Broadening the options range

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The latest changes for members of defined benefit schemes are explained by Andy Kelly.

A very important change to the options available to members of defined benefit (DB) pension schemes came into effect on 22 June 2016. From that date DB scheme members became entitled, at retirement, to transfer their pension benefit into a buy-out bond (BOB) and to use this bond to purchase an approved retirement fund (ARF).

Prior to this, the option to invest in an ARF was only available to defined contribution (DC) scheme members and those with PRSAs or personal pension arrangements. While the option to transfer their pension benefit into a buy-out bond did exist for DB scheme members they could only use this bond to purchase an annuity.

Members of DB schemes are now able to choose between drawing down a lump sum based on their final salary and service and using the balance of their fund to purchase an annuity or taking a lump sum based on 25% of the total value of their fund and retaining the balance for investment in an ARF.

This is certainly a welcome change as it opens up new possibilities for DB members at retirement. For many people the principal attraction of an ARF is the greater degree of control it gives them over their pension. An ARF is a tax efficient post retirement fund which can be invested in various asset classes such as shares, property, bonds and cash in accordance with the risk appetite of the investor.

An ARF also offers flexibility as you can withdraw income when required. Any growth in your ARF is tax-free, however withdrawals from an ARF are taxable (subject to PAYE, USC and PRSI). In the event of an ARF holder aged 60 or over not making any withdrawals the Revenue Commissioners will assume they have withdrawn 4% each year (for those under 71 years and whose fund is less than €2 million) and they will be taxed and charged USC on that amount.

A frequently asked question is what happens to my ARF if I die?

You are free to leave funds in your ARF as an ordinary part of your Estate. If you leave the funds to your husband or wife, the funds are transferred to their name, and can remain invested. In all other cases the funds are wound up and the proceeds are passed to your Estate. Your dependants may have to pay tax depending on who inherits the funds. The table below is a summary of the tax rules applying after your death.

When choosing an ARF investors have to consider a number of factors. The first being their own attitude towards risk. What appears to be an attractive balanced and mixed investment portfolio may not deliver the returns required to provide a reasonable income in retirement. That will result in the ARF holder depleting the capital and the ARF actually running out over time. There is no case for taking unwarranted risks at this crucial time and as with any investment professional advice should be sought before making any decision.

The option to purchase an annuity remains open to those who decide at a later date that they need a secure and regular income. Indeed, by opting to wait they may be able to avail of a higher annuity rate for the same lump sum as they will be older and bond yields may have recovered in the interim.

It is also important that when establishing an ARF that there is clarity and transparency in respect of charges. Independent professional advice is essential before making a decision.

Invesco's team of investment advisers can help guide DB scheme members to the options which best suit their circumstances and attitude to risk.

Approved Retirement Fund Inherited By	Income Tax Due	Capital Acquisitions Tax Due
Surviving husband or wife	No tax is due on the transfer to an ARF in the husband's or wife's name	No
Children under 21	No tax is due	Yes (normal limits apply)
Children 21 and over	Yes, at 30%	No (depending on certain conditions)