Redundancy & Pensions

This is not a customer document and is intended for Financial Advisers only

Redundancy occurs where an employee's job ceases to exist, and the employee is not replaced for reasons such as reorganisation, not enough work available, financial state of the company, company closure etc.

This document aims to highlight how redundancy and pensions interact and what needs to be considered by an employee when they are being made redundant.

The key points are

- The tax exempt amount of a redundancy payment will not affect the tax free lump sum from a pension scheme. However, the tax free lump sum from a company pension scheme may affect the tax exempt amount of a redundancy payment.
- For those in pensionable employment, Employee, AVC or PRSA AVC contributions can only be made while still in employment. Once an employee has left service company pension contributions should cease. The date of leaving service is determined by the date of their P45 form
- For those in non-pensionable employment, it is possible to make Personal Pension or PRSA contributions after the date of leaving employment, and still claim tax relief against income earned from that employment.
- A redundancy payment is not considered to be income so cannot be used when calculating final salary for pension purposes.
- A pension contribution cannot be set against the tax due on a redundancy payment.
- If the employer wishes to make a pension contribution this decision must be made in advance of agreeing the severance package. The client cannot choose a pension contribution, instead of a part of the redundancy payment, in order to reduce the tax liability.
- Members of company pension schemes must be presented with all options that are available to them on leaving service or on scheme wind up.

Statutory Redundancy

Statutory redundancy payments are exempt from income tax under Schedule E. This does not reduce the exemptions available in respect of other redundancy payments.

Who is eligible for Statutory Redundancy?

- Over 16
- Must be in employment that is insurable under Social Welfare Acts i.e full-time employees must be paying Class A PRSI. (This requirement does not apply to part-time workers)
- Must have at lease two years continuous service with employer.

Examples of cases that do not break continuity of service:

- Maternity leave, adoptive leave, parental leave, carer's leave
- Off work due to illness, agreed absence (i.e career break), holidays
- Strike or locked out of employment
- Transfer of business to new employer

Statutory Redundancy entitlements:

- Two weeks pay (subject to maximum €600 per week) for every year of service (days count), regardless of age

and

- One further weeks pay

Pay refers to normal weekly pay, before tax and PRSI deductions. The gross weekly pay divided by number of hours worked per week should never be less than the minimum wage.

Employer rebates:

Employers who pay statutory redundancy are entitled to a 60% rebate from the Social Insurance Fund.

What happens if an employer cannot or fails to pay statutory redundancy?

Under the Redundancy Payments Act employers are obliged to make statutory redundancy payments. In situations where the employer is unable to pay employees their statutory redundancy entitlement, the Department of Enterprise, Trade and Employment will pay the full entitlement to the employees from the Social Insurance Fund. The employer must provide all financial information required by the Department showing the employer's inability to pay statutory redundancy.

The Department will seek reimbursement from the employer through its Redundancy Recovery Scheme.

Additional Ex gratia payments from employer

Payments made by the employer over and above the statutory redundancy lump sum are taxable. There are a number of exemptions which reduce the amount of tax payable.

1) Basic Exemption:

In addition to the statutory redundancy a lump sum of €10,160 plus €765 for each full year of service with the employer can be paid tax free.

2) Increased Exemption:

This basic exemption can be increased by a further €10,000, less any tax free lump sum received or receivable in the future from an occupational pension scheme, if

- the employee has not claimed relief (other than the basic exemption) on a redundancy payment in the 10 years previous

In effect, if an employee has a lump sum entitlement from an occupational pension scheme relating to that employment that is greater than €10,000, then this increased exemption will not apply.

Tax free sump sum entitlements from personal pensions or PRSAs are not taken into account.

Revenue Approval must be received in advance if the increased exemption is to be used.

3) Standard Capital Superannuation Benefit (SCSB)

The standard capital superannuation benefit is an alternative exemption which is available to all employees. It can be of benefit to employees with high earnings and long service.

The formula for calculating the SCSB is

$$A \times \frac{B}{15} - C$$

Where
A is the average annual remuneration for the last 3 years (including benefit in kind)

B is the number of years complete years of service

C is the amount of any tax free lump sum from an occupational pension scheme received or receivable in the future.

Note: That a pension tax free lump sum receivable from an occupation pension scheme relating to that employment in the future will limit the entitlement to the Increased Exemption or Standard Capital Superannuation Benefit unless the employee irrevocably gives up his right to receive the pension tax free lump sum.

What tax is due on redundancy payments?

The following payments are exempt from tax

- Statutory Redundancy payment

And the greater of

- Basic exemption,
- Increased exemption,
- Standard Capital Superannuation Benefit

Any lump sum amount over this will be subject to tax in the year of assessment in which the termination of the employment occurs.

In certain circumstances an additional relief called Top Slicing Relief may be due. Top Slicing relief relates to the tax rate applied to any taxable part of a redundancy payment and ensures that the lump sum is not taxed at a rate higher than the employee's average rate of tax for the 3 years prior to redundancy. Top Slicing Relief may be claimed by contacting Revenue after the end of the tax year.

Additional Benefits:

If as part of the redundancy payment the employee is given a non-cash benefit e.g. allowed to retain the company car, then the cash value of the car will be treated as part of the ex-gratia payment.

Is the Income Levy, PRSI and Health Levy payable?
The income levy and the health levy are due on the taxable part of the lump sum. There is no PRSI liability.

Redundancy and pensions:

Company pension schemes clearly affect redundancy payments in the calculation of the tax exempt amount.

Redundancy will also have an affect on the ability of both employer and employee to continue making pension contributions to the company scheme.

Employer Contribution
Generally speaking an employer can only make pension contributions in respect of a current employee. So once an employee has been made redundant the employer should cease pension contributions.

It may be possible for an employer to make a single premium contribution for a former employee if this is to make up a shortfall in the promised level of pension funding. If the employer wishes to make a contribution to the member's company pension scheme this

decision must be made before or at the same time as the severance package is decided. The employer should be clear about how much of a pension contribution they will make and how much is being put towards the redundancy package. If the redundancy payment is later reduced and a pension contribution made in its place, then this may be viewed as tax evasion by the Revenue Commissioners.

The employer can make a pension contribution for the member in addition to any redundancy payment but not instead of.

Employee AVC Contribution
Once an employee has left employment they can no longer make employee, AVC or PRSA AVC contribution in respect of that employment.

Should employees wish to make AVC or PRSA AVC payments in respect of the current or previous tax year in order to gain tax relief these payments must be made before they leave service. The date of leaving service is determined by the date of their P45 form.

Example:

John Murphy has 10 years service in ABC Ltd from 1999 to April 2009 when he is made redundant. John was a member of the company's occupational pension scheme and had no other source of income.

In October 2009 John wants to make a pension contribution and backdate it to 2008 tax year.

→ As John left service with his employer in April 2009 he can no longer make AVC / PRSA AVC contributions in respect of that employment. So he cannot make an AVC / PRSA AVC payment in October 2009 and backdate to 2008. The AVC / PRSA AVC payment should have been made before he left service.

→ As John had no other source of income in 2008 he cannot to take out a personal pension and make contributions in October 2009 to claim against 2008 tax year.

A redundancy payment is not considered an income so cannot be used when calculating final salary for pension purposes.

Similarly a pension contribution cannot be set against the tax due on the taxable portion of a redundancy payment.

Company Pension Options on Leaving Service or on Wind-Up

The other thing to be considered by someone taking redundancy is what to do with their pension scheme. There are a number of options available.

1) Transfer to new employer company scheme:

If the employee has joined a new company pension scheme then they have the option to transfer their benefits from their previous employer to the new company scheme.

Alternatively if the company pension scheme with the previous employer is a one-man arrangement, the new employer can take over the scheme by completing a supplementary letter of exchange. The supplementary letter of exchange must be completed by the trustees of the old scheme as well as the trustees of the new scheme and by the member.

2) Transfer to Personal Retirement Bond (PRB):

The value of the company pension may be transferred to a Personal Retirement Bond (Buy Out Bond) in the employee's own name. This is a contract between the employee and the insurance company.

The options available at retirement will be the options that were available under the company pension scheme. So for example the tax free lump sum payable from the PRB will be the same as the tax free lump sum from the company pension scheme.

3) Transfer to a PRSA:

If the member has less then 15 years service in the company scheme with his employer (including service in all company schemes relating to that employer or any associated employer) then he can transfer his benefits to a PRSA.

Please note that Irish Life can only accept transfers from company pensions where

- the transfer value is less than €10,000, or
- the company pension scheme is wound up.

Where the company scheme is being wound up there is no limit on the amount of a transfer value Irish Life can accept into a PRSA. However the member must have less than 15 years service in total in any company pension scheme relating to that employer.

4) Early Retirement:

If the employee has reached age 50 then they can avail of early retirement and take their pension benefits immediately with the agreement of the employer and scheme trustees. Benefits payable will be those available under the company pension scheme on early retirement.

Alternatively if the employee has reached age 50 he could transfer his company pension to a PRSA (subject to certain restrictions, see point 3 above). The employee can then take 25% of the value as a lump sum immediately and transfer the balance to an annuity or AMRF/ARF. Another option is to leave the balance after taking the tax free lump sum in the PRSA. The balance in the PRSA effectively becomes an ARF or AMRF.

Note: If the employee makes a contribution to the PRSA after the transfer value has been applied then benefits cannot be taken until age 60, or until he retires from a subsequent employment.

5) Refund of pension contributions:

Where the individual has less than 2 years service in the scheme for retirement benefits (including service relating to any transfer paid into the scheme) then on leaving service they may receive a refund of their own contributions. The employer premiums will be refunded to the company.

Under the standard Irish Life scheme rules, it is the employee who decides whether they want to take a refund or not. It is not the employer's decision.

If the member opts for a refund of contributions, standard rate tax must be deducted. Any refund to the employer should be treated as a trading receipt in the books of the company and is subject to tax under Schedule D.

Note: This option is not available to 20% Directors.

6) Preserved Benefit
This only applies if the scheme is not being wound up.

Assuming the company is not being wound up and the pension scheme is remaining in place then the employee can leave their pension in the scheme and take the benefits once they reach retirement age.

Company Pension Scheme Wind Up

The trust deed and rules of the company pension scheme will usually lay out the circumstances in which the scheme can be wound up. An example of reasons would be,

→ the employer going into liquidation

→ the employer being bought out by another company and that company deciding not to continue to operation the company pension scheme.

This is not an exhaustive list; there are many other reasons why a company scheme would go into wind up.

The employer can wind-up the scheme by providing Irish Life with written confirmation of their decision to wind-up the plan. Irish Life will then look after notifying the Revenue Commissioners and the Pensions Board of this decision. The options on wind-up are the same as those above for leaving service, excluding preserved benefit.

Surplus of Assets

Under an Irish Life one-member company scheme a surplus of assets would only arise if the fund value exceeded Revenue maximum benefit limits. Should this happen then the surplus will be refunded to the employer.

For all other company pension schemes how the surplus is distributed will ultimately depend on the trust deed and rules. The surplus could be used to increase benefits for the member, be refunded to the employer or a combination of both.

Deficit of Assets – Defined Benefit Schemes

This section refers only to defined benefit schemes; there will never be a deficit on a one-member defined contribution scheme.

The Pensions Act lays out the order in which benefits must be secured in the event that the assets available from the defined benefit scheme are not enough to secure the required benefits for all members.

Benefits must be secured in the order of priority shown below.

1) Additional benefits secured by Additional Voluntary Contributions, and/or including AVCs transferred from another occupational pension scheme.

2) Pensions in payment and benefits for members who have reached normal retirement age.

3) Benefits relating to deferred members and current employees, including the non-AVC portion of transfer values from another occupational pension scheme.

Assets will be used to secure benefits under points 1 and 2 above before being used to secure benefits for deferred members and those still in employment. If there is a scheme deficit, then deferred members and current employees will only get a percentage of their entitlement.

If there are only assets available to secure benefits in respect of AVCs and pensions in payment, then these benefits will be secured in full and no other benefits will be available.

The trustees will go through the priority list and secure benefits in that order until all available assets are used up.

Insolvency Payments Scheme

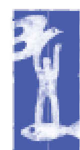
If the employer failed to make the required payments to the occupation pension scheme or a PRSA and the employer becomes insolvent then the lower of the following can be recovered from the Insolvency Payments Scheme;

- unpaid contributions for the previous 12 months, including employees' contributions not remitted to the scheme

or

- the amount required to clear the deficiency of the fund in a Defined Benefit scheme.

The application for payment of outstanding pension payments is usually made by the scheme trustees or the liquidator.



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