OHT Guide

Taxation of Pensions - Approved Retirement Fund (ARF)

Approved Retirement Fund (ARF)

An ARF is a pension investment vehicle that allows the funds to grow while being exempt from income tax and CGT. The Revenue Leaflet IT14 deals with the taxation of ARFs and I set out some extracts below.

> *<u>What is an Approved Retirement Fund (ARF)?</u>*
>
> *These are funds managed by a Qualifying Fund Manager (QFM – see below for definition) into which you can invest the proceeds of your pension fund when you retire. Income and gains of an ARF are exempt from tax within the fund. Any amounts withdrawn from an ARF are referred to as a distribution. A distribution is treated as income from an employment. It is subject to income tax and the QFM must operate the PAYE system on it.*
>
> *An individual may have more than one ARF. Transfers may be made from one ARF to another ARF.*
>
> *Certain transactions involving ARF funds are treated as distributions. This is an anti-avoidance measure to ensure that all funds are invested on an arms-length basis.*”

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.

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

The concept of an ARF was introduced which allows taxpayers with a good level of income from other sources to leave their pension funds intact in the ARF, so that they are not drawing the pension as income. 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% (previously 3%) each year, even if there is no distribution.

Most pensioners with an ARF will take a distribution of 5% (previously 3%) 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 gets 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 is dependant 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 standard rate of tax (currently 20%). 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 …		Death of Spouse Will the person inheriting the ARF be liable to …	
Who inherits the ARF?	Income Tax?	CAT?	Income Tax?	CAT?
Spouse	No	No	N/a	N/a
Child under 21	No	Yes	No	Yes
Child over 21	Yes	No	Yes	No
Others	Yes	Yes	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 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.

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