

QROPS – Troubled Waters, Sharks and Mines

There has and continues to be a lot of talk and controversy surrounding the issue of QROPS pensions. This article seeks to clear up some of the issues and complications arising and provide a guide of what to look out for when considering a QROPS pension.

Qualifying Recognised Overseas Pensions Schemes – “QROPS” – are pension schemes which are:-

- recognised by Her Majesty’s Revenue & Customs (“HMRC”);
- are, along with the trustees, located outside the UK; and,
- are eligible to receive transfers of UK tax relieved pension funds.

So far, so good.

The complications begin to surface as different factors are considered:-

1. Recognised does not mean approved, vetted or otherwise positively screened. It means that the Trustees of the overseas scheme have asserted that they meet the requirements of the QROPS rules as laid down by HMRC – whether they do or not is another matter entirely.
2. QROPS recognition can be withdrawn by HMRC without notice or *prima facie* without justification.
3. The penalties chargeable against the pension fund for holding pension assets where there is no QROPS recognition can be up to 55% of the fund.
4. HMRC defines a pension as a tax relieved fund intended to provide the beneficiary with an income in retirement, although their rules state that at least 70% of the transferred fund must be used to provide an income, inferring that up to 30% of the fund may be paid to the beneficiary as a lump sum.
5. OECD and various other international bodies have a number of definitions as to what constitutes a “harmful” tax practice. Generally speaking however a harmful practice is one that treats non-residents of a jurisdiction more favourably than its residents.
6. Until very recently anybody with a tax relieved UK pension could transfer their pension rights to a QROPS recognised scheme, irrespective of where they are resident and / or domiciled.
7. A QROPS recognised pension scheme has a reporting obligation to HMRC that lasts 5 years from the date of the pension transfer. This obligation requires the Trustees to report any payments or other crystallisation of benefits to the beneficiary.

8. After 5 years the reporting obligation ceases but the Trustees have an on-going obligation to adhere to the QROPS rules, including the satisfying the requirements for the UK tax relieved fund to provide an income to the beneficiary in retirement.
9. Normally when using a QROPS, income tax is paid on pensions income at the rate which applies in the jurisdiction that the QROPS is registered in, rather than at the rate under which the assets were accumulated. A UK resident who retires overseas to a territory with a lower income tax rate would receive tax relief on their UK contributions but receive their pension as income with a lower rate of tax.

These various points have led to a number of twists and turns in the use and evolution of QROPS and give rise to many considerations.

The whole process was originally designed to facilitate the transfer of pension funds from the UK to the new jurisdiction where the beneficiary had become resident. With the increased globalisation of financial services however it is now not uncommon for a QROPS transfer to place the pension in a third jurisdiction, with which the beneficiary has no connection whatsoever.

This flexibility gave rise to aggressive strategies as advisers began to look for ways to use different pensions regimes to try to extract as much of the pension fund in a lump sum – so called “pension busting”. It is also worth noting at this juncture that the pension busting advisers were motivated to do this in pursuit of hefty charges levied against the pension fund for their advice.

This flexibility was developed further by advisers then turning their attention to UK residents and transferring their pension funds to another jurisdiction, even though the beneficiary remained and intended to remain resident in the UK.

The first major shock in the evolution came in summer 2007 when HMRC took the dramatic step of withdrawing QROPS recognition to all of the pension trustees in Singapore. The primary reason for this was that trustees were using Singaporean rules that allowed them to pay the entire pension fund by way of a lump sum to a non-resident beneficiary. The Singaporean trustees were therefore waiting for the passage of the 5 year reporting period and then paying away the entire fund. This is very clearly contrary to the pension definition detailed above and also constituted harmful tax competition.

Other jurisdictions such as New Zealand and Hong Kong have at various times raised their profiles in a bid to generate QROPS business by permitting different variations on the theme. For example, pension trustees in Hong Kong were recently the subject of scrutiny as their pensions were being used by UK residents to hold their pension funds and draw an income paying a much lower rate of tax than the UK and suffering no further taxation in the UK. HMRC quickly moved to close this anomaly down by introducing anti avoidance rules.

As can be seen, there are many potential problems that can be encountered in carrying out a QROPS transfer and the threat of a 55% penalty makes it very worthwhile to understand these.

When looking at a QROPS transfer there are many points to consider which include:-

- Who is the intended Trustee, what is their substance and what is their technical pensions expertise?
- Which jurisdiction should you choose – a AAA rated jurisdiction such as the Isle of Man is likely to provide significant comfort in the strength of its infrastructure, regulation and control of its pension trustees.
- What are the taxation implications of a) the jurisdiction in which you reside, b) the UK, c) if applicable the jurisdiction in which you hold your pension and d) how these different jurisdictions interact.
- How well qualified is your adviser and do they understand or are they even aware of these issues? A 55% penalty is an expensive way to find out.
- How should you invest the money once it is in your jurisdiction of choice?
- How much does it cost both for the pension structure and the advice? You should take care over this aspect because not all jurisdictions mandatorily disclose commissions and it is not unusual to see significant charges being hidden in the pension and investment structure.
- What are the benefits that one jurisdiction can offer over another? Take care however not to be drawn by headline promises and remember the old adage, “if it seems too good to be true...”

Above all else you should make sure that you find a properly qualified adviser who has a working knowledge of the subject and who provides a transparent service and who can recommend a suitable Trustee.

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