SELF-DIRECTED TRUSTS (PENSIONS)

A SIMPLE GUIDE

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CHARTERED ACCOUNTANTS

What is a Self-Directed Trust?

A Self-Directed Trust is a variation of the conventional occupational pension scheme. Each Self-Directed Trust is separately approved by the Revenue as a tax-exempt scheme. Unlike traditional pensions from an insurance company however, there is complete control and flexibility over the selection of investments. For example it is possible to invest directly in all types of property or equities. All gains and profits arising from these investments within the fund are taxfree.

Who can set up a Self-Directed Trust?

It is suitable for proprietary directors or indeed any employee with the ability to invest, say €12,000 per annum. There must be an employer/employee relationship so it is not suitable for sole traders or partners.

What advantages does a Self-Directed Trust have over traditional pensions?

It allows significantly greater contributions than personal pensions and offers the individual personal choice in the type of asset to be invested in by the scheme. Unlike traditional insurance company pensions there are no financial penalties if you reduce your contribution or fail to make a contribution in any given year. Flexibility is a key component of Self-Directed Trusts both in term of contributions and investment options. In terms of wealth management and exit planning the ability to transfer business profits to a personal trust and ultimately onward to the next generation in a tax efficient manner is a key factor.

How does a Self-Directed Trust benefit my Company?

From a company perspective there are decided advantages to setting up a Self-Directed Trust. All monies transferred to the scheme are tax deductible and the amounts transferred can be varied on a yearly basis to suit the financial circumstances of the company.

There are no entry/exit penalties or hidden charges and the individual can therefore obtain better value for money and a larger pension fund as a result. The Self-Directed Trust can also be used as part of a very tax efficient business exit strategy where a proprietary director is leaving the business.

How does a Self-Directed Trust benefit a proprietary director?

While a Self-Directed Trust can be established for any employee it is particularly attractive for proprietary directors. A booming economy has seen a substantial increase in profits for a large number of companies. Proprietary directors therefore have been seeking ways to move these profits out of the company in a tax efficient manner. A Self-Directed Trust is the most efficient way to transfer company profits into personal capital.

The Self-Directed Trust is established on behalf of a proprietary director who then controls its investment. The proprietary director has effectively got the freedom to invest that they would have if they were acting in their own name. If you, as a Proprietary Director, wished to have an equity holding in certain companies or if you wished to purchase a specific property you would be able to do so through your Self-Directed Trust. You have control over how your pension trust is invested and may change the investment mix over time to suit your changing circumstances. The proprietary director benefits from the following tax breaks:

- All transfers by the company to the trust are tax deductible to the company.
- The proprietary director is not liable to tax in respect of these transfers.
- All capital gains generated by the trust are tax-exempt.

- All income received by the trust is tax exempt.

- When you retire you can take out 25% of the fund tax-free and move the balance to a further tax-exempt fund.

You and your family are the sole beneficiaries of the trust. In the event of the company being liquidated, the scheme is protected from the company's creditors.

How do I establish a Self-Directed Trust?

A separate legal entity called a trust is established with a trust deed and trustees. Revenue approval is then sought for the trust which, when received, will confer tax-exempt status to the trust. The consent of the employer is required to establish a trust.
Typically a trust will have two trustees – a Pensioneer Trustee and an ordinary trustee, sometimes called the Additional Trustee. It is common for you the beneficiary to act as the ordinary trustee as this gives you complete control over the movement of funds and the placing of investments.

Why a Pensioneer Trustee?

It is a Revenue requirement that one of the trustees appointed will be a Pensioneer Trustee. This person, a pre-approved pension expert, ensures the scheme operates in accordance with Revenue regulations. The Pensioneer Trustee undertakes not to terminate the trust except in accordance with the terms of the approved winding up provisions. In effect the Pensioneer Trustee ensures a person can't "take the money and run". We have appointed Independent Trustee Company, Ireland's leading provider of trustee services, to act as Approved Pensioneer Trustees on behalf of our clients.

How much can I contribute?

The amount of an individual's contribution varies according to their age, salary, years of service and the amount of pension assets they have already accumulated. However as a rough guide you will be allowed to contribute approx. 150% of your salary at age 40 and approx. 250% if you are aged 50. These percentages increase significantly thereafter. So if you are aged 50 on an annual salary of €150,000 you will be allowed an annual contribution of approx. €375,000. There is no ceiling on earnings imposed by the Revenue when calculating contributions to an Self- Directed Trust.

Can the Trust borrow?

Yes. Recent legislative changes now allow pension trusts to borrow. Banks are currently lending using normal lending criteria.

What can I invest in?

Pension schemes through an insurance company normally only give the individual access to those products offered by that particular insurance company and the individual has no influence on the investment strategy adopted by the fund manager. A Self-Directed Trust, however, gives the individual access to a far wider range of investment opportunities and control over the trust's investment policy. A Self-Directed Trust can invest in property, both residential and commercial, private companies, equities, gilts, tracker bonds, deposit accounts and managed funds etc.

Are there any restrictions?

There are two restrictions imposed by the Revenue:

1. Self dealing

The main restriction on the investment by Self-Directed Trusts is on self-dealing i.e. the trust cannot sell, or lease to, or buy from the company the beneficiary or his immediate family. The logic behind this restriction is obvious. Given the extremely valuable tax breaks available it is important for the Revenue to ensure that all transactions are accruing on an arms length basis.

2. Pride in Possession articles

Fine wines, vintage cars, works of art, yachts etc. are prohibited investments Arms length and transparency are key words with regard to investments. You must look beyond your immediate company and family for your investments or run the risk of falling foul of Revenue regulations and losing your tax exemptions. Your Pensioneer Trustee will guide you in this regard.

When can I access funds?

The normal retirement age is usually age 60 and funding projections will be based on this. At age 60 you may draw down your benefits and continue to work for the employing company. However, you may access your benefits from the age of 50 but you **must** retire from the employing company. You may continue to work for a different company if you wish. You may retire due to ill health at any age.

What options have I on retirement?

There are 3 options available to you on retirement.

Option 1

On retirement you can immediately take 25% of the value of your pension fund as a tax-free cash payment and transfer the balance into an Approved Retirement Fund (ARF). The ARF can continue to invest in a range of assets similar to the Self-Directed Trust. The profits and gains within an ARF are non-taxable, however withdrawals are subject to income tax.

Option 2

You can take out the 25% tax-free lump sum and purchase an annuity with the balance.

Option 3

You can take out the 25% tax-free lump sum and encash the rest – subject to a minimum amount remaining in your ARF until you are 75.

What about passing on the assets to the next generation?

An ARF inherited by children over 21 will be exempt from Inheritance Tax but is subject to PAYE at 20%. An ARF inherited by children under 21 is exempt from Income Tax but is potentially liable to Inheritance Tax. It is therefore a very tax efficient way of passing on wealth to the next generation.

What happens if I die before retirement?

In the event of your untimely death your beneficiary can immediately take 4 times your salary as a tax-free lump sum. In most cases this will absorb the full value of the fund unless you are close to retirement. A pension benefit product can be purchased with any surplus monies in the fund.

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