

Lump Sum Benefits and Commutation

Chapter 7

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General

7.1

This chapter sets out the maximum lump sum benefits that may be provided under an approved scheme. The level of lump sum benefits that is approvable is calculated by reference to an employee's length of *service* and *final remuneration* with the relevant employer.

Lump sum benefits must only be paid once, normally at the time of retirement (i.e. the date on which the pension becomes payable).

Please refer to [Chapter 25: Limit on Tax Relieved Pension Funds](#), as the payment of a lump sum benefit in excess of a specified monetary amount may trigger a tax charge.

Maximum Lump Sum Benefits

7.2

Lump sum benefits greater than 3/80ths of *final remuneration* for each year of *service* may be given on retirement at *NRA* in accordance with the table set out below provided that the aggregate of the value of non-pension retirement benefits in respect of *service* with the current employer and any *retained benefits* does not exceed 1.5 times *final remuneration*.

Years of <i>Service</i>	Eightieths of <i>final remuneration</i>
9	30
10	36
11	42
12	48
13	54
14	63
15	72
16	81
17	90
18	99
19	108
20 or more	120

Please refer to [Chapter 23.8](#) for details of the calculation of lump sum benefits for retiring employees taking “ARF options”.

Commutation Factors

7.3

If an approved scheme permits a retiring employee to commute pension up to the amount required to provide a lump sum within the permitted maximum, the reduction in pension must be commensurate with the amount of the lump sum. The relationship between lump sum and pension may be calculated on any one of the different bases explained below:

- (a) If it is desired that the relationship between lump sum and pension should not vary with age or sex or take into account any other considerations, the rules may provide for the same fixed relationship prescribed in [Chapter 6.4](#) for schemes with an independent lump sum, e.g. €1 of pension may be commuted for a lump sum of €9.
- (b) A scheme may use a specifically designed table that will be subject to actuarial review at intervals. Continued approval of the scheme will be dependent on the table being changed if any of the assumptions on which it is based have to be varied.
- (c) A scheme may provide for individual calculations by a qualified actuary for every commutation. These must be consistent with other calculations made for the same individual and for other purposes of the scheme having regard to changing financial conditions.

A uniform basis should apply to all members (subject to variations of age) of one scheme and to all schemes that have a substantial common membership.

Commutation factors fall within two broad categories depending on whether or not they take account of the value of any entitlement to cost of living post-retirement increases on the pension. Factors that do take account of such increases are commonly referred to as 'enhanced' and are not appropriate to a scheme giving no such entitlement (but see below in relation to schemes which provide for regular reviews and an expectation of resultant increases).

For schemes not using enhanced factors, commutation factors in the range 10.2 to 11.0 at age 60 and 9.0 to 9.8 at age 65 may be used for members. Values for other ages within the acceptable range for normal retirement may be calculated by adding or subtracting 0.02 per month of age difference. The factors are acceptable whether pensions are guaranteed for 5 or 10 years or not guaranteed at all, irrespective of whether payments are in advance or in arrears and regardless of the frequency of payments.

If the rules of the scheme provide for pensions to be reviewed regularly and increased (within the limit of the rise in the cost of living) at the discretion of the employer or trustees if funds permit, enhanced commutation factors may be used provided that a certificate by an actuary is furnished stating the anticipated percentage rate of future increases on the basis of the current annual contributions without taking into account any future special contributions which the employer might make.

The pension equivalent of a lump sum taken from a defined contribution scheme is determined by application of the annuity rate used to determine the balance of the pension.

Where scheme rules permit the application of enhanced commutation factors and where post-retirement increases are not applicable on commuted pensions, the commutation factor may be calculated by reference to current open market annuity rates despite the amount of pension prior to commutation not being dependent on open market annuity rates.

Trivial Pensions

7.4

An approved scheme may permit full commutation of a pension if the aggregate benefits payable to an employee under that scheme and any other scheme relating to the same employment do not exceed the value of a pension of €330 per annum. Pensions for spouses, civil partners and *dependants* may also be commuted at the same time as commutation of the member's pension if they are independently trivial. If commutation of part of a greater pension than €330 per annum leaves a residual pension within the triviality limits then this residual pension may not then be commuted on triviality grounds.

In a defined contribution context, for the purposes of establishing whether or not benefits come within the triviality limit, the calculation should be based on the cost of a single life annuity with no escalation.

The 10% tax rate under section 781(3) Taxes Consolidation Act 1997 also applies where members' pensions are fully commuted on the grounds of triviality. The chargeable part of the payment may be calculated in the same manner as indicated for lump sum payments under the section dealing with serious ill-health (see paragraph 7.5). However, when calculating the maximum commutation (in the context of triviality), potential service should not be taken into account.

Where a trivial pension is a deferred pension, it may not be commuted until it begins to be payable. Furthermore, if such a pension is secured by an annuity contract or a policy which has been bought in the name of the employee, or assigned to the employee, because the scheme has been wound up or the employee has left service, commutation will be possible only if satisfactory arrangements have been made with the Life Office concerned for payment out of the policy proceeds of any tax due. For the purposes of the €330 limit, a deferred pension will be that pension as increased by virtue of the preservation requirements of the Pensions Act, 1990.

The treatment described above in relation to the commutation of trivial pensions may also be offered in the same circumstances to holders of RACs and PRSAs.

As an alternative to the above, and with the agreement of the scheme beneficiary and trustees, there is no objection to the payment of once-off pensions. This may take place

where the total of all funds available for pension benefits, following payment of any lump sum benefit, is less than €20,000. The quantum of retirement benefits from all sources must be taken into account for the purpose of calculating the €20,000 limit. In a defined benefit context, the pension benefit needs to be converted to a fund value to determine if the benefits are within the €20,000 limit. This should be done by reference to the scheme commutation factors. The rates of tax, USC and PRSI to be applied are those that apply to any other pension payment. Prior Revenue approval is not required.

The above option may be offered to all scheme members, including buy out bond holders, and also to RAC and PRSA holders who do not satisfy the specified minimum income requirement, as an alternative to annuity purchase/investment in an AMRF where the fund is less than €20,000.

The above treatment may also be applied to residual funds available to secure spouses', civil partners' and dependants' pensions.

Pension adjustment orders

7.4.1

Where benefits are payable under a pension arrangement in respect of which a pension adjustment order (PAO) has been made in favour of a non-member spouse or civil partner, the requirements described above may be applied to the separate entitlements of each party under the arrangement (having regard to the PAO) to determine if they independently satisfy the trivial "once-off pension" options.

Serious Ill-Health

7.5

An approved scheme may include a rule that permits for commutation of a pension if at the time it becomes payable the recipient is in "exceptional circumstances of ill-health". This phrase is to be interpreted strictly and narrowly. It is not intended to refer to the kind of ill-health which prevents somebody from working but to cases where the expectation of life is unquestionably very short. In other words, commutation on these grounds should not take place unless the administrator has been satisfied by receipt of adequate medical evidence that terminal illness is in point and that the expectation of life is measured in months rather than years. Whether a particular individual is in this position is a matter for decision by the administrator (with the exception of cases involving 20% directors and members of small self-administered schemes which should be reported to Financial Services (Pensions), Large Cases Division) but the inclusion of a rule on these lines in an approved scheme is accepted on condition that it will be interpreted invariably in this sense.

To arrive at the taxable part of the payment, there may normally be deducted an amount (inclusive of the aggregate of any lump sums already permitted) not exceeding 3/80ths of the employee's *final remuneration* multiplied by the number of years of *service* with the relevant employer. In this context *final remuneration* will, irrespective of any definition in the rules, be taken as the average annual remuneration of the last 3 years' *service* (clearly

this deduction will frequently eliminate any tax liability where a trivial pension is commuted). The rate to be applied is 10%.

An alternative deduction in arriving at the taxable part of the payment is the largest amount which could have been received apart from the special circumstances i.e. the triviality of the pension or the employee's exceptionally serious *ill-health*. In calculating the largest amount one must look at the rules of the particular scheme; if it is one that does not permit commutation except on serious *ill-health* grounds for the category of employee concerned, or ordinarily restricts the lump sum to $3N/80$ or some lower amount, then no alternative deduction can be made. Where the rules leave the trustees or the employer discretion to determine (within approvable limits) to what extent an employee may normally commute his pension, or to increase the lump sum part of the benefits, it may be assumed for the purpose of calculating the tax charge that they would have exercised their discretion to permit the maximum lump sum.

Example

An employee with 40 years potential *service* retires 10 years early because of serious illness as a result of which his life expectancy is extremely short. His final salary is €12,000, but the average of the last 3 years is €10,800. The actuarial value of the amount of his pension is €54,000, payment of which sum is, in the circumstances, permitted under the rules of the scheme. The general rule of the scheme permitting commutation specifies that every employee may have a lump sum of $3/80$ ths of *final remuneration* (defined in the scheme rules so as to include remuneration for the final 12 months' *service*) for each year of *service*.

Section 781(1)(i) permits an automatic deduction of

$$30 \times 3/80 \times €10,800 = €12,150$$

but Section 781(1)(ii) which applies in this case increases the permitted deduction to

$$30 \times 3/80 \times €12,000 = €13,500$$

Tax at 10% will therefore be charged on €54,000 less €13,500 = €40,500.

If the general rule of the scheme had given the scheme trustees discretion to approve, in normal circumstances, commutation of a greater amount, (see paragraph 7.2) the deduction under Section 781(1)(ii) would have been increased to

$$120/80 \times €12,000 = €18,000$$

(leaving tax to be charged on €36,000 of the commutation payment) since it is proper to take account of the fact that the employee is retiring on grounds of incapacity, and that the maximum lump sum would have been based on his 40 years potential *service* (see paragraph 9.4) rather than his 30 years actual *service*.

7.6

Where the scheme provides for a lump sum 3N/80ths of *final remuneration* separately from the pension (and not in commutation of it), and the pension itself is commuted, e.g. because the employee is seriously ill, the whole of the commutation payment will be chargeable to tax.

Lump sums receivable by way of commutation in special circumstances of pensions under two or more separate schemes relating to the same employment are to be aggregated for the purposes of determining the taxable part.