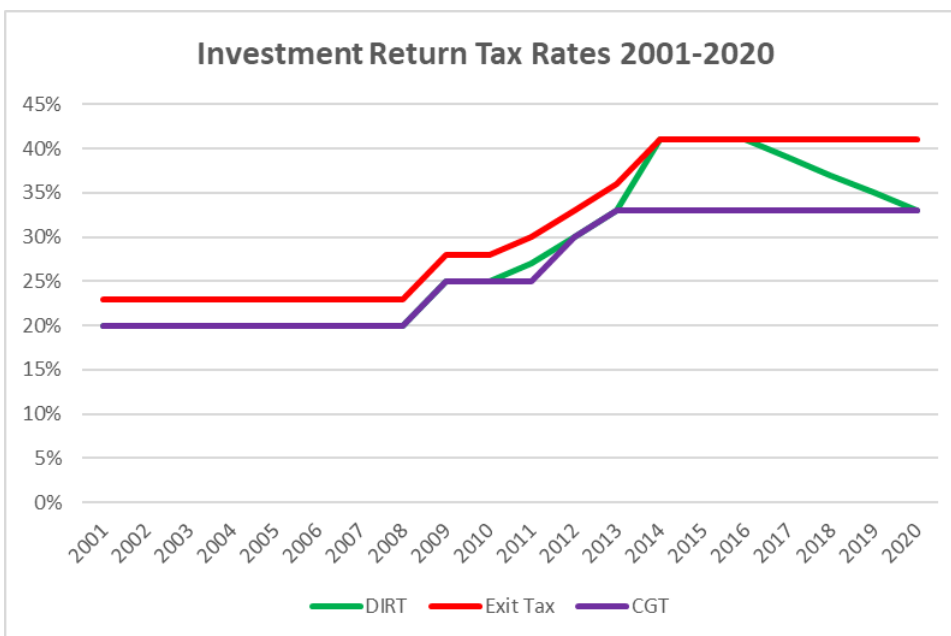
Link the life assurance exit tax rate to Capital Gains Tax rate

When the life assurance gross roll up taxation of savings and investment life assurance policies was introduced in 2001, the exit tax rate was set as [the standard rate of income tax + 3%], while the DIRT rate at that time was standard rate income tax (20%) and the capital gains tax (CGT) rate was also 20%.

The life assurance exit tax rate and DIRT rates became unlinked from the standard rate of income tax from April 2009 when the rates moved to a rate linked to the then CGT rate.

However, by 2014 the DIRT and exit tax rates had both increased to 41% but the CGT rate was and still is 33%.

Following Budget 2017 the DIRT rate was reduced in 2% annual steps to the CGT rate of 33% by 2020, but the exit tax rate has remained at 41%.



A comparison of the taxation of returns from investing directly in risk assets and investment in those assets through collective funds such as life assurance savings and investment policies is as follows:

Taxation of investment returns from risk assets

	DIRECT INVESTMENT	INVESTMENT IN LIFE ASSURANCE POLICIES/COLLECTIVE INVESTMENT FUNDS
Tax on realized gains	33%	41%
Offsetting losses against gains for tax purposes	Yes; indefinite carry forward of realised losses	Only with the same policy/umbrella fund structure
Annual exemption from tax on realized gains	Yes; €1,270	No.

	DIRECT INVESTMENT	INVESTMENT IN LIFE ASSURANCE POLICIES/COLLECTIVE INVESTMENT FUNDS
Deemed encashment every 8 years for tax purposes	No	Yes
Deemed encashment on death for tax purposes	No; there is gross roll up to death, as death does not give rise to a CGT liability and beneficiaries are deemed to acquire assets at their value at the date of death.	Yes.
Income returns	<p>Income tax and USC at marginal rate; PRSI up to age 66 if subject to self assessment or with total investment income of more than €5,000.</p> <p>However, income tax credits and allowances can be used to reduce or eliminate the income tax liability.</p> <p>Those over age 65 may be able to benefit from tax free income returns if their total income is under €36,000 for a married couple or €18,000 for a single person.</p>	<p>Life assurance policies: income rolled up into unit price and taxed at 41% on encashment or deemed encashment.</p> <p>Collective investment funds: income tax at 41%. However, income tax credits and allowances can be used to reduce or eliminate the income tax liability.</p>
1% insurance levy on investment	No	Yes, for life assurance policies only.

Therefore, investors who are prepared to take a risk enjoy a lower tax rate and more benign tax regime if they invest *directly* in property, stocks and shares than if they invest collectively in similar assets through life assurance policies/collective investment funds. There is no logical reason for such discriminatory taxation treatment of collective investment and it disincentivizes safer investment in collective investments which are safer for investors with a wider spread of investments professionally managed.

There is no logical reason why:

- deposit interest should be taxed at a lower rate than returns from savings and investment policies/collective investment funds; or why
- returns from life assurance investment policies/collective investment funds should be taxed at a rate higher than the prevailing CGT rate which applies to direct personal investment in similar assets.

Tax Strategy Group Paper 17/11 25th July 2017 indicated that the refusal to reduce the exit tax rate was based principally on cost grounds and not for any rational policy objective reason:

“The principal reason for not reducing the 41 per cent rate applicable to investment products in Budget 2017 when the rate of DIRT was being reduced was the cost of this change. At the time the cost of reducing the rates of exit taxes, by two percentage points, was estimated by the Revenue Commissioners to be €14 million per annum,”

Tax Strategy Group Paper 22/09 from July 2022 estimates the annual cost of reducing the LAET rate of 41% to 22% at €24m. The same paper also stated:

“Despite the higher (than CGT) headline rate for LAET, with certain reasonable assumptions regarding different rates of return, the result at the end of an 8 year period was a lower tax payment for the life assurance product, due to compounding interest over the 8 years before the tax was imposed.”

However, the Tax Strategy Group Paper 22/09 failed to outline the investment return, the investment term, or other assumptions which justified the conclusion above of ‘a lower tax payment for the life assurance product, due to compounding interest over the 8 years before the tax was imposed.’

With an exit tax rate of 41% versus a CGT rate of 33%, the life assurance product can never provide a lower tax payment in cash terms in respect of a similar realised gain, regardless of when it occurs. Indeed, with investment growth, the exit tax payable after 8 years in cash terms will be higher than the CGT that would have been paid at the time of crystallising the gain on a direct investment.

Take a simple example of a €1,000 gain realised at the end of year 4 of an 8 year investment period:

- with direct investment, CGT of 33% of €330 is payable immediately leaving a net gain at the end of year 4 of €670. Let us assume that this €670 net amount can then be reinvested for the next 4 years, to the end of the 8 year period, at 3% pa return, another gain of €84 is realised after 8 years, incurring a further CGT charge of €28.

So that at the end of 8 years, with the direct investor, the total CGT paid over the period has been €358, and the investor has a net amount of €726 left after taxes at the end of the 8th year.

- However in the life policy, the €1,000 gain realised after 4 years is maintained within the policy fund and with assumed further investment growth of 3% pa for the next 4 years, will have accumulated to €1,125 after 8 years. **By investing through a life policy, the total exit tax charge of 41% will be €461 and the net amount of the gain for the investor will be €664.**

The comparison above does not take account of other favourable aspects of direct investment:

- The use of the annual CGT exemption of €1,270. In the example above it would have wiped out the chargeable gain.

- The ability to offset losses on other direct investments gain the realised gain.
- The 1% life assurance premium levy does not apply to direct investments.

It is therefore hard to rationalise the statement in Tax Strategy Group Paper 22/07 that *‘with certain reasonable assumptions regarding different rates of return the result at the end of an 8 year period was a lower tax payment for the life assurance product, due to compounding interest over the 8 years before the tax was imposed.’*

We believe the exit tax rate on life assurance policies/collective investment fund returns should be the same as the CGT rate, in addition to the abolition of the 1% insurance premium levy, in order to ensure consistency and equality in the taxation of investment returns from risk assets as between collective investment funds, such as life assurance unit funds, and direct investment in similar risk assets.

Recommence indexation of the pensions earnings tax relief limit

With earnings and profit growth returning to the economy it is appropriate for the Minister for Finance to recommence indexing the pensions earnings tax relief cap in s790A TCA of €115,000, which applies to tax relief personal pension contributions.

This limit has been fixed at €115,000 since 2011. **If the earnings limit for pensions tax relief had been indexed in line with average earnings since 2011, it would now be €151,000**, as average earnings have increased since 2011 by 31%.

If not increased annually in line with average earnings, the real value of retirement provision which can be made by sole traders and partnerships in the private sector (who do not benefit from an employer contribution) is being reduced, as retirement provision to be effective must be linked to current earnings.

We note the recommendation in Chapter 8.4 of the Commission on Taxation and Social Welfare Report of 2022 :

“The Commission recommends the removal of age-related contribution rates to be replaced with a single annual contribution rate. The Commission also recommends the removal of the annual earnings cap on contributions subject to appropriate lifetime limits remaining in place.”

We suggest that the current pensions earnings limit for tax relief of €115,000 be increased annually from 1st January 2024 in line with the growth of average earnings over the preceding year.

Recommence indexation of Standard Fund Threshold (SFT)

The limit referred to as the Standard Fund Threshold (SFT) has been reduced a number of times from its initial (2005) €5m value to its current €2m value. It has not been increased since 2009. The SFT system imposes a penal 40% tax charge on the capital value of private pension benefits taken in excess of the SFT limit, in addition to taxing the residual excess benefits again at PAYE rates.

The original chargeable excess tax system provided for *automatic* annual indexation of the SFT in line with an earnings index, and indexation was therefore applied in 2007 and 2008. However, since 2009 automatic indexation of the SFT has been replaced with optional indexation by the Minister for Finance in line with “*an earnings adjustment factor which may be designated in writing by the Minister for Finance in December of the year of assessment preceding the relevant year*”.³ The Minister has chosen not to index the €2m SFT limit since 2009.

If the SFT of €2m had been indexed in line with average earnings since 2009, today it would be circa €2,540,000 as average earnings have increased over that period by circa 27%.

The non-indexation of the SFT encourages some to transfer their retirement funds to overseas arrangements⁴ before they reach the SFT level, with any further growth in their overseas fund then outside the Irish Threshold limit system. It also limits higher earners ability to fund for retirement benefits related to their full current earnings.

We note the recommendation in Chapter 8.5.4 of the Commission on Taxation and Social Welfare Report of 2022 :

“The Commission recommends the periodic benchmarking of the Standard Fund Threshold to an appropriate and fair level of estimated retirement income.”

We therefore suggest that the Minister for Finance use his discretion to increase the current Standard Fund Threshold limit of €2,000,000 from 1st January 2024 in line with the growth of average earnings over the preceding year.

³ From definition of Standard Fund Threshold in s7870(1) Taxes Consolidation Act, 1997

⁴ Under S.I. No. 716/2003 - Occupational Pensions Schemes and Personal Retirement Savings Accounts (Overseas Transfer Payments) Regulations, 2003

Allow salary/service lump sum option on taking retirement benefits from a PRSA, in addition to the 25% fund option

Currently, employees who fund their retirement through a PRSA to which they and/or their company have contributed, are placed at a disadvantage at retirement, when their only lump sum option is to take a 25% lump sum.

In contrast, the same employee in a scheme could opt for a salary/service lump sum (up to 150% x final remuneration) with any balance of their fund used to purchase an annuity, or they can opt for a 25% lump sum and transfer the balance to an ARF. For employees whose funds at retirement are low relative to their salary, the net effect is that as an employee in a scheme they can take the entire fund tax free, but under a PRSA they are limited to 25% of their fund.

This anomaly was pointed out in the IDPRTG Report of 2020, paragraph 3.61 which stated *'There is no objective basis for this differential treatment and the discrepancy arises from the traditional link to salary and service which cannot be replicated in a personal pension product.'*

We therefore urge an amendment to S787G(3)(a) TCA 1997 to facilitate for employees to take a lump sum of the higher of the salary/service lump sum and 25% of the fund.

Allow PRSA retirement benefits to be taken on ill health early retirement at any time, using the same Revenue Practice definition as currently applies to schemes.

Currently, PRSA holders who fall seriously ill before age 60 are disadvantaged in terms of accessing their retirement fund by being required to be *'permanently incapable through infirmity of mind or body of carrying on his or her own occupation or any occupation of a similar nature for which he or she is trained or fitted.'*

This is a far higher bar to reach to access retirement benefits before age 60 than is allowed in scheme, where the current Revenue practice definition of ill health is: *'physical or mental deterioration which is serious enough to prevent the individual from following her/his normal employment or which seriously impairs her/his earning capacity.'*

In the IDPRTG Report of 2020, paragraph 3.61, it is stated *'occupational schemes/BOBs are more flexible with respect to early access on the grounds of ill-health. In the absence of harmonisation, this inconsistency could have the effect of discouraging consolidation.'* The Report then goes on to recommend *'To the extent possible, the respective definitions of ill health to access benefits at any age before age 60, should be harmonised.'*

We therefore urge an amendment to s787K(2)(a) TCA 1997 to adopt a similar, to that used for schemes, definition of ill health for access to PRSA benefits before age 60.

Retain current taxation of ARF distributions on death

It has been proposed in Pensions Reform proposals to double tax ARF inheritances on death, i.e.:

- First subject the ARF balance to PAYE as income of the deceased in the year of death; and
- Then apply the current taxation of post death ARF inheritances from the net balance above, e.g., when inherited by an adult child a flat rate of 30% tax be applied to the net balance.

The net effect could be a total effective tax rate of approximately 64% on ARF balances inherited by adult children of the deceased. This is a penal rate of tax way in excess of the rate of pension tax relief originally granted on contributions which created the ARF in the first place.

Such a penal rate of tax on ARF balance on death will further encourage transfers of accumulated funds prior to maturity to Malta and other overseas jurisdictions, where on death the balance of the overseas fund would not be taxed in the double tax manner proposed for Irish ARF balances.

We therefore urge the retention of the current 30% flat tax rate on ARF inheritances taken by adult children of the deceased, or if additional taxes are to be imposed then the flat rate be linked to the CGT rate of 33%.

