

Opportunities with overseas pensions

Part 2

June 2010

In a recently published article about Qualifying Recognised Overseas Pension Schemes (QROPS) and how they can be used to receive UK pension benefits for those who are likely to become non UK resident, we also made reference to Qualifying Non-UK Pension Schemes (QNUPS). This article provides more detail on how individuals can potentially use QNUPS as a very attractive financial planning tool and, as such, avoid the restrictions applicable to UK pension plans.

The term QNUPS has arisen from new regulations which were introduced earlier this year to correct an error in the Finance Act 2004 relating to the inheritance tax treatment of overseas pension funds, including QROPS. As I explained in my previous article, a QROPS will always be classed as a QNUPS but a QNUPS may not always be a QROPS. This is an important distinction, because a QNUPS (not a QROPS) enjoys a lot more flexibility than either UK pension plans or QROPS in terms of contribution levels, what the plan may invest in and how benefits can be provided, as well as an absence of reporting obligations to HMRC. In addition, a correctly operated QNUPS in the right jurisdiction allows virtually tax-free growth, tax-free benefits and, like UK pensions, exemption from inheritance tax on any death benefits arising.

Figure 1 sets out the main taxation benefits of a leading Guernsey QNUPS compared with a UK pension plan for new contributions.

Figure 1

	UK pension	QNUPS
In specie' transfers of residential properties etc	No	Yes
Contributions unlimited	No	Yes
Fund grows tax-free	Yes	Yes
Tax on death before retirement	0%	0%
Tax on death after retirement pre age 75	35%	0%
Tax on death after retirement post age 75	Up to 82%	0%
Cash-out	25% max	Up to 100%
Loans to member allowed	No	Up to 80%
Tax on income / annuity	Up to 50%	Tax-free loans
Unlimited fund size - fund can be accumulated without penalty	No, 55% on excess over £1.8M	Yes
Exempt from pension sharing on divorce	No	Yes

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Making contributions

Because no tax relief is provided on contributions there is, in theory, NO LIMIT to the amount that you may contribute to a QNUPS. The QNUPS can be funded from business profits (but contributions cannot be paid to the QNUPS by the employer), other after tax income or, more interestingly, personal assets/investments. Unlike UK pension plans, because no tax relief is provided on contributions to a QNUPS, contributions are not subject to annual allowance or special annual allowance restrictions and neither do they require the member to have earnings to justify any personal contributions.

So if you are caught by the pension funding restrictions or are near the lifetime allowance (£1.8M), and wish to make additional 'pension' provision, a QNUPS could offer a useful alternative to UK pensions for new contributions. In addition, because QNUPS benefit from UK inheritance tax (IHT) exemption, regardless of whether the funds arose from a transfer of UK tax-relieved pension funds or contributions of cash, investments or assets, offer the potential for immediate IHT savings. Figure 2 summarises the tax position of personally owned assets compared with those owned via a QNUPS.

Figure 2

	Personally owned	QNUPS
Fund grows tax-free	No	Yes
Tax on income taken from the fund	Up to 50%	Tax-free loans
IHT on death	Up to 40%	No

Employee Benefit Trusts (EBTs) and Employer Financed Retirement Benefit Schemes (EFRBS) are still preferable where it is desired to make contributions by the company/employer, rather than suffering personal taxation to extract the profits. They also have the advantage of allowing an employer to obtain corporation tax deduction when benefits are finally taken by the member. However, where the member has the means to make personal contributions, QNUPS are more tax efficient and flexible than EBTs or EFRBS. This is because EBT/EFRBS benefits are still taxable against the member when taken unless the member is definitely non-UK resident at the time. Whether a corporation tax deduction is still permitted as and when the member takes benefits from his or her EBT/EFRBS is anyone's guess!

Investing the funds

The funds held within the QNUPS can grow tax-free with the exception of non-reclaimable withholding tax on UK dividends or rental income arising from UK property. Non UK assets would grow completely tax-free. The fund would allow investment in a wide range of other



investments including residential property and holiday homes as well as the scheme being able to borrow to assist with purchasing such assets. Subject to normal prudent investment there are no prescriptive rules about how much the scheme is permitted to invest in one asset. Although it is possible to hold one's main residence within a QNUPS it would probably be prudent to avoid doing so to avoid any possible assertion that the scheme was not being operated as a pension plan.

Taking the benefits

The best way of taking benefits from a QNUPS is to take a loan or a series of loans with or without interest charged. The benefits of the member paying interest on the loan is that the interest charge removes further wealth from the member's personal estate and is received by the QNUPS tax-free. Such loans, as well as being tax efficient, allow the member to have access to up to 80% of the fund.


Access to up to 100% of the fund is possible if the member becomes non-UK tax resident. The beauty of this treatment is that the member does not need to prove non-UK residence or leave the UK in order to avoid the punitive 50% income tax rate on 'income'. In addition the loans taken to fund lifestyle would be fully deductible from the member's estate for IHT purposes upon their death - a double benefit.

QNUPS provide more cash

Figure 3 compares the benefits of making a contribution to a SIPP and a QNUPS for a high earner who is caught by the restriction on UK pension contribution tax relief. If they pay £100K into their UK pension, with tax relief this would cost him/her £80K – so the alternative is to pay £80K into a QNUPS. If we assume that, over time, the fund doubles in value then the pension would be worth £200K compared with the QNUPS worth £160K.

Figure 3

	UK pension	QNUPS
Paid in with tax relief	£100,000	£80,000
Grows to	£200,000	£160,000
Tax Free Cash/Tax-free loan	£50,000	£128,000
Tax on death after retirement pre age 75	£52,500	£Nil
Tax retirement post on death after age 75	£123,000 (if paid as lump sum)	£Nil
Tax on Income / Annuity	Up to 50% on gross	Nil on loans
Unlimited Fund can be accumulated without penalty	No - subject to £1.8M annual allowance	YES



Taking these assumed future values let's now consider the cash position when the member wishes to take benefits. With the UK pension he has paid in £80,000 and can take £50,000 out. With the QNUPS he has also paid in £80,000 but can take out up to £128,000 as a tax free loan so in terms of day one cash the QNUPS is £78K better for the member.


Let's now consider income, and assume that the member could draw, say, half of all the remaining funds as income before he dies. The total cash position for the UK pension would be the original tax free lump sum of £50,000 plus half of the remaining fund of £150,000, taxed at his top rate. Assuming the member pays 40% tax in retirement then they might reasonably expect to receive a further £45,000 net of tax. Thus the total net cash received from the UK pension would be £95,000 compared with £128,000 from the QNUPS or a difference of £33,000!

If the member dies after taking out tax free cash but **before age 75** and the residual fund is paid as a lump sum, the total cash position with the UK scheme would be a £50,000 initial tax free lump sum taken plus £97,500 (65% of £150,000) net return of fund, a total £147,500. This compares with the QNUPS position which would be an initial tax free loan taken of £128,000 plus the remaining net fund of £32,000, a total of £160,000. Thus the QNUP would provide £12,500 more benefit than the UK scheme.

If the member dies after taking the tax free cash and **after age 75** and the residual fund is paid as a lump sum the total cash position with the UK scheme would be a £50,000 initial tax free lump sum taken plus £27,500 (18% of £150,000) net return of fund, a total £77,000. This compares with the QNUPS position which would be an initial tax free loan taken of £128,000 plus the remaining net fund of £32,000, a total of £160,000. Thus the QNUPS would provide £82,500 more benefit than the UK scheme.

In every scenario the QNUPS is considerably better than the UK pension. As explained earlier, the recent amendments to legislation specifically provided for overseas pension plans to be exempt from UK inheritance tax. Therefore, as long as the principal reason for establishing and contributing to the QNUPS is to provide retirement benefits and this is done on normal 'commercial' terms, this potentially offers a very attractive way of avoiding IHT, while still continuing to benefit from those assets. Against the backdrop of restrictions on UK pensions, what can be contributed to discretionary trusts, the need to either give up access to or use of assets or accept inflexible 'reversionary' interests of capital, in the right circumstances a QNUPS offers a much more flexible and tax efficient wealth planning structure.

As with any innovative planning which exploits legislation, there is always a risk that HMRC either 'interprets' the law differently from advisers in terms of QNUPS or they amend legislation to render some or all of it ineffective. However those active in international planning can see no justification for interpreting the rules differently and the law has only just been amended to allow overseas pensions to be IHT exempt.



Any planning 'risks' associated with QNUPS, such as they are, need to be weighed against the alternative of paying your 'fair' share of the high rates of UK income and capital gains taxes during your lifetime and 40% being deducted from your hard earned assets upon your demise. Pension planning, whether you continue to earn or not, needs re-thinking in the light of all the restrictions applied to it, as well as those to trusts generally. The days of thinking about a pension as purely a way of providing income when you cannot work is as old hat as thinking that retirement is about hanging up your clogs after 40 years of work. Doing nothing might just be the highest risk strategy you could pursue!

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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