OHT Guide

Taxation of Approved Retirement Funds (ARF) in Estates

A taxpayer with a good level of income from other sources can leave his pension funds intact in the ARF, so that he is not drawing the pension as income.

Various options were introduced to provide alternatives to the purchase of the traditional pension annuity (which ceased when the pensioner and his spouse died) and to facilitate a more flexible income stream during retirement, and the retention of the capital value of the fund for the family.

An ARF is a pension investment vehicle that allows the funds to grow while being exempt from income tax and CGT.

Approved Retirement Fund (ARF)

Chapter 23 of the Revenue Manual (available here) deals with the taxation of ARFs. ARFs are an alternative to a full withdrawal from a pension.

Income and gains on ARF funds are tax exempt. Amounts withdrawn or deemed withdrawn are referred to as distributions and they are subject to Schedule E (income tax).

An individual may have more than one ARF and transfers may be made from one ARF to another provided that a transfer does not occur between a post-April 2000 ARF and a pre-April 2000 ARF. This is due to differing tax treatment between those two funds.

Deemed Distributions

In certain circumstances, a distribution can be deemed to have been made from the ARF. A deemed distribution occurs in the following circumstances;

- Loans made to the beneficial owner or a connected person
- Acquisition of property from the owner of the ARF or a connected person
- Sale of an ARF to the beneficiary or a person connected with that owner
- Acquisition of a residential or holiday property for use by the owner or a connected person
- Acquisition of a property which is to be used in connection with any business held by the owner, or a connected person
- Acquisition of shares in a closed company in which the owner or a connected person

If any of these circumstances arise, then a distribution is deemed to have occurred from the fund and income tax would apply accordingly.

ARFs are noteworthy in that there is specified tax treatment for the distribution of these funds where the beneficial owner dies. Where an individual who holds the beneficial interest in an ARF dies, the ARF becomes an asset of the estate.

While the ARF is an asset of the estate, the executors become responsible for directing the investments made by the ARF during the administration of the estate.

Due consideration should be given by the executors to the investments being made by the ARF, and any directions in relation to distributions from it.

Imputed Distribution

To prevent the fund being stockpiled indefinitely, Revenue introduced an "*imputed distribution*".

The annual imputed distribution was increased by Finance Act 2011 from 3% to 5%. In simple terms the fund manager (QFM) pays income tax as if there was a distribution from the ARF of 5% each year, even if there is no distribution. In Finance Act 2014 an increased imputed distribution rate of 6% was introduced for funds valued over €2m.

Most pensioners with an ARF will take a distribution of 5% (or 6% if the fund is valued over €2m) from their ARF, on the premise that if tax is being charged as if cash had been withdrawn from the fund the pensioner might as well take the cash from the fund.

Taxation of ARF Distributions to Family Members after Death

The tax treatment of an ARF depends on who inherits the ARF.

Distribution to Spouse

Section 784A(4)(b)(i) TCA 97 deals with cases the where the ARF is transferred to another ARF in favour of the spouse of the deceased. In effect the spouse "steps in to the shoes" of the deceased.

In this case, the distribution is not subject to income tax and no CAT should arise on this benefit due, to the spouse exemption under S. 71 CATCA 03.

However, as the spouse withdraws pension income from the fund the withdrawal will be subject to income tax, operated by the fund manager.

Distribution to Children

Where an ARF is distributed to a child of the deceased the treatment depends on whether the child is over or under 21 on the date of death of the parent.

21 or over

Under S. 784A (4) (c) TCA 97, the distribution will be subject to income tax at the rate specified (currently 30%). Under S.85 CATCA 03 where the child has attained the age of 21, CAT will not be charged on the capital value of the fund.

Under 21

In the case of a child who has not attained the age of 21 at the date of death, the distribution will not be chargeable to income tax; however, the capital value of the fund will be subject to CAT in usual manner (following deduction of the available class (a) threshold).

If an ARF is distributed to anyone other than a spouse or a child, then the distribution is subject to income tax at the marginal rate (currently 41% income tax) and CAT.

Revenue have a useful table on their website which I have set out below:

Income Tax and/or CAT on an ARF

Death of Holder

Will the person inheriting the ARF be liable to …

Who inherits the ARF?	Income Tax?	CAT?
Spouse	No	No
Child under 21	No	Yes
Child over 21	Yes	No
Others	Yes	Yes

Death of Spouse

Will the person inheriting the ARF be liable to …

Who inherits the ARF?	Income Tax?	CAT?
Spouse	N/a	N/a
Child under 21	No	Yes
Child over 21	Yes	No
Others	Yes	Yes

It should be noted that there is no requirement under S. 784A TCA 97 that the deceased should have directed how the ARF would be distributed, by Will or some other form of direction before his death.

Once the funds are distributed to the spouse or child, by decision of the pensioner or the fund manager/pension trustees, the tax treatment set out above will apply.

Caveat: *These notes are intended as a general guide to Taxation of Approved Retirement Fund (ARF). OHT has endeavoured to provide an accurate commentary but the notes cannot cover all circumstances. OHT strongly recommends that formal tax advice be obtained before any steps are taken that may have a tax effect.*

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