



Eolas
Money

Termination payments and pension lump sums

In this post, we look at the interaction of taxable termination payments and pension lump sums.



Termination payments

A lump sum payment by an employer on the termination of an employee's service is generally liable to PAYE but with some exemptions.

Termination payments not liable to income tax

The following lump sum benefits which an employee may receive on termination of employment are **not** liable to income tax:

- A lump sum taken on retirement from the employer's approved pension scheme which is within the €200,000 limit on all pension lump sums taken since 7 December 2005;
- Statutory redundancy payment where the employee has worked for that employer for at least two years; the payment is 2 weeks for each year of service (and portion of a year's service) plus one week's pay, with pay limited to €600 per week before taxes (€31,200 per annum)
- An ex gratia payment made by the employer on account of injury or disability of the employee which gives rise to the termination of employment, up to a personal lifetime limit of €200,000 for such payments. These payments do not reduce the €200,000 tax free limit referred to below for normal ex gratia termination payments

Any other lump sum payments made by the employer on termination of service are generally taxable, although part or all of such lump sums may be tax free as explained below, if the payments were not provided for in the contract of employment, i.e. are ex gratia.

Example

Joe has worked for 15 years and 3 months with his employer and is now being made redundant. His weekly gross earnings are €850 per week.

His statutory redundancy payment is:

$$(2 \times 15.25 + 1) \times €600 = €18,900$$



Ex gratia termination payments exempt from income tax

An ex gratia termination payment may be exempt from income tax, USC and PRSI, up to the higher of the following three amounts, within an overall lifetime limit of €200,000 on all tax free ex gratia termination payments from all sources:

Basic exemption

€10,160 plus €765 for each **complete** year of service

Example

Alice's employment is being terminated after 24 years and 7 months. Her basic exemption is:

$$€10,160 + €765 \times 24 = €28,520$$

The basic exemption applies in all cases and is not impacted by whether the individual also has an entitlement to a tax free

Increased basic exemption

The basic exemption plus up to €10,000, provided the individual has not received a tax free termination payment within the last 10 years and has no right to a lump sum under a pension scheme related to this employment, or has waived their right to such a lump sum.

Where the individual has a right to a pension lump sum whose present value is less than €10,000, the €10,000 on the basic exemption is reduced by this amount if not waived.

Standard Capital Superannuation Benefit (SCSB)

This is calculated as:

$N/15 \times$ (average annual Schedule E remuneration from that employment over last 36 months to termination of employment). Note that the remuneration taken is **before** the deduction of any employee pension contributions.

Less

the value of any **tax free** pension lump sum received or receivable under a pension scheme related to this employment, where **N** = number of **complete** years' service to the date of termination of employment

Standard Capital Superannuation Benefit (SCSB) continued

If the individual **signs a waiver** giving up their right to take a tax free lump sum from their employer's pension scheme, there is no offset against the $N/15$ ths of average annual remuneration, i.e. the SCSB is $N/15$ ths $\times$ (average annual Schedule E remuneration from that employment over last 36 months to termination of employment).

Where the individual **does not sign a waiver** giving up their right to take a tax free lump sum from their employer's pension scheme:

- the SCSB is reduced by the actual tax free lump sum received where the individual is taking early retirement and drawing on his or her retirement benefits immediately on termination of employment; or
- where the individual does not take the tax free lump sum immediately, for example, maintains a preserved benefit in the scheme, the SCSB is reduced by the actuarial or **present value** of the tax free pension lump sum receivable in the future. In this case the future tax free pension lump sum will usually be calculated on the salary/service basis, i.e. under the traditional benefit option

In most cases, the highest exemption will be a straight 'shoot out' between:

- SCSB1, not signing the waiver** leading to a lower tax free lump sum now, but holding onto the right to take a tax free lump sum from the employer's pension scheme either now or in the future; and
- SCSB2, signing the waiver** and getting a higher tax free lump sum now but with no tax free pension lump sum now or later from the employer's pension scheme.

Examples

There are a few points to note about the choice of signing the waiver or not:

- If the **taxable termination payment is less than SCSB1**, it makes no sense to sign the waiver as the full termination payment is tax free anyway without signing the waiver

Example 1

Taxable termination payment: €50,000

- SCSB1 assuming waiver is not signed: €70,000
- SCSB2 assuming waiver is signed: €100,000

There is no benefit in signing the waiver as the SCSB1 from not signing the waiver, i.e. €70,000, already covers the full taxable termination payment.

- If the **taxable termination payment is between SCSB1 and SCSB2**, signing the waiver will increase the tax free termination payment, but by less than the value of the tax free lump sum given up

Example 2

Taxable termination payment: €70,000

- SCSB1 assuming waiver is not signed: €50,000
- SCSB2 assuming waiver is signed: €90,000, i.e. the value of the tax free pension lump sum is €40,000

Signing the waiver increases the tax free termination payment by €20,000, i.e. from €50,000 to €70,000, but the individual has given up the right to take a tax free pension lump sum valued at €40,000. Signing the waiver in this case may be bad value for money for the

- If the **taxable termination payment is greater than SCSB2**, signing the waiver exchanges the value of the tax free pension lump sum given up for an equivalent amount of additional tax free termination payment

Example 3

Taxable termination payment: €95,000

- SCSB1 assuming waiver is not signed: €60,000
- SCSB2 assuming waiver is signed: €90,000, i.e. the value of the tax free pension lump sum is €30,000

In this case signing the waiver increases the tax free termination payment by €30,000, from €60,000 to €90,000, i.e. the value of the €30,000 tax free pension lump sum given up. If the tax free pension lump sum is deferred whether it makes sense to sign

Lifetime limit

The **maximum ex gratia termination payments which can be received tax free in a lifetime are €200,000**. If an individual has already taken prior tax free termination payments and their total taxable termination payments will be over €200,000, signing the waiver may not make financial sense as the individual may give up the right to take a tax free pension lump sum but not increase their tax free termination payment at all or increase it by a lesser amount than the tax free pension lump sum given up.

Example 4

Taxable termination payment: €115,000
Prior taxable termination payments received from other employments: €150,000. Remaining tax free termination payments limit: €200,000 less €150,000 = €50,000.

- **SCSB1 assuming waiver is not signed: €60,000**
- **SCSB2 assuming waiver is signed: €90,000, i.e. the value of the tax free pension lump sum is €30,000.**

The maximum tax free termination payment from this employment is

Only tax-free pension lump sums are offset against SCSB

An individual might have a lump sum entitlement under their employer's scheme which is not offset against their SCSB even if the waiver is not signed, i.e. where the lump sum will be all subject to standard rate tax. This could happen where the individual has already used up their €200,000 tax free pension lump sum limit by taking lump sums from other arrangements not linked to this employment. This works because the offset against the SCSB only applies to 'tax free' lump sums from the employer's scheme, and ignores pension lump sums taxable at standard rate.

Example 5

Client had RACs and PRSAs related to other employments and self employment of €900,000. He matured them last year and took the maximum lump sum of €225,000, of which €200,000 was tax free. He is now taking a taxable termination payment from his current employer and will have a pension lump sum from his employer's scheme of €250,000, all subject to standard rate tax.

Taxable ex gratia termination payment

Where part of a termination payment is taxable, after allowing for the exempt part, the balance is liable to income tax and USC, but not to PRSI.

Interaction between the two €200,000 tax free limits

Confusion can sometimes arise as to whether you can get a €200,000 tax free pension lump sum and another €200,000 tax free ex gratia termination payment from the same employer? Yes, it's possible because the maximum tax free pension lump sum offset against the SCSB is €200,000, so that if the SCSB is at least €400,000 then the individual may be able to get another €200,000 tax free termination payment.

However this 'double' only happens where the individual has very high earnings and long service.

Example 6

Service to date of termination: 20 years

Average annual earnings over last 3 years to termination of employment: €400,000

Value of tax free pension lump sum: €200,000; waiver will not be signed.

$SCSB = 20/15 \times €400,000 - €200,000 = €200,000$

So the 'double' is possible but happens very rarely because of the high earnings and long service required to pull it off.

The double can also be obtained where €200,000 of tax free pension lump sums have been taken from other arrangements not related to this employment, so that the individual can

potentially get a €200,000 tax free termination from his or her current employment.



Get all the information

It is crucial when providing advice to individuals receiving termination payments to get all the required information including in particular:

- the detailed calculations of the termination payment offered, including the split of the termination lump sum between statutory and ex gratia;
- a copy of the retirement benefits options on termination of employment including the deferred and immediate tax free lump sum under the employer's scheme following termination of employment, and the present value of the deferred tax free lump sum where retirement benefits will not be taken immediately;
- details of any other tax free pension lump sums and/or ex gratia termination payments the individual has previously taken.



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