

Opportunities with overseas pensions

Part 1

June 2010

We've previously explained the basics of Qualifying Recognised Overseas Pension Schemes (QROPS) and how they offer certain tax benefits and flexibility for pension benefits transferred from the UK for those emigrating or expecting to do so. Following a number of developments in overseas pensions, including recently enacted legislation, this article sets out the key planning opportunities associated with overseas pensions and points to consider.

The legislation relating to QROPS and other types of overseas pensions is in the Finance Act 2004 but has since been augmented by The Inheritance Tax (Qualifying Non-UK Pension Schemes) Regulations [SI 2010 /0051] which came into force on 15 February 2010 and introduced the concept of Qualifying Non UK Pension Schemes (QNUPS), more of which later.

QROPS basics

The key features of a QROPS which will meet the requirements of UK legislation are as follows, regardless of whether the member is a UK resident or not:

- It is established in a jurisdiction outside of the UK, which allows membership to local residents and has a system of personal taxation and tax relief on pension contributions;
- The scheme rules provide that no less than 70% of the residual fund must be used to provide retirement 'income' benefits to the member no earlier than age 55 but no later than age 75 or for his/her dependants;
- The scheme administrator must report to HMRC any payment of benefits or transfer value while the member is a UK resident and for five tax years after they cease to be a UK resident (although certain QROPS must report certain transactions to HMRC beyond this time regardless of residence status);
- The lifetime limit ceases to apply to benefits held within the QROPS, although benefits will be tested against the member's lifetime limit (currently £1.8M) at the time they are transferred to the QROPS;
- Lump sum death benefits arising from pre-retirement funds (i.e. those from which no lump sum and/or income benefits have been provided) are not subject to any UK tax charge.

In addition to the above factors, for those who are **UK resident**, or have been so in any of the previous five complete tax years:

- Any lump sum death benefits arising after retirement benefits have been taken would incur a UK tax charge of 35% regardless of age;
- Pension options both before and after age 75 are broadly similar to those for UK pension schemes.

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- For those who are **not UK resident** and have not been so in any of the previous five complete tax years:

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- Any lump sum death benefit arising either before or after age 75 would be free of UK tax charge thus saving 35%;
- Pension benefit options are more flexible. In addition to taking a lump sum of 25%, income can be provided, whether before or after age 75, by either an annuity, income withdrawal (based on factors prescribed by the UK authorities) or income based on a 'Properly Valued' (PV) basis. The PV basis allows an income to be withdrawn from the fund which is, typically, 50% higher than that allowable under UK pension plans for most ages.

Other considerations

Her Majesty's Revenue and Customs (HMRC) are taking an interest in overseas pensions in general and QROPS in particular. QROPS schemes which HMRC judge to be 'abusive' are attracting most attention and investors would do well to avoid schemes which: promote the possibility of taking 100% lump sums; are 'sham' occupational schemes; promoted to UK residents with no intention to leave; provide lending associated with but not charged on the pension fund; or which fail to report to HMRC within the required 5 year period.

There are a number of other points to bear in mind when considering a transfer of a UK pension to a QROPS based outside of the European Economic Area (EEA). Firstly, any transfer of UK sited property assets which generate rental income will immediately become subject to income tax at the rate applicable to trusts, which for 2010/11 is 50%. You either need to dispose of any UK rental property before transferring or use a QROPS based somewhere within the EEA which is also tax friendly to the country of which you intend to become resident.

Secondly, you need to check how your future country of residence taxes QROPS. The tax treatment may well be affected by where your proposed QROPS is based with non-EEA countries subject to more extensive rules and potential risks. Some advisers think that an EEA based QROPS is less vulnerable to attack by the UK tax authorities and virtually impossible for them to remove qualifying status, as European legislation provides over-riding protection for free movement of capital between member states.

Thirdly, some QROPS jurisdictions are more developed than others with places like Guernsey considered a well developed, stable and well regulated QROPS location with nil taxation for non-resident QROPS members. Hong Kong has a similar tax treatment for non-resident QROPS members, although the amount of tax free cash is not guaranteed. The Isle of Man (IOM) has a developed QROPS market but levies income tax at 20% on QROPS income (with no personal allowance) and a death duty of 7.5% of fund value. However, for those who have been non-UK resident more than 5 tax years IOM QROPS permit up to 30% to be taken as tax free cash.



Luxembourg and Gibraltar both offer QROPS, and Malta (which is an EEC country) has now passed all necessary legislation to enable QROPS providers to operate. Finally, and possibly most importantly, you need to determine whether your potential provider's QROPS is 'investment regulated' or not. The reason for this will become clear so read on.

From QROPS to QNUPS

The Inheritance Tax (Qualifying Non-UK Pension Schemes) Regulations [SI 2010 /0051] referred to earlier were enacted on 15 February 2010 and retrospective to 6 April 2006. and introduced QNUPS. These regulations now mean that any individual may transfer UK pension rights to a QROPS and upon death, whether before or after age 75, no Inheritance Tax liability arises. There are a few other implications arising from these new regulations which relate to investment rules associated with one form of QROPS and a restriction on the tax relief available on pension contributions to high-earning UK residents.

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For an overseas scheme to be treated as a QNUPS it must satisfy the same conditions necessary for a Recognised Overseas Pension Scheme (ROPS) (SI 2006/206) with the important exception that there is no necessity for there to be Double Taxation Treaty (DTA) with the overseas scheme's jurisdiction if the scheme is outside of the European Economic Area. A DTA is not necessary because there are no reporting requirements from the QNUPS to HMRC. The outcomes are that a QNUPS benefits from **UK IHT exemption** in respect of UK tax-relieved pension funds that have been transferred to a QNUPS, or contributions made to a QNUPS and assets held by a QNUPS generally. A QROPS will by definition be a QNUPS, but a QNUPS need not be a QROPS. A QNUPS (which is not a QROPS), is a potential home for UK pension funds which were originally transferred to a QROPS. A QNUPS (which is not a QROPS) need have **no specific investment restrictions** and may, for example, invest in residential property, fine wine etc. But the key to this is transferring from the QROPS to a QNUPS. As pointed out earlier, we need to differentiate between "investment regulated" and "non-investment regulated" QROPS. This is because regulations [SI 2006 / 207] which relate to investment in certain assets such as residential property, fine wines, antiques etc., known as 'taxable property', extend UK investment rules to some QROPS. If the QROPS is "investment regulated" then the rules provide for a 70% tax charge where investment is made into taxable property out of UK pension funds which have been transferred to the QROPS.

Know your RTF from your TATF!

The regulations state that a transfer of a UK pension to a QROPS is a 'Relevant Transfer Fund' (RTF). This means that one has to determine whether the QROPS fund comprises what is known as a 'Taxable Asset Transfer Fund' (TATF). If UK pension benefits have been transferred to an 'investment regulated' QROPS since April 2006 then they will be treated as a TATF.



So why does it matter if a QROPS fund is treated as a TAFT? Well in the words of HMRC's own manual "A payment to a transfer member has to be **notified to HMRC regardless of whether or not they have been non-resident for more than five tax years** if it is deemed to have been made from their Taxable Asset Transfer Fund" (RPSM14101070). An investment-regulated QROPS means that the member is able to direct influence or advise the investments made. Most Guernsey QROPS have concluded that they are not investment regulated. Some have not declared their hand and one considers the distinction to be "immaterial". New Zealand QROPS are not investment-regulated pension schemes. Some Hong Kong QROPS have taken the same view. The same is likely to apply to schemes in Gibraltar, Isle of Man and Malta.

The safest approach would seem to be to assume that all QROPS providers are investment regulated, unless they can categorically demonstrate that they are not. A careful review of the scheme rules will determine the investment powers available to the member, and whether they amount to 'direction, influence or advice of investment of the fund. Interestingly a member can 'recommend' investments or strategies to the trustees, who may accept or reject such recommendations, without falling within the meaning of the 'investment regulated pension' rules.

It would appear that maximum flexibility would be provided by only transferring UK pension funds to a QROPS which is not investment regulated. Although it was originally thought that taxation consequences for the member relating to the TATF would only apply if the funds were used to acquire taxable property such as residential property etc., HMRC has indicated that a transfer from an investment regulated QROPS to another overseas scheme which is not a QROPS is reportable irrespective of time, is not a recognised transfer and is taxable at 55% on the member. If, however, a transfer is made from a QROPS which is not investment regulated


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to a QNUPS this transfer is not reportable beyond five complete tax years of non-UK residence, is not a recognised transfer but, is not taxable on the member. So if it is planned to use UK source pension funds to acquire taxable property in the future (residential property etc.), then it is best to transfer to a QROPS which is not 'investment regulated'. Once the QROPS scheme member has been outside of the UK for five complete tax years a transfer of the QROPS to a

QNUPS should be contemplated. The QNUPS should be to an identical scheme which is a complying QNUPS and which has not been registered with HMRC as a QROPS. After such a transfer TATF status no longer applies and there is no HMRC reporting. But it is important to remember that it is only a non-investment regulated QROPS that can transfer to a QNUPS without a 55% unauthorised payment charge.

QNUPS for UK high earners

From 6 April 2011, individuals in the UK earning over £150,000 p.a. will have limitations on fully tax-relieved pension contributions. These provisions are being introduced as the highest rate of income tax on earned income rises to 50%. Some will receive full income tax relief only on the first £20,000 of pension contributions and only 20% relief on the rest. A UK resident may contribute to a QROPS (also a QNUPS) or to a QNUPS (not a QROPS) but will not receive tax relief on the contributions.



Overseas pensions are evolving and becoming more established. Despite the UK tax authorities' desire to extend its reach around the world, the reality is that overseas pension arrangements which are properly constituted and follow the letter and the spirit of both UK and EU legislation, can be completely removed from the UK tax net for those genuinely leaving the UK.

For further information please get in touch with your usual Bloomsbury contact, telephone 0207 194 7830 and ask for a member of the wealth team or alternatively e-mail info@bloomsburyfp.co.uk.

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