Jupiter
TRUSTEES LIMITED

A GUIDE TO

RETIREMENT ANNUITY TRUST SCHEMES ("RATS")

IN GUERNSEY

TABLE OF CONTENTS

INTRODUCTION 3
WHAT IS A RETIREMENT ANNUITY TRUST SCHEME? 3
THE TRUSTEES 4
APPROVAL 4
CONTRIBUTIONS BY MEMBERS 5
CONTRIBUTIONS BY EMPLOYERS 5
TRANSFERS FROM OTHER OCCUPATIONAL OR PERSONAL PENSIONS 6
INVESTMENT 6
FEES AND COMMISSIONS 7
LOANS TO MEMBERS 7
BENEFITS – PENSION AND LUMP SUM PAYMENT 8
DEATH OF THE MEMBER 10
ACCOUNTS 11
IF THE MEMBER LEAVES GUERNSEY 11
IMPLICATIONS OF UK RESIDENCE 12
CONTACT FOR FURTHER INFORMATION 15

INTRODUCTION

Retirement Annuity Trust Schemes (commonly known as a "RATS") provide a flexible and tax efficient pension option and are widely used by Guernsey residents as an alternative to the traditional insurance company based pension plan. These can be structured either as a bespoke individual plan or as a multi-member scheme.

Guernsey RATS are governed by the Retirement Annuity Trust Scheme Rules which were established by the Guernsey Financial Services Commission in 2010. These rules outline certain procedures in relation to the initial set up and approval of RATS together with details regarding permitted investments, gearing, reporting to Members and the payment of benefits.

This guide outlines the key aspects relating to the use of RATS, including an overview of the tax treatment. The guide is intended primarily for Guernsey resident individuals seeking to make Guernsey tax relieved contributions to a RATS or to transfer funds from another Guernsey based pension plan.

Whilst this guide provides an overview of the main features of RATS, it is imperative that individuals seek professional advice in relation to their personal circumstances before entering into any such scheme.

WHAT IS A RETIREMENT ANNUITY TRUST SCHEME?

A Retirement Annuity Trust Scheme ("RATS") is a discretionary pension scheme trust set up under Guernsey law as a tax efficient method to specifically house assets (the "Pension Fund") set aside to make provision for a person's retirement.

The RATS is governed by a Trust Deed and administered by trustees. The individual who is saving for their retirement (known as the "Member") will typically be the main beneficiary. Other beneficiaries can include the Member's family and dependents.

The primary benefit is that contributions into the RATS, whether they are transfers from existing pension plans or regular payments, build up free of Guernsey Income Tax. Further any income derived from investments, whilst remaining in the RATS, is exempt from Guernsey Income Tax.

Another major benefit is that the RATS is not obliged to take out a commercially available annuity on the retirement of the Member. Instead the RATS can pay a regular income to the Member from the Pension Fund, as well as the option pay a tax free lump sum on retirement up to 30% of the value of the fund at the time, subject to some restrictions.

The Member has the ability to select their pension age anywhere between 50 and 75 so that a Member can draw benefits whilst still working.

On the death of the Member, the RATS can either distribute the remaining assets to the other beneficiaries, or could even continue providing pension benefits for the other beneficiaries according to the Member's wishes. If the member dies before any benefits are drawn, the whole of the pension fund can be distributed without a Guernsey tax charge. This is a major benefit when compared to traditional insurance based pension plans where on the death of the Member any remaining fund is lost.

The RATS also has a wider range of investment options not available to the traditional pension plans, including investment in most financial instruments, private companies and property, subject to certain conditions.

Finally the RATS is able to make loans to the Member of up to 30% of the value of the Pension Fund on normal commercial terms at any one time, allowing the Member to make use of their savings before retirement. There is a requirement that any loans are paid before the drawing of benefits commences.

THE TRUSTEES

There must at all times be two Guernsey resident individual trustees, except in the case of a Guernsey corporate trustee where there may be only one trustee.

Members may not be trustees, nor may any relative of the Member or his or her spouse. For these purposes "relative" means a person related to the Member by either blood or marriage.

This condition may be waived, however, if the Trust Deed specifically enables the trustees to act by majority and the majority of those trustees are neither Members nor relatives, as defined above.

For ease of administration purposes a professional Guernsey corporate trustee is usually appointed.

Any change to the trustees must be notified to the Guernsey Income Tax Office within 30 days of such change.

APPROVAL

Approval for the RATS is granted by the Guernsey Income Tax Office in accordance with s.157A (4) of the Income Tax (Guernsey) Law 1975. This process is straight forward as long as the RATS meets certain requirements.

The RATS must be established under the laws of the UK or Guernsey and its purpose is to provide retirement annuities for individuals, their families and dependents and is irrevocable. RATS are open to membership by both Guernsey residents and non-residents.

At the initial set-up stage the trustees will require full details of the Member's circumstances and will need to be satisfied that the proposed investments and investment strategy will provide a suitable form of retirement annuity for the Member and (where appropriate) their spouse and/or dependants. In doing so, there may be circumstances where the trustee will want to be satisfied that the Member has obtained independent advice from a professional advisor with the necessary expertise to provide such advice.

It is also a requirement that the Member signs an undertaking indicating that they understand the risks that the lifespan of a Member of a RATS, and the investment performance of the assets held in the RATS, are impossible to predict. As a result, once a Member has started to draw down benefits from the RATS and depending on the level of benefits paid, the assets may be exhausted before the death of the Member.

CONTRIBUTIONS BY MEMBERS

Contributions by Members in any year up to the lower of £50,000 and 100% of Taxable Income will be allowable as a deduction for tax purposes. This is an overall limit applicable to all approved schemes and approved occupational schemes relating to the Member.

Contributions in excess of these limits may be made to the RATS but no tax relief will be granted.

Where the available tax relief cannot be used in a particular year, the unused tax relief may be carried forward for a maximum of six years, subject to certain limitations.

In practice, Members may only contribute to the RATS up to the age of 75 as the Guernsey Income Tax Office requires that benefit is taken no later than age 75. Therefore any contributions made to a RATS after age 75 would need to immediately crystallise benefits. It is possible to continue to contribute to a RATS until the maximum lump sum has been taken or until the fund has been assigned to provide a pension.

Where a Member is employed, social security contributions are payable on the Member's gross salary. There is no relief from this liability for a Member's own pension contributions. So a Member's pension contributions are effectively ignored for the purposes of calculating the Member's liability to social security on their salary.

CONTRIBUTIONS BY EMPLOYERS

A Member's employer may also contribute to the RATS. Generally, employer contributions are not treated as a benefit in kind for the Member and do not count towards the Member's contribution limit.

The social security treatment mirrors this treatment and the contributions are not added to a Member's gross earnings for the purposes of calculating a liability to social security.

However in relation to Proprietary Directors and Proprietary Employees of private companies, employer contributions are limited to 25% of the individual's net relevant earnings. Any contributions in excess of 25% are treated as a benefit in kind for both taxation and social security purposes.

TRANSFERS FROM OTHER OCCUPATIONAL OR PERSONAL PENSIONS

Inward transfers from Guernsey (or overseas) pension schemes do not usually require prior approval from the Guernsey Income Tax Office.

However for inward transfers of funds in excess of £30,000 from a defined benefit pension scheme, there is a requirement that the trustees obtain a report from a suitably qualified person independent from the trustees and any other advisor involved. The report must compare the benefits being given up in the defined benefit scheme with the projected returns from the RATS on a range of assumptions. The Member must also sign an undertaking acknowledging that they understand the benefits being given up.

Regard should also be had to the relevant legislation relating to pension transfers in the transferring territory. Before a transfer is accepted, evidence may be required to show that the payment has been approved by the relevant authority in the transferring territory.

Since 6 April 2006 when the simplification of the UK Pensions Regime was introduced by the 2004 UK Finance Act, transfers of UK registered pension funds are only possible without Member Payment Charges applying where the recipient scheme is a Qualifying Recognised Overseas Pension Scheme (“QROPS”). Furthermore transfers of UK registered pension funds to a Guernsey QROPS could now potentially incur an Overseas Transfer Charge.

Should you be considering making a transfer from a UK registered pension scheme, please refer to our guide entitled “A Guide to Qualifying Recognised Overseas Pension Scheme (“QROPS”)”.

INVESTMENT

A major aspect of a trustee’s role is to consider the suitability of the RATS investments and investment strategy. In carrying out this role, it may be necessary to appoint an investment advisor with suitable expertise.

Although there are restrictions on the investment criteria, which are to ensure that the investments are on a commercial basis so that the Pension Fund is protected and can expect a reasonable return on investment, generally the RATS has a wider choice of investment options than the traditional pension plan.

The following are suitable investments:

(a) equity investment in any company quoted on a stock exchange;

(b) equity investment in companies not quoted on a stock exchange. Where any Member holds, together with relatives or any other Member, more than 15% of the issued share capital of the company, not more than 10% of the total Pension Fund value shall be invested in the company;

(c) any other investment marketed by a generally recognised financial institution;

(d) purchase of property let on a commercial basis. Again, this may include property occupied by a Member, their relatives or connected companies, provided that a properly valued commercial rent is paid. Property should be wholly owned by the RATS; part ownership is not permitted.

For property occupied by a Member, this can either be purchased at its market value or contributed "in specie" into the RATS, although if the value of the transfer exceeds the statutory contribution limits, tax relief would be restricted accordingly. Once in the RATS, occupation of the property must be subject to a commercial rent payable to the RATS. Such rental income received by the RATS will be exempt from liability to Guernsey tax but may be subject to taxation in the country where the property is located if the property is not located in Guernsey.

The RATS is also able to borrow funds to invest in real property. In doing so, the trustees will need to be satisfied that the level of growth and the income generated by the additional assets acquired are sufficient to service the debt. Where a RATS borrows money, the Member is required to sign a disclosure confirming their understanding of the risks involved.

It is also possible that the member may self direct the investments and strategy of the scheme. This is known as the “self-invested approach” and is governed by the Retirement Annuity Trust Scheme Rules, 2015 as issued by the Guernsey Financial Services Commission. The trust deed will need to be drafted in such a way to allow this approach and the member will be asked to sign a certificate confirming that responsibility rests with the member as to the type and performance of the investments. The trustee will still however need to ensure that the investments are appropriate as regards the member’s circumstances and the overall aim of providing pension benefits.

FEES AND COMMISSIONS

The trustees are required to disclose to Members the amount of fees and commissions that will apply at any level in relation to the investment of the funds. Such fees may include trustee fees, commissions or fees payable out of the investments to the trustees, any independent financial advisor, other intermediary, investment or fund manager or adviser. Fees charged on arm’s length terms for transactions (such as a stockbroker’s share dealing fees) which are not shared with other parties need not be disclosed unless requested by the Member. The disclosure must be made on an annual basis.

LOANS TO MEMBERS

Loans to Members may be made from the RATS, provided that:

(a) the total amount advanced at any time does not exceed 30% of the Pension Fund value;

(b) interest is charged on a commercial basis. Such interest must be paid at least annually and, for these purposes, "commercial basis" means interest should be charged on the loan at a rate no lower than that obtainable on a similar amount deposited with, and no higher than that payable on a similar amount borrowed from, a financial institution;

(c) the Trustees should ensure that they hold sufficient security for the loan, to enable them to enforce repayment at any time;

(d) the loan must be repaid before benefits commence to be paid in respect of the Member for whom the loan was made.

However amounts that would otherwise have been paid to the RATS as contributions during the year could be used to cover the interest payments on the loan. However, subject to the specific circumstances the payment may not then qualify for Guernsey tax relief as a contribution and generally tax relief would not be available for interest payments of this nature.

BENEFITS – PENSION AND LUMP SUM PAYMENT

Benefits may commence at any time between the Member's 50th and 76th birthdays (i.e. before the Member reaches age 76), although an earlier date may be allowed if the Member is unable, through illness, to carry on their normal occupation.

Benefits may be taken in the form of a pension and / or as a lump sum.

<u>Pension benefits:</u>

Pension benefits can generally be taken in two ways:

(a) the RATS purchases an annuity from an insurance company using the Pension Fund, which then pays a pension;

(b) the RATS pays a pension from the Pension Fund itself, which is more usual, although this amount should be either equivalent to an annuity from an insurance company or a quotation be obtained from an actuary.

In obtaining a quotation, the pension annuity may allow for no increases or for annual increases of a fixed rate of up to 5% per annum or in line with the Guernsey Retail price Index.

Alternatively it is acceptable to determine the amount of an annuity payment by reference to the drawdown tables published by the UK Government Actuary's Department (GAD). If this approach is adopted, the annuity payable should be in the range of 100% to 150% of the GAD basis amount unless prior arrangement for an alternative percentage has been obtained from the Guernsey Income Tax Office.

The pension paid by the RATS is subject to Guernsey Income tax at up to 20% deducted at source and the trustees are responsible for operating the ETI (Employees Tax Instalment) Scheme.

The terms and conditions of such pension payments will be reviewed at intervals of not less than 3 years to ensure that the payments are at an appropriate level on realistic assumptions to secure satisfactory provision for the retirement of the Member and his spouse and/or dependants. Where necessary the trustees may consider it appropriate to take actuarial or other professional advice. At the outset and whenever a review is executed, details must be lodged with the Guernsey Income Tax Office.

Lump sum benefits:

On retirement, a lump sum benefit of up to 30% of the fund value can also be drawn. Lump sums may be drawn at intervals.

A proportion of this lump sum amount will be free of Guernsey Income tax. As of 2017 the maximum tax free amount that can be claimed is £188,000 and then the excess over this amount is taxed at 20%.

If the lump sum benefit is derived from a source originating in an overseas scheme, the maximum tax free limit may be waived although it will still be capped at 30% of the relevant funds.

It is possible to withdraw a lump sum payment and defer the drawing of a pension until a later date (although it is not necessary for a Member to retire from work before drawing a pension), providing the pension or annuity commences by age 75.

Commutation:

If the Pension Fund is very small and the ongoing maintenance of the fund is uneconomical it may be possible to obtain agreement from the Guernsey Income Tax Office that the RATS be terminated and the Pension Fund paid out. This is possible where the total of all pension funds of an individual aged 50 or over does not exceed £30,000. Where the value of a fund within a scheme does not exceed £15,000 there is no requirement to seek prior approval from the Director of Guernsey Income Tax and the administrators could allow full commutation without taking account of the value of funds in other schemes. Otherwise, the Member and the Director of Income Tax would be responsible for ensuring that the limits are not breached.

Any commutation in these circumstances would be subject to a tax charge at the rate of 20% if the Member is under age 50 and 10% if the commutation occurs on or after the Member reaches age 50.

DEATH OF THE MEMBER

If the Member dies **before drawing any benefits**, there are four options available:

(a) The payment of a lump sum (up to the value of the entire Pension Fund less any costs) may be made to the surviving spouse, dependants or beneficiaries. There will no charge to Guernsey Income tax as the funds will be treated as capital for tax purposes, although any non-Guernsey resident dependant or beneficiary receiving the lump sum payment may be subject to a tax charge depending on the tax regime in their jurisdiction of residence and specific tax advice should be sought in this respect prior to payment;

(b) A pension may be paid to the Member's spouse, dependants or beneficiaries (i.e. either an annuity is purchased from an insurance company or paid directly from the Pension Fund). The pension will be subject to Guernsey tax if the beneficiary is Guernsey resident. If the recipient is not resident in Guernsey, the pension may be subject to Guernsey tax although the recipient's personal circumstances and any applicable double tax treaty should be taken into account;

(c) Subject to the terms of the deed, the RATS may continue as a standard discretionary trust. There will be no initial charge to Guernsey Income tax as the funds will be treated as capital for tax purposes. If there are no Guernsey resident beneficiaries and no Guernsey rental income, there will be no Guernsey income tax on any income arising in the trust. If there are Guernsey resident beneficiaries then there will be a liability to Guernsey income tax on the trustees in relation to any income arising, regardless of whether there is a distribution. Thereafter distributions are paid at the trustee's discretion. These distributions may be subject to taxation in the recipient's jurisdiction of residence and specific advice should be sought in this respect. If distributions are paid to Guernsey resident beneficiaries it may be possible for the beneficiary to claim a refund against the tax paid by the trustees depending on the amount of the distribution and the availability of personal allowances. Specific tax advice should be sought prior to any such distribution.

(d) if there is no surviving spouse, dependants or other beneficiaries, the trustee will transfer the balance of the fund to the member's legal representatives (i.e. their estate). There will be no Guernsey tax charge.

If the member dies **after having commenced drawing benefits**, then the options are as follows:

(a) The payment of a lump sum (up to the value of the entire Pension Fund less any costs) may be made to the surviving spouse, dependants or beneficiaries. The lump sum is subject to a Guernsey Income tax charge at the rate of 20% regardless of the residence status of the surviving spouse, dependants or beneficiaries. Recipients who are not resident in Guernsey may also be subject to a tax charge in their jurisdiction of residence and specific tax advice should be sought in this respect prior to payment;

(b) A pension may be paid to the surviving spouse, dependants or beneficiaries (i.e. either an annuity is purchased from an insurance company or paid directly from the Pension Fund). Pension payments will in most cases be subject to Guernsey income tax in the first instance. Recipients who are not resident in Guernsey may also be subject to tax in their jurisdiction of residence and specific tax advice should be sought in this respect prior to payment (Note: The Double Taxation Agreement with the UK provides that a UK resident recipient will only pay income tax in the UK and will not be subject to Guernsey income tax);

(c) Subject to the terms of the deed, the RATS may continue as a standard discretionary trust. The Guernsey Tax Office would be likely to seek Guernsey Income tax at 20% on the whole fund at the time of death. If there are no Guernsey resident beneficiaries and no Guernsey rental income, there will be no Guernsey income tax on any income arising in the trust. If there are Guernsey resident beneficiaries then there will be a liability to Guernsey income tax on the trustees in relation to any income arising, regardless of whether there is a distribution. Thereafter distributions are paid at the trustee's discretion. These distributions may be subject to taxation in the recipient's jurisdiction of residence and specific advice should be sought in this respect If distributions are paid to Guernsey resident beneficiaries it may be possible for the beneficiary to claim a refund of the tax paid by the trustees depending on the amount of the distribution and the availability of the beneficiary's personal allowances. Specific tax advice should be sought prior to any such distribution.

(a) if there are no surviving dependants or other beneficiaries, the trustee will transfer the balance of the fund to the member's legal representatives (i.e. to his estate). There will be an immediate Guernsey income tax charge of 20% on the value of the fund.

ACCOUNTS

Accounts for the RATS must be prepared annually as at the 31st December and a signed copy submitted to the Guernsey Income Tax Office. There is no requirement by law to have the accounts audited.

The trustees are also required to provide the Member with a statement indicating the RATS financial position and the performance and value of its investments, as well as any statement prepared by any other parties relating to the performance of the RATS investments.

IF THE MEMBER LEAVES GUERNSEY

If the Member wishes to transfer his pension fund to his new country of residence, the payment may be made to an approved scheme in another jurisdiction. Generally this will be subject to a Guernsey income tax charge of 10% of the transfer payment amount.

However if the transfer is to a registered pension scheme in the UK or an approved scheme in either Jersey, the Isle of Man or the Republic of Ireland, there is no tax charge.

Alternatively the member's fund may remain within the Guernsey RATS. Benefits taken from the fund will remain potentially subject to Guernsey Income tax. The benefits are also likely to be taxable in the Member's country of residence but double tax relief may be available under the relevant double tax treaty.

If a Member leaves Guernsey and has already drawn benefits from the RATS, then, subject to the claim available to UK residents as noted above, it is not possible to transfer the RATS to an approved scheme in another jurisdiction. It will continue to be treated as a Guernsey pension subject to Guernsey income tax.

IMPLICATIONS OF UK RESIDENCE

A change in residence of the member can impact not only his personal tax position but that of the RATS. However a UK income tax charge can only arise on the RATS if it holds UK income producing assets.

<u>Tax position of RATS:</u>

If there are no UK resident beneficiaries, certain types of UK income such as interest and dividends will be outside the scope of UK tax on the RATS. The term "beneficiaries" in this context is quite wide and potentially includes not only the Member but also the beneficiaries who can only receive benefit after the member's death.

If there are any UK resident beneficiaries, the UK interest and dividend income of the RATS will potentially be subject to UK income tax at the higher tax rates of 45% and 38.1% respectively.

Other income such as UK rental income remains potentially subject to 45% UK income tax on the RATS irrespective of the residence status of the beneficiaries.

The higher tax rates referred to above only apply to "settlements" and it may be possible to agree with HM Revenue & Customs that a RATS, as a pension scheme, should not be regarded as a settlement, there being no gratuitous element to the arrangement (i.e. the member makes contributions and receives retirement benefits in return).

Should the RATS not be regarded as a "settlement", the lower tax rates of 7.5% (in respect of UK dividend income) and 20% (in respect of interest or rental income) would apply.

<u>Tax position of Member:</u>

If the Member receives a pension or annuity from the RATS whilst UK resident, he would be subject to UK income tax at rates of up to 45%. Prior to 6 April 2017 a 10% foreign pension deduction would have applied but this has been withdrawn with effect from 6 April 2017.

In relation to UK resident Members, the tax treatment of a lump sum payment from a Guernsey RATS has historically been open to some interpretation. Potentially a lump sum could have been taxed in the UK as pension income if it would have been treated as an income withdrawal (i.e. an amount to which the Member is entitled from his flexi-access drawdown fund) had the RATS been a UK registered pension scheme. However, there was a view that such payments may escape tax altogether.

However new legislation has been introduced with effect from 6 April 2017 under which all lump sum payments received from a Guernsey RATS by a UK resident will be taxable in the UK, subject to certain exemptions. In particular, to the extent the lump sum payment made after 5 April 2017 is referable to a pre-6 April 2017 pension right (which made specific provision for a lump sum only to be paid), it will not be taxable,

In addition, lump sum payments made from 6 April 2017 onwards from schemes which meet the definition of an "Overseas Pension Scheme" will be taxed in the same way as payments from UK registered pension schemes i.e. benefiting from a 25% tax free lump sum.

The conditions to be an Overseas Pension Scheme are defined in the QROPS Regulations and a Guernsey RATS with Guernsey resident members should satisfy the requirements.

Where the Member of the Guernsey RATS has become UK resident, it may still be possible to satisfy the requirements to be an Overseas Pension Scheme, subject to the. "Open to Residents Test" continuing being satisfied.

In this respect it may be possible to agree with HMRC that the scheme remains open to Guernsey residents on the basis that the Member was Guernsey resident when he was admitted to the scheme and there have been no changes to the scheme rules in this respect. HMRC's guidance specifically states that in order to satisfy the "Open to Residents" condition, only residents of the country or territory in which the scheme is established can join single member schemes but does not cover a subsequent change in residence. The position would therefore be subject to agreement with HMRC.

It should therefore be potentially possible for a Member of a Guernsey RATS who has become UK resident to qualify for a 25% tax free lump sum payment, subject to agreement with HMRC.

As mentioned above, where a charge to tax on a payment from the RATS also arises in Guernsey (i.e. if the Member has previously been resident in Guernsey), the UK/Guernsey double tax treaty passes the taxing rights of pension income to the UK. It is generally considered that a lump sum payment should be subject to treaty protection in the same way as it will be regarded as falling within the definition of "pension or other similar remuneration".

In addition, there are certain anti-avoidance provisions contained in the UK tax legislation which could potentially apply to charge income arising in the RATS to UK income tax on the member as the "transferor" of the funds. It may therefore be necessary for the UK resident member to make a specific claim on his UK tax return to avoid being taxed on the income arising within the pension scheme.

Any Member contemplating a move to the UK should seek specific UK tax advice.

CONTACT FOR FURTHER INFORMATION

Chris de Putron
Director
Jupiter Trustees Limited
PO Box 344
Mont Crevelt House
Bulwer Avenue
St Sampson
Guernsey GY1 3US

Tel (direct):	+44 (0) 1481 201720
Tel (main):	+44 (0) 1481 242233
Fax:	+44 (0) 1481 249233
Email:	chris.deputron@jupiter.gg
Web:	www.jupiter.gg

November 2017