OHT Guide

Taxation of Approved Retirement Funds (ARF) in Estates

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.

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. However, there is an imputed distribution (currently 5%) so most taxpayers draw 5% per annum from their ARF.

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 Amounts withdrawn or deemed withdrawn are referred to as distributions and they are subject to Schedule E (income tax).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.

Imputed Distribution

To prevent the fund being stockpiled indefinitely, Revenue introduced an *"imputed distribution"*. There are currently two rates of annual imputed distribution for ARF's and vested PRSA's with asset values of €2m or less:

- 4% where the owner is not aged 70 years or over for the whole of a tax year.
- 5% where the owner is aged 70 years or over for the whole of a tax year.

A 6% rate applies in all cases where the value of the ARF/vested PRSA is greater than €2m.

Most pensioners with an ARF will take a distribution of 4%, 5% or 6% (depending on applicable rate) from their ARF, on the premise that if tax is being charged as if cash had been withdrawn from the fund the pensioner might as well take the cash from the fund.

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.

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).

Distribution to Other Person

If an ARF fund is distributed directly to anyone other than a spouse or a child of the pensioner, the distribution is subject to income tax at the marginal rate (currently 41%) and CAT (currently 33%) on the net of income tax amount.

This equates to an effective rate of tax of just over 60%.

If the funds remain in an ARF for the benefit of the surviving spouse of the pensioner, and then passes to a person other than that survivor's child, the distribution is subject to income tax at 30% and also to CAT.

For this purpose child includes a stepchild, adopted child or child of a civil partner (s. 6 TCA 97 & s. 2 CATCA03).

Income Tax and/or CAT on an ARF

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

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

Caveat: *These notes are intended as a general guide to Taxation of Approved Retirement Funds (ARFs). 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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