Spring Budget 2017—qualifying recognised overseas pension schemes

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Pensions analysis: The government has introduced a charge on transfers to qualifying recognised overseas pension schemes (QROPS). Nigel Sloam, senior partner at Nigel Sloam & Co Actuaries and Consultants, and Liz Fallon, partner at Eversheds Sutherland, discuss the proposed changes.

Why is the government introducing a charge on transfers for QROPS?

Nigel Sloam (NS): The government's stated objective in the policy paper entitled 'Qualifying Recognised Overseas Pension Schemes: charge on transfers' and published on 8 March 2017, is that this measure has been introduced to support 'the government's objective of promoting fairness in the tax system'. It is added that the measure:

'…continues to allow overseas transfers from pension schemes that have had UK tax relief that are made when people leave the UK and take their pension savings with them to their new country of residence'.

Many will, however, interpret the changes as having been introduced to:

- raise more taxation revenue from pension transfers from UK registered pension schemes to QROPS and between QROPS, and
- potentially deter transfers from UK registered pension schemes to QROPS, which the government believes would result in subsequent tax savings to the member

Liz Fallon (LF): This change came out of the blue and the only mention of it in Philip Hammond's Budget speech was a vague reference to the need to 'tackle abuse of foreign pension schemes'. Delving into the detailed Budget policy documents reveals (at least part of) the rationale—the government provides generous tax relief on UK registered pension savings, says an HMRC policy paper, yet the QROPS regime has increasingly been marketed as a way of gaining what HMRC describe as an 'unfair tax advantage' on savings that have benefited from UK tax relief. HMRC sees this as contrary to the policy of allowing transfers to be made free of UK tax.

In other words, QROPS have become more popular, with the result that some tax revenue that would otherwise have filled HMRC's coffers, when people came to take their UK pensions is instead sailing off overseas.

Another likely reason for the change (one that isn't explained in the Budget documents) is that the package of QROPS changes appears to be designed with a view to reducing transfers to pension liberation or scam arrangements, many of which are based overseas. This chimes with the government's wider aims and the recent DWP consultation on tackling pension scams.

What are the key elements of the charge? How will it work? Are there any exceptions?

NS: Draft legislation was published by the government on 8 March 2017 and this is to be included in Finance Bill 2017.

The draft legislation amends Part 4 of the Finance Act 2004 in the following manner:

Transfers subject to the charge

Section 244A(1) provides that the new overseas transfer charge (OTC) applies when a recognised transfer is made to a QROPS or former QROPS to another QROPS.

Exceptions to the charge

There are a number of exceptions where the charge will not apply and these are detailed in sections 244B to 244F of the draft legislation and include situations where:

- both the individual and the QROPS are in the same country after the transfer
- the QROPS is in one country in the European Economic Area (EEA)—an EU Member State, Norway,

Iceland or Liechtenstein—and the individual is resident in another EEA country after the transfer

- the QROPS is an occupational pension scheme sponsored by the individual's employer
- the QROPS is an overseas public service pension scheme as defined at regulation 3(1B) of the Pension Schemes (Categories of Country and Requirements for Overseas Pension Schemes and recognised Overseas Pension Schemes) Regulations 2006, SI 2006/206 (Pensions Scheme Regs 2006) and the individual is employed by one of the employer's participating in the scheme, or
- the QROPS is a pension scheme established by an international organisation as defined at Pensions Scheme Regs 2006, reg 2(4) to provide benefits in respect of past service and the individual is employed by that international organisation

The rate of the charge

Section 244K(1) of the draft legislation confirms that the rate of the charge is 25% of the transferred value.

LF: Broadly, a 25% tax charge will apply to pension transfers made to QROPS except where certain exemptions apply. These include where the individual and the pension scheme are both located within the EEA, the individual and the scheme are in the same country, or the QROPS is provided by the individual's employer. Other limited exceptions apply in relation to overseas public service pension schemes and schemes established by an 'international organisation' (which has a specific meaning for HMRC purposes—it is not simply a multi-national employer).

According to government policy papers, 'if the individual's circumstances change' within five tax years of the transfer, the tax treatment of the transfer 'will be reconsidered' (ie the tax charge may be imposed retrospectively).

How will the charge be implemented, and when does it take effect?

NS: The OTC applies to transfers requested on or after 9 March 2017.

Scheme administrators of UK registered pension schemes and scheme managers of QROPS are jointly and severally liable to the OTC with the individual pension member making the transfer.

The charge does not simply apply at the point of transfer but rather section 244A(4) of the draft legislation introduces the 'relevant period' during which the charge applies as any period from the transfer to the next 5 April plus five years.

If there is a substantive change in the 'relevant period' this could lead to the OTC being levied. Equally, there are also provisions to reclaim the OTC charge within the 'relevant period'.

LF: The government will legislate for the 25% charge in the Finance Bill 2017. This change applies to transfers requested on or after 9 March 2017 (ie, this change is of immediate effect). The scheme administrator (for tax purposes) and the member will be jointly and severally liable for the charge.

In this context, it is worth setting out what HMRC means by 'requested'. They say a transfer has been requested when a member has made 'a substantive request to the scheme administrator' on which they are 'required to take action in relation to the transfer'. This means that the member has given the scheme administrator an instruction to transfer £X or X% of pension funds to a named overseas pension scheme. A 'casual enquiry' is not a transfer request. Assessing whether a transfer request has already been made before 9 March 2017 sounds simple but there are likely to be borderline cases where it is not clear.

What actions should members and pension schemes be taking?

NS: Below are the actions that should be taken:

Members

In cases where pension scheme members have requested transfers to QROPS on and/ or before 8 March 2017 transitional protection from the OTC is available under section 244G(1) of the draft legislation and, if such requests are still appropriate, these can be executed.

In all other cases, pension scheme members contemplating QROPS transfers should take expert advice from experienced, independent practitioners as to the full range of options available which could include retaining UK pension arrangements in an appropriate format as well as transferring to QROPS (in both cases where the OTC does and does not apply).

The UK's future position in the EEA after Brexit may impact upon the exception to the OTC charge where the QROPS is in one country in the EEA and the individual is resident in another EEA country after the transfer.

QROPS scheme managers and UK registered pension scheme administrators

Draft Guidance issued by HMRC on 8 March 2017 confirms on pages 4 and 5 the actions QROPS Scheme Managers and UK Registered Pension Scheme Administrators should take.

In particular, the scheme managers of QROPS must submit a revised undertaking to HMRC by 13 April 2017 if they wish their pension scheme to continue as a QROPS.

As indicated above, scheme administrators of UK registered pension schemes and scheme managers of QROPS are jointly and severally liable for the OTC with the individual making the transfer and will need to ensure that their due diligence processes in respect of future transfers are appropriately enhanced to ensure that relevant information is captured and the requirements to settle the OTC charge, where due, are met.

LF: Trustees and administrators will now need to review their overseas transfer procedures, member communications and information requests urgently in light of new HMRC guidance, noting that the new 25% tax applies to individuals who request an overseas pension transfer on or after 9 March 2017. If due, the tax will need to be deducted from the member's funds before the transfer is made.

On a related topic, schemes should also note that HMRC's registered overseas pension scheme list is due to be suspended on 14 April 2017 (and re-published on 18 April 2017)—see further below.

Members should be aware that they might be liable for the overseas transfer charge if they transfer their benefits and do not fall within one of the exemptions. Also, if the receiving scheme is no longer a QROPS (eg, because it has not completed the HMRC undertaking referred to below) they could be hit with an unauthorised payment charge. Members wishing to benefit from one of the overseas transfer charge exemptions will also need to be prepared to provide detailed information to their scheme in a timely manner, so that the scheme can satisfy itself that the exemption does indeed apply. In addition, they need to know that if their circumstances change within five tax years of the transfer (eg, they move country), they may still be liable for the 25% charge.

HMRC has already issued 43 pages of guidance on the transfer charge. There is plenty more detailed information on steps that both schemes and members should take. I would suggest that scheme administrators in particular digest this immediately.

Are there any other points worth mentioning here?

NS: The introduction of the OTC may well result in:

- a reduction in the number of transfers from UK registered pension schemes to QROPS and
- a reduction in the number of QROPS scheme managers

As a result the government's revenue may be lower than that predicted—which calls into question the reasoning behind the introduction of these measures.

An increasing globally mobile population will continue to include individuals who have at some point in their career accrued pension savings in the UK. Such pension arrangements may no longer be fit for purpose—including if, for example, they have a restrictive linkage to sterling rather than to the currency of the territory in which the individual becomes resident and spends money. Further, it must be recognised that there are a large number of countries without pension regimes and people who move to such territories may henceforth suffer as a result of these changes, depending on the tax laws of the territories to which they move.

Professional advisers will now have to consider an even more complex combination of pensions, legal, investment and tax considerations in diagnosing the optimum solutions for clients—and the introduction of the OTC charge in some transfer cases could result in poorer pension outcomes.

LF: The other key point to note is that scheme managers of QROPS must now decide whether they wish their scheme to continue to be a QROPS and to operate the overseas transfer charge. If so, they must submit an undertaking to HMRC by 13 April 2017 (confirming that they will operate the overseas transfer charge). If this is not done, the scheme will cease to be a QROPS from 14 April 2017. HMRC has said that it plans to suspend its registered overseas pension scheme notification list from 14 April 2017 and publish an updated list on 18 April 2017.

It is important to note that a transfer to a scheme that has ceased to be a QROPS is likely to be an unauthorised payment (and potentially also lead to a scheme sanction charge).

Nigel Sloam is a leading expert on the utilisation of member directed pension schemes for entrepreneurs, executives, professionals, artists and sportsmen and was the first and is the current chairman of the Association of Consulting Actuaries Committee on small self-administered pension schemes and self-invested personal pensions. He has lectured widely in the UK and internationally at actuarial, accountancy and legal conferences and seminars.

Liz Fallon is a partner in the human resources practice group responsible for the firm's pensions team internationally. She is involved in advising companies, trustees and also other professional advisers in a whole range of pensions work including mergers and acquisitions, funding negotiations, employer covenant issues, scheme mergers and rationalisations, scheme conversions from defined benefit to defined contribution and hybrid schemes. Liz also has experience of employment-related aspects of pensions including the transfer of businesses, executive packages and severances and the ramifications of scheme change.

Interviewed by Kate Beaumont.

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