

Pension Post

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For financial advisers only

Gross v net income replacement in retirement

In this issue of Pension Post, Tony Gilhawley, Technical Guidance Ltd, looks at how the over 65's get a lot of tax benefits and reliefs on their income. As a result their net income in retirement does not fall by as much as their gross income.

Tax benefits for the over 65's

When a client hits age 65, and later when they pick up the State Pension, a number of tax reliefs and benefits kick in:

- An additional age tax credit of €245 per person; for a married couple this amounts to an additional €490 tax credit
- Income tax exemption if total income (including the State Pension) is less than €18,000 pa for a single person or €36,000 for a married couple. Even if the client's income goes over this figure, there is marginal relief on income up to double the limit, which can reduce the client's income tax bill
- No USC on the State Pension
- A reduced rate of USC of 2.0% for the over 70's whose income (other than the State Pension) is less than €60,000 pa
- No PRSI on the State Pension, private pensions and annuities. PRSI applies to ARF and AMRF withdrawals but only up to age 66 currently

Net income replaced

The resulting tax savings for the over 65's can be significant.

Take an example of a married couple, one income. Let's take a 50% target gross income replacement in retirement, inclusive of the State Pension (Contributory) at the assumed maximum rate of €248.30 pw¹, so that the balance of retirement income will come from private pensions, annuities and/or ARF/AMRF withdrawals:²

Married couple, one income

Under 65								
Gross income (100%)	€50,000	€60,000	€70,000	€80,000	€90,000	€100,000	€110,000	€120,000
IT, USC & PRSI	€9,763	€14,613	€19,463	€24,661	€29,861	€35,061	€40,261	€45,461
Net income	€40,237	€45,387	€50,537	€55,339	€60,139	€64,939	€69,739	€74,539

Over 65								
Gross income (50%), inclusive of State Pension	€25,000	€30,000	€35,000	€40,000	€45,000	€50,000	€55,000	€60,000
IT, USC	€0	€160	€260	€1,960	€4,060	€6,160	€8,260	€10,360
Net income	€25,000	€29,840	€34,740	€38,040	€40,940	€43,840	€46,740	€49,640
Net income replacement	62%	66%	69%	69%	68%	68%	67%	67%

A few surprising facts emerge:

- A 50% gross income replacement in retirement is more like 2/3rds net income replacement, when allowance is made for the various tax reliefs and benefits applying to retirees over age 65
- The retiree in this example above only starts to pay taxes when their retirement income (inclusive of the State Pension) exceeds €26,000 pa. Up to that level of retirement income, they pay no taxes at all on their income
- €60,000 income for a working couple under age 65 gives rise to a total tax liability of €14,613; however a retired couple over age 65 with €60,000 income (inclusive of the State Pension), pays taxes of €10,360 pa, or some €4,253 pa less than the under 65 couple with the same income

¹ i.e. max personal rate. No Qualified Adult increase assumed.

² No PRSI is assumed and the lower 2% USC rate is assumed to apply throughout.

2 Gross v net income replacement in retirement

The figures for a single person are broadly similar:

Single person

Under 65								
Gross income (100%)	€50,000	€60,000	€70,000	€80,000	€90,000	€100,000	€110,000	€120,000
IT, USC & PRSI	€12,913	€17,763	€22,613	€28,259	€33,909	€39,559	€44,846	€50,046
Net income	€37,087	€42,237	€47,387	€51,741	€56,091	€60,441	€65,154	€69,954

Over 65								
Gross income (50%), inclusive of State Pension	€25,000	€30,000	€35,000	€40,000	€45,000	€50,000	€55,000	€60,000
IT, USC	€1,455	€2,616	€3,716	€5,756	€7,856	€9,956	€12,056	€14,156
Net income	€23,545	€27,384	€31,284	€34,244	€37,144	€40,044	€42,944	€45,844
Net income replacement	63%	65%	66%	66%	66%	66%	66%	66%

Conclusion

Assuming the current taxation system remains broadly as is, retirees over 65 will benefit from a significant reduction in taxes on their income. This means that a 50% target gross income replacement in retirement will replace about 2/3rds of net income, the difference being the tax 'bounce' which the over 65's get.

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