Jupiter
TRUSTEES LIMITED

A GUIDE TO

QUALIFYING RECOGNISED OVERSEAS PENSION SCHEMES ("QROPS")

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INTRODUCTION

A QROPS is a pension scheme established outside the UK that is broadly similar to a UK registered pension scheme.

QROPS were introduced from 6 April 2006 to enable individuals permanently leaving the UK to take their pension savings with them to their new country of residence. The intention is that an individual who transfers their pension savings to a QROPS should be in broadly the same position as someone who remains in the UK with their pension savings in a registered pension scheme.

In May 2012, HM Revenue & Customs (HMRC) amended the regulations to ensure that only Guernsey schemes that did not include non-Guernsey resident members could become QROPS. Therefore, in order to become a QROPS, a Guernsey schemes must now only have Guernsey resident members.

In April 2017, the UK government amended the regulations for overseas pension schemes to reflect the flexibilities available to UK registered pension schemes and included a new regulatory requirement.

Therefore, it is not possible to make transfers from a UK registered pension scheme (or any other scheme containing UK tax relieved funds, such as other QROPS), to a Guernsey pension scheme without punitive tax charges, unless all members of the scheme have taken up residence in Guernsey.

In 2017 the law governing fiduciary businesses in Guernsey was amended which introduced specific regulation by the Guernsey Financial Services Commission ("GFSC") of pension providers to ensure that the formation, management or administration of pensions, and the provision of advice in relation to them, is a regulated activity. On 31 December 2020 the GFSC issued The Pension Scheme and Gratuity Scheme Rules and Guidance, 2020 ("Pension Rules"). The Pension Rules cover the formation, governance and administration of all pension schemes in Guernsey, including QNUPS.

This guide is intended primarily for Guernsey resident individuals wishing to transfer UK pension schemes to a Guernsey scheme and for non-UK resident members of "de-listed" QROPS; however, some references are made to the position of UK resident members of de-listed QROPS.

The guide outlines the key aspects relating to a Guernsey QROPS, including an overview of the potential UK and Guernsey tax treatment. However, individuals should seek professional advice in relation to their personal circumstances before entering into any such scheme.

REQUIREMENTS FOR A GUERNSEY QROPS

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

The QROPS 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 (the "death beneficiaries") can include the Member's spouse, dependants and family members.

All new QROPS administered by a regulated corporate trustee must be notified to the GFSC within 2 months of establishment and there is also both quarterly reporting and annual reporting requirements to the GFSC that must be undertaken by the trustees.

All Members must be provided with an information pack which will cover: the key features, benefits and provisions of the scheme; an explanation of Members, trustees and other service providers rights and responsibilities; details of relevant fees and charges; details or rights to opt out or withdraw from the scheme; how to make complaints; and a Statement of Investment Principals.

In order for a Guernsey pension scheme to be a QROPS it must meet four key definitions at all times:

1. The scheme must be a pension scheme (i.e. an arrangement, the purpose of which is to provide benefits for the Member on retirement, on death or in the event of ill-health or incapacity);
2. The pension scheme must meet the definition of an "Overseas Pension Scheme";
3. The overseas pension scheme must meet the definition of a Recognised Overseas Pension Scheme ("ROPS");
4. The ROPS must become a QROPS as defined by the legislation.

A pension scheme will be treated as an Overseas Pension Scheme if it is established outside the United Kingdom and satisfies two main tests.

The first test is the "Regulatory Test" which requires that there is a regulatory body in place that regulates pension schemes and that the scheme in question is regulated. Guernsey schemes have been able to meet this requirement since the introduction of the GFSC as the pension regulator from 1 July 2017.

The second test is the "Tax Recognition Test" which considers whether the scheme is recognised for tax purposes in the relevant jurisdiction. In order to satisfy this test in relation to a Guernsey based scheme, the following conditions must be considered:

1. Membership of the scheme must be genuinely available to Guernsey residents and if the scheme is a single member scheme, this condition will only be satisfied if the

Member is resident in Guernsey;

2. There must be a system of personal tax in the jurisdiction under which tax relief (which includes exemption from tax) is available in respect of pensions and either no tax relief is available on contributions, or benefits paid to members are subject to taxation.
3. The scheme must be approved or recognised by or registered as a pension scheme with the Guernsey Revenue Service.

Conditions 2 and 3 should both be satisfied by a RATS approved under s157A of the Income Tax (Guernsey) Law 1975 (the "Law").

In order for an Overseas Pension Scheme to be a Recognised Overseas Pension Scheme (ROPS) it must meet the "Benefits Tax Relief Test" and the "Pension Age Test".

The "Benefits Tax Relief Test" requires that the same form of tax relief (or exemption from tax) should apply to members whether they are local or non-Guernsey residents. This test would not be met in respect of a multi-member scheme with both Guernsey resident and non-Guernsey resident members (as the non-Guernsey members are likely to be exempt from tax on pension benefits), so the scheme will not satisfy this condition unless it is open only to Guernsey resident members.

The "Pension Age Test" requires that benefits are not payable earlier than the minimum pension age (age 55), unless as a result of ill health.

Finally, in order for a ROPS to be a QROPS, the scheme manager of the ROPS must:

- Notify HMRC that the scheme is a ROPS;
- Provide evidence to satisfy HMRC that the scheme is a ROPS;
- Inform HMRC if the scheme ceases to be a ROPS;
- Confirm to HMRC that it is understood that is a potential liability to the overseas transfer charge and that any such liabilities will be met;
- Comply with the reporting requirements in relation to the scheme i.e. providing information to HMRC, the scheme managers of other QROPS or UK registered pension schemes, the members and certain authorities, as applicable in accordance with the regulations.

Furthermore, in order to be a QROPS, the overseas pension scheme must not be excluded from being a QROPS under the legislation that governs exclusions (e.g. where there has been a significant failure to comply with the requirements or information provided is materially inaccurate).

Following the introduction of a Pension Regulator in Guernsey, schemes that were previously de-listed QROPS (as a result of the 2012 changes) may re-apply for QROPS status providing all the Members are Guernsey resident.

The reporting obligations to HMRC outlined above generally only apply to former QROPS that ceased to be QROPS on or after 14 October 2013, although HMRC can issue an information notice to a former QROPS regardless of when it ceased to be a QROPS.

The commentary below will be applicable to de-listed QROPS, de-listed schemes that have re-applied for QROPS status and new QROPS.

CONTRIBUTIONS BY MEMBERS

Any additional contributions made to a QROPS by a Guernsey resident Member will not be regarded as UK tax relieved funds and the ongoing treatment of these contributions will therefore differ from those funds transferred from the Member's UK registered pension in that they cannot be subject to Member Payment Charges or the Taxable Property Provisions.

Contributions made by the Guernsey resident member will be allowable as a deduction for Guernsey tax purposes up to 100% of the Member's "taxable income", subject to a monetary cap. Currently (for 2020), the cap is £35,000.

However, individuals with taxable income in excess of £100,000 will have allowances and deductions withdrawn at a ratio of £1 for every £5 that a person's income exceeds this withdrawal threshold. The tax relief is withdrawn in a specific order, with the personal allowance withdrawn first, then any mortgage interest relief and finally pension contributions. The residual minimum amount of tax relief available for pension contributions is £1,000 no matter what an individual's taxable income is.

This contribution limit is an overall limit applicable to all approved schemes and approved occupational schemes relating to the Member. 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, principally that there must be a level of pension contribution in a year in order for it to be included in the carry forward.

Contributions in excess of the above limit may be made to the QROPS but no tax relief will be available.

Following Guernsey's 2019 Budget, the definition of "acceptable contributions" to pension schemes (i.e. those which can attract tax relief) has been amended and the stipulations are as follows:

- Any money contributed to the pension must be paid in cash or by cheque, debit/credit card, standing order, direct debit or bank transfer;
- A transfer from another pension scheme is not treated as a contribution or premium paid by the Member and cannot be utilised under the carry forward provisions;
- Any contributions to the pension scheme that consist of funds withdrawn from any approved pension scheme will not be eligible for tax relief.
- In-specie contributions (i.e. the transfer of an asset into the pension scheme) will not be eligible for tax relief nor can they be utilised under the carry forward provisions.

In practice, Members may only contribute to the QROPS up to the age of 75 as the Guernsey Revenue Service requires that benefit is taken no later than age 75. Therefore, any contributions made to a QROPS after age 75 would need to immediately crystallise benefits. It is possible to continue to contribute to a QROPS 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

The Member's Guernsey employer may also contribute to the RATS. Generally, employer contributions are not treated as a benefit in kind to the Member for tax purposes and do not count towards the Member's contribution limit. The social security treatment mirrors the tax treatment and the contributions are not added to a Member's gross earnings for the purposes of calculating 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

Transfers into a QROPS generally comprise UK tax relieved funds i.e. funds from a UK registered pension scheme or another QROPS. Such transfers have historically been free of UK tax.

However, with effect from 9 March 2017, the Overseas Transfer Charge was introduced. The charge, where applicable, will be 25% of the transferred value. The charge can potentially apply to transfers made from a UK registered pension scheme to a QROPS and from a QROPS (or former QROPS) to another QROPS.

The Overseas Transfer Charge will not apply if both the Member and the scheme receiving the transfer are located in the same country.

As noted earlier, a Guernsey scheme can only be a QROPS if it is a "residents only" scheme (i.e. only open to Guernsey residents). Therefore, any transfers made to a Guernsey QROPS from 1 July 2017 onwards (i.e. the date from which Guernsey pension schemes could potentially qualify as QROPS following the introduction of a pension regulator) will be outside the scope of the Overseas Transfer Charge as the Member will be resident in the same country as the country in which the QROPS is established.

The "same country" exemption from the charge will be lost if the Member ceases to be resident in Guernsey within the period of five full tax years (6 April to 5 April) from the date on which the transfer is made to the Guernsey QROPS.

In order to be eligible for the exemption, the Member of the transferring scheme (whether a UK registered pension or another QROPS or former QROPS) must have provided the required information (as specified in the applicable regulations) regarding the transfer request to the scheme administrator or scheme manager.

A transfer from a UK registered pension scheme to a Guernsey QROPS will not incur Member Payment Charges as the transfer will be an authorised payment.

A transfer from a UK registered pension scheme to a QROPS will be a Benefit Crystallisation Event ("BCE") under the provisions of BCE 8. If the value of a Member's accrued benefits exceeds their available lifetime allowance, a lifetime allowance charge will arise. Once the funds have been transferred into the QROPS, no further BCEs will apply due to the fact that any further growth on the funds held within the QROPS will not benefit from UK tax reliefs (unlike UK registered pensions) and so benefits taken cease to be tested against the member's lifetime allowance.

UK CHARGES APPLICABLE TO QROPS

Certain charges can apply to the "transfer member" of a QROPS (i.e. a member in respect of whom funds have been received from a UK registered pension scheme or a Relevant Non-UK scheme ("RNUKS"), the latter being a scheme that holds UK tax relieved funds) or to the "taxable asset transfer fund" (i.e. funds previously held on a UK registered pension that have been transferred to a QROPS, either directly or via a RNUKS).

Member Payment Charges

Certain charges can be imposed by HMRC in respect of certain "unauthorised payments", such as a transfer to another pension scheme that is neither a QROPS nor a UK registered pension scheme. Such unauthorised payments are liable to the Unauthorised Payments Charge of 40% and potentially, the Unauthorised Payments Surcharge of 15%, if certain unauthorised payment thresholds are breached. These charges are collectively known as Member Payment Charges.

Member Payment Charges can potentially apply even if the Member is not UK resident if the "UK Residency Condition" is met by the Member.

In respect of funds transferred to a QROPS from a UK registered pension scheme (or a RNUKS) on or after 9 March 2017 (which are termed a "ring-fenced transfer fund"), the UK Residency Condition is met if the Member is UK resident at the time of the unauthorised payment or if he is not UK resident at that time but was UK resident in (i) any earlier part of that tax year, (ii) in any of the ten tax years immediately preceding the tax year in which the unauthorised payment was made or (iii) if the unauthorised payment occurs within five years after 6 April 2017 (the "key date" of a ring-fenced transfer fund) i.e. by 5 April 2022.

In respect of funds transferred to a QROPS from a UK registered pension scheme (or an RNUKS) before 9 March 2017, the UK Residency Condition is met if the Member is UK resident at the time of the unauthorised payment or if he is not UK resident at that time but was UK resident in (i) any earlier part of that tax year or (ii), in any of the five years immediately preceding the tax year in which the unauthorised payment was made.

Taxable Property Charges

Taxable Property Charges can arise in respect of a transfer Member of a QROPS in relation to the funds transferred to the scheme from a UK registered pension scheme or from a RNUKS.

HMRC take the view that the Taxable Property Charges can apply to a QROPS that is the equivalent to an investment regulated pension scheme i.e. a scheme where the Member (or a person related to the Member) is able, directly or indirectly, to direct or influence the manner of investments the scheme makes.

Taxable Property Charges relate only to the acquisition of "taxable property", being residential property and tangible moveable property. See the "Investment" section below for further details.

The Taxable Property Charges will apply regardless of whether the Member satisfies the Residency Condition which was outlined above in respect of Member Payment Charges.

Any amount subject to Taxable Property Charges will be liable to an Unauthorised Payments Charge of 40% and potentially, an Unauthorised Payments Surcharge of 15%, if certain unauthorised payment thresholds are breached.

Both Member Payment Charges and Taxable Property Charges apply to RNUKS (i.e. schemes that contain UK tax relieved funds) so they will apply equally to QROPS and de-listed QROPS, subject to the Residency Condition being satisfied in respect of Member Payment Charges.

INVESTMENT

A Guernsey based QROPS will be a RATS scheme approved under s157A of the Law. A scheme approved under s157A of the Law must be established for the purpose of providing retirement annuities for the Member and therefore the scheme's assets must be able to generate sufficient cash flow or liquidity to support that purpose.

The Practice Notes published by the States of Guernsey Revenue Services in relation to Guernsey RATS contain details of the requirements for the approval of the scheme and stipulate the following investments to be appropriate:

(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, including 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 QROPS; part ownership is not permitted.

Property may either be purchased at its market value by the trustees or contributed "in specie" into the QROPS by the Guernsey resident member, although an in-specie contribution would not be eligible for tax relief as outlined under the “Contributions by Members” section above.

As mentioned above, there is a restriction on the holding of certain assets within a QROPS as this will give rise to Taxable Property Charges. “Taxable property” includes residential property and tangible moveable property such as art, antiques, jewelry, fine wine, boats, classic and vintage cars. Investment in commercial property is permitted.

The QROPS is also able to borrow funds to invest in real property (but will only avoid incurring taxable property charges if the property acquired is commercial). In doing so, the trustees will need to be satisfied that the anticipated level of growth and the income that will be generated by the investment is sufficient to service the debt.

The investment parameters and the other requirements specified within the Practice Notes for section 157A RATS schemes do not apply to schemes seeking exemption from Guernsey tax under the provisions of section 40(ee) of the Income Tax (Guernsey) Law 1975 (e.g. a scheme with a Member who was not resident in Guernsey when he entered into the scheme, and who has not been resident in Guernsey at any time since). As a scheme can now only be a QROPS if it has Guernsey resident members, this exemption can only apply in relation to Members of delisted QROPS.

LOANS TO MEMBERS

Loans to Members may be made from the QROPS but the conditions that need to be satisfied will depend on the residence status (or former residence status) of the Member.

In relation to a QROPS whose Member is (or has previously been) resident in Guernsey, the Practice Notes stipulate the following conditions:

(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, under the QROPS legislation the making of a loan to a Member (or a person connected with a Member) will be an unauthorised payment, and therefore subject to Member Payment Charges, unless the Member is outside the scope of these charges by virtue of having been non-UK resident for the specified time period as outlined in the section above.

In respect of a de-listed QROPS, the Member could potentially now be resident in the UK. However, as a de-listed QROPS will be a RNUKS (i.e. a scheme that has received UK tax relieved funds), a loan to a UK resident Member will be an unauthorised payment and will therefore incur Member Payment Charges. Loans to UK resident members should therefore be avoided and have been considered further in this guide.

OTHER LOANS

The QROPS Regulations do permit loans to third parties who are not connected with either the Member or the sponsoring employer (i.e. if the scheme funds have been transferred from a UK occupational scheme) as a genuine investment of the pension funds providing these are secured and on a commercial basis.

UK INCOME TAX

Whilst UK registered pension schemes are exempt from UK income tax, QROPS are not afforded this exemption. The Guernsey resident trustees may therefore be subject to UK income tax in relation to any UK source income that is received. The trustee's exposure to tax in relation to UK source interest and dividend income will depend on the residence of the Member and any death beneficiaries. In contrast, UK rental income will be taxable irrespective of the residence status of the Member or death beneficiaries.

Whilst a Guernsey pension scheme with QROPS status cannot have a UK resident Member, it can still have UK resident "beneficiaries" as the term "beneficiaries" in this context is extremely wide and includes both current and potential beneficiaries. It is HMRC's view that death beneficiaries are "potential beneficiaries" for this purpose.

If a multi-member QROPS is being used, a single UK resident beneficiary will potentially cause the UK source income across all Member funds to be subject to UK tax. It is the general view of HMRC that a multi-member pension scheme should be treated as a single trust for income tax purposes unless the trustees have specifically elected for each Member Fund to be treated as separate trusts (i.e. by making a sub-fund election).

A de-listed QROPS could potentially have a UK resident Member and/or UK resident death beneficiaries.

Subject to the above, the trustees of a QROPS will be subject to UK income tax on UK income at the Rate Applicable to Trustees of 45%. UK source dividend income will be subject to UK tax at the dividend rate applicable to trustees of 38.1% with a 7.5% non-repayable tax credit applying to non-UK resident trustees.

Other income such as UK rental income profits remain subject to 45% UK income tax on the QNUPS irrespective of the residence status of the beneficiaries.

The rate at which UK income is taxed in the hands of the trustees is dependent on whether HMRC determine the QNUPS to be a "settlement" for the purpose of the legislation which applies the Rate Applicable to Trustees.

HMRC's view is that a trust-based pension scheme should be treated in the same way as any other non-UK trust and on the basis that the income is accumulated until such time as the Member can takes the income as benefits, tax will be applied at the Rate Applicable to Trustees on UK source income. Contract based schemes may be treated differently.

If the QROPS (or de-listed QROPS) has no UK resident "beneficiaries", UK source interest and dividend income will be wholly outside the scope of UK tax on the trustees. As noted above, any UK rental income would remain taxable.

In addition, there are certain anti-avoidance provisions contained in the UK tax legislation which could potentially apply to charge income arising in the QROPS to UK income tax on the Member if he is the original provider of the funds (i.e. the "settlor" or "transferor"), as outlined below.

<u>The Settlement Provisions</u>

These provisions can apply to treat income arising in a trust as the income of the settlor. In respect of a non-UK resident settlor (as would be the case for the Member of a QROPS), these provisions can only apply in relation to UK source trust income (although such income may be tax free in the non-UK resident Member's hands depending on its nature). The provisions could also potentially apply to any UK resident Members of de-listed QROPS.

However, in order for these rules to apply, there must be a "settlement" as defined by the legislation. For the purpose of these provisions, a "settlement" only exists if there is an element of bounty. It is generally accepted that no element of bounty exists if the intention of the Member making the contributions is to receive pension benefits. Therefore, in most circumstances the Settlement provisions should not apply to a QROPS.

Transfer of Assets Abroad provisions

These rules only apply to UK resident "transferors" so could potentially apply to charge UK resident Members of de-listed QROPS to income tax in respect of income arising in an underlying offshore company of the pension scheme, providing that the UK income is not subject to UK corporation tax (which UK rental income will be). Any UK income arising in the pension scheme at trust level that is not taxable under the Settlement Provisions above could potentially be charged under these provisions.

With effect from 6 April 2017, these "look through" rules will be restricted to UK source income only if the UK resident Member has a non-UK domicile of origin. To preserve this treatment, the pension trust must not be "tainted" (i.e. added to in any way) after the Member has become deemed domiciled in the UK (i.e. having completed 15 tax years of UK residence out of the previous 20 tax years).

For a UK resident and domiciled Member, these "look through" rules could potentially apply to all income arising in an underlying company (except UK rental income).

There are exemptions to these rules if the arrangements have no tax avoidance purpose. Exemption can also apply if the transactions are commercial transactions or if the anti-avoidance provisions are considered to contravene certain EU freedoms.

Generally, making contributions to a pension scheme should not be regarded as having a tax avoidance purpose but subsequent actions, such as transferring UK assets to an underlying company to avoid higher taxation at trust level, could cause the exemption to be lost.

If the UK resident Member is relying on one of the exemptions, an appropriate entry would need to be made on his UK tax return in this respect and the position would be subject to agreement with HMRC. Members should seek specific tax advice to ascertain their personal position.

The Transfer of Assets Abroad rules can also apply to tax benefits taken from the pension scheme by UK resident Members (unless they are being taxed under the "look through" rule for transferors above) or UK resident death beneficiaries in relation to stored up income in the pension scheme (known as "relevant income"). However, to the extent that benefits taken are otherwise treated as income (e.g. pension income), these provisions will not apply. The exemptions referred to above are also applicable to the benefits charge.

UK CAPITAL GAINS TAX

Although non-UK trustees are generally outside the scope of UK capital gains tax ("CGT"), offshore companies and other corporate vehicles owning UK land or property are now within the scope of UK CGT regardless of whether the UK land or property interest is residential or commercial. Further gains arising on the disposal of interests in close companies (i.e. those controlled by five or fewer participants) which are "land rich" (i.e. more than 75% of the value is attributable to UK land) are also within the scope of UK CGT, providing that the interest is 25% or more.

Whilst QROPS (or de-listed QROPS) are unlikely to hold UK residential property due to the applicable of Taxable Property Charges, they could potentially hold UK commercial property.

However, capital gains arising in a pension trust are specifically exempted from charge under the UK tax legislation if the pension satisfies the definition of an Overseas Pension Scheme. As outlined above under "Requirements for a Guernsey QROPS", a QROPS will be an Overseas Pension Scheme. Therefore, any capital gains realised in the QROPS in respect of UK property will be outside the scope of UK CGT.

It is not however considered that the exemption from UK CGT that applies to Overseas Pension Schemes is wide enough to cover gains realised from commercial UK land or property interests in an underlying company of the QROPS as the property would not be held "for the purpose" of the overseas pension scheme. Therefore, any gains realised in relation to commercial UK land or property in an underlying offshore company would be subject to UK corporation tax (currently 19%).

There are certain anti-avoidance provisions contained in the UK CGT legislation which serve to attribute gains in trust structures to the settlor (if UK resident and UK domiciled) or to the beneficiaries (if UK resident). However, these provisions apply only to "settlements" that have an element of bounty and HMRC appear to accept that for the purpose of these anti-avoidance rules, a QROPS (or former QROPS) is not a "settlement".

Therefore, neither a UK resident Member of a de-listed QROPS nor any UK resident death beneficiaries of a QROPS (or de-listed QROPS) should be subject to UK CGT in relation to gains realised within the pension scheme.

UK INHERITANCE TAX

A QROPS (or de-listed QROPS) should satisfy the Qualifying Non-UK Pension Scheme ("QNUPS") regulations (which are outlined in detail in our QNUPS guide) and should therefore be exempt under the UK tax legislation from UK inheritance tax ("IHT") charges on the trustees, as the assets held in the pension scheme are not treated as relevant property. The only exception to this is where lump sum death benefits are not paid within two years of the Member's death becoming known to the trustees.

In addition, the value of the Member's fund should not generally form part of his death estate, subject to certain limited exceptions, for example continuing guaranteed pension payments and payments that are not subject to the trustee's discretion.

The Gift with Reservation of Benefit ("GWROB") provisions (under which value gifted by an individual remains in his estate as he is still able to derive benefit from the gifted amount) should not generally be applicable in relation to a QROPS as no "gift" has been made (i.e. contributions were made with the expectation of receiving pension benefits in return).

Therefore, it should generally be the case that no UK IHT charges arise on the death of the Member and the trustees of the pension scheme should not be subject to any relevant property charges (i.e. ten-year charges or exit charges).

BENEFITS – PENSIONS, LUMP SUM PAYMENTS & TRIVIALITY

In accordance with the ROPS Regulations, benefits may commence at any time after the Member reaches normal minimum pension age, which is currently 55. There is no upper age for receiving benefit under the ROPS/QROPS Regulations although one of the conditions for approval of the scheme under section 157A of the Income Tax (Guernsey) Law 1975 is that the annuity payable to the Member must commence once he reaches age 75.

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

<u>Pension payments</u>

Pension benefits can be taken in one of two ways:

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

(b) The scheme 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 should 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 Revenue Services.

The terms and conditions of pension payments should 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 Revenue Service.

- Guernsey tax treatment of pension benefits

A pension paid by a QROPS (or de-listed QROPS) will be subject to Guernsey Income tax at 20% in the hands of a Guernsey resident Member. The tax is deducted at source and the trustees are responsible for operating the Employees Tax Instalment ("ETI") Scheme.

If the Member has no current or previous (i.e. since the scheme was created) residence connection with Guernsey (which may be the case for a de-listed QROPS), the pension will not be taxable in Guernsey but is likely to be subject to tax in the jurisdiction of residence.

- UK tax treatment of pension benefits

In relation to a UK resident Member (e.g. of a de-listed QROPS), pension payments would be treated as foreign pension income, subject to UK income tax at rates of up to 45%, depending on the individual's circumstances.

<u>Lump sum payments</u>

For a regulated Guernsey ROPS (whether a QROPS or de-listed QROPS) there is no longer a requirement under the ROPS regulations for 70% of the Member's fund to be used to provide and income for life. Therefore, lump sum payments are not required by the ROPS regulations to be limited to 30% of the Member's fund, albeit that a condition of approval of the scheme under s157A of the Law is that lump sum payments do not exceed 30% of the Member's fund. In certain circumstances, as outlined further below, full commutation of the Member's fund may be possible.

It is possible to withdraw a lump sum payment and defer the drawing of a pension until the Member has retired (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.

- Guernsey tax treatment of lump sum payments

A lump sum of up to 30% of the Member's fund that relates to UK tax relieved funds would be free of Guernsey tax.

However, in respect of any Guernsey tax relieved funds, the 30% tax free lump sum is subject to an upper limit. The lump sum in excess of this limit will be subject to Guernsey Income tax to the extent it exceeds the permitted tax-free amount. With effect from 1 January 2020, the maximum tax-free amount is the lower of 30% of the value of the Pension Fund and the upper limit of £203,000. This upper limit is reviewed annually.

A lump sum paid to a non-Guernsey resident member (e.g. of a Member of a de-listed QROPS) will only be exempt from tax in Guernsey if the Member has not been resident in Guernsey at any time since the scheme was entered into. The recipient may also be subject to tax in the country in which they are resident, although the position will be subject to the applicable double tax treaty.

- UK tax treatment of lump sum payments

Lump sum payments can potentially be subject to UK income tax as pension income if the amount is within the definition of a "relevant lump sum" or would be treated as income withdrawal, if the scheme was a UK registered pension (i.e. an amount paid from the Member's flexi-access drawdown fund – i.e. a lump sum payment in excess of 25%).

However, a payment to the Member can only be treated as a "relevant lump sum" if the Member is UK resident *and* the Member Payment Charge provisions do not apply to the funds, therefore lump sum payments made from a QROPS or former QROPS should not constitute "relevant lump sums". If the payment is treated as income withdrawal, it will be subject to UK income tax as foreign pension income in the hands of a UK resident Member.

The Relevant Benefit provisions and the Disguised Remuneration provisions, which apply to employer financed retirement benefit schemes ("EFRBS") will not generally apply to an RNUKS (i.e. a scheme holding UK tax relieved funds) where the transfer funds originated from the Member's employer (see "Employer Funding" section below).

Potentially, any lump sum amounts not otherwise taxed as income under the UK tax legislation could in certain circumstances be taxed under the Transfer of Assets Abroad relevant income provisions (as referred to earlier) in the hands of a UK resident Member of a former QROPS. However, it is likely to be the case that one of the defences against this charge will apply.

<u>Flexible access for Guernsey pensions</u>

The UK pension rules were amended from 6 April 2015 to allow flexible access to UK registered pension schemes.

With effect from 2 October 2015, Guernsey introduced flexible access rules specifically in relation to schemes which had received transfers of tax relieved funds from other jurisdictions (such as the UK).

Following the introduction of a pension regulator in Guernsey, it is no longer a requirement of ROPS/QROPS status that Guernsey schemes designate 70% of the of the Member's fund to provide an income for life. Therefore, schemes may offer flexi-access without breaching their ROPS/QROPS status

Although a requirement for a pension scheme obtaining approval under s157A of the Law is that the scheme rules do not permit the payment of a lump sum in excess of 30% of the

Member's fund, s157A (12) of the Law allows flexibility in relation to pension funds derived from a pension scheme in another jurisdiction, such as the UK.

Therefore, it should be possible for a Member to have flexi-access to his transfer fund deriving from UK tax relieved contributions. Care still needs to be taken in respect of non-UK tax relieved funds which cannot be flexi-accessed by Guernsey residents, except in certain limited circumstances (see below).

Triviality

The triviality limits for Guernsey pension schemes (i.e. the fund value limit under which the entire pension fund may be paid out as a lump sum to Members) have been amended following Guernsey's 2019 Budget.

For pension funds valued at up to £15,000, the full amount may be taken as a lump sum by the Member, at any age, without approval from the Guernsey Revenue Service. For a Guernsey resident Member, the tax rate will be 20% is aged under 50 and 10% if aged 50 or over.

For pension funds valued between £15,000 and £50,000, the full amount may be taken as a lump sum by the Member if aged over 50. It is no longer necessary to obtain approval from the Guernsey Revenue Service before making a lump sum payment of this nature. For a Guernsey resident Member, 30% of the payment will be received as a tax-free lump sum and the tax rate applicable to the remainder will be 20%.

It is the Pension Fund value *after* the deduction of a notional 30% lump sum that is used for the purpose of "testing" the £50,000 triviality limit but the full Fund Value is used to test the lower limit of £15,000.

The Pension Fund value is assessed against the above-mentioned triviality limits on a scheme by scheme basis. It is no longer a requirement for fund values to be aggregated across all approved Guernsey pension arrangements.

If the pension scheme is already in drawdown (i.e. of funds have already been withdrawn), the triviality rules can be applied providing the Pension Fund value is no more than £50,000 or the Fund Value is between £50,000 and £100,000 and the Member has a Guaranteed Minimum Aggregate Retirement Income (not necessarily from the scheme) of at least £20,000 per annum for life. Prior approval from the Guernsey Revenue Service may be required in some circumstances if the Fund Value in excess of £50,000.

TAX IN RELATION TO UK EMPLOYER FUNDING

If the Member's transferred fund was originally contributed by the Member's UK employer, it is necessary to consider the application of tax charges under the UK employment legislation (i.e. the Disguised Remuneration legislation or the Relevant Benefits legislation) when benefits are taken from the scheme These provisions can potentially apply to both UK residents and non-UK residents, although for Guernsey residents, the UK/Guernsey Double Tax Treaty should confer sole taxing rights on Guernsey (thus preventing tax in the UK), providing the payment from the scheme is regarded as being with the definition of "pensions and other similar remuneration".

However, despite the existence of a UK employment connection, a scheme comprising a relevant transfer fund (i.e. UK tax relieved funds) is specifically outside the scope of the Disguised Remuneration legislation (which was introduced in 2011 to counter perceived avoidance of tax and National Insurance Contributions through the use of third-party arrangements to provide benefits in respect of a person's employment).

Lump sum payments made from a UK employer-funded scheme should also be outside the scope of the Relevant Benefits legislation provided the funds are within the scope of the Member Payment Provisions. If the Residency Condition is not met by the Member (such that Member Payment Charges no longer apply), a lump sum payment could be within the scope of the relevant benefit legislation, although in such circumstances, it is likely that sole taxing rights would be conferred on the country of residence (i.e. Guernsey) and no UK tax would therefore be payable,

DEATH BENEFITS

On the death of the Member, 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 death beneficiaries (i.e. surviving spouse, dependants or beneficiaries).

(b) A pension may be paid to the Member's the death beneficiaries (i.e. either an annuity is purchased from an insurance company or paid directly from the Pension Fund).

(c) Subject to the terms of the deed, the scheme may continue as a standard discretionary trust.

(d) If there is no surviving death beneficiaries, the trustee will transfer the balance of the fund to the Member's legal representatives (i.e. their estate).

If the Member dies <u>before drawing any benefits</u>, the Guernsey tax position would be as follows:

(a) There will no charge to Guernsey Income tax on a lump sum payment as the funds will be treated as capital, although any non-Guernsey resident death beneficiary receiving the lump sum payment may be subject to a tax charge in their jurisdiction of residence.

(b) Payments of pensions income to a death beneficiary will be subject to 20% Guernsey tax in the hands of a Guernsey resident beneficiary. Exemption from Guernsey tax will only be available if neither the deceased Member of the Scheme nor the recipient beneficiary have been resident in Guernsey at any time since the pension scheme was entered into, although for a beneficiary not resident in Guernsey at the time of the payment, any Guernsey tax charges would be subject to the terms of the applicable double tax treaty.

(c) If the scheme continues 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 death beneficiaries and no Guernsey source rental income, there will be no Guernsey income tax exposure on any income arising in the trust. If there are Guernsey resident death 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. If distributions are paid to Guernsey resident death 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. Distributions to non-Guernsey residents may be subject to taxation in the jurisdiction of their residence and specific advice should be sought in this respect.

(d) There will be no Guernsey tax charge if the Pension Fund is transferred back to the Member's estate.

If the Member dies <u>after having commenced drawing benefits</u>, the Guernsey tax position would be as follows:

(a) The lump sum will be subject to a Guernsey Income tax charge at the rate of 20% if the Member or the death beneficiary have been Guernsey resident at any time since the scheme was entered into. In respect of a death beneficiary not resident in Guernsey at the time of the payment, any Guernsey tax charges would be subject to the terms of the applicable double tax treaty.

(b) Pension payments will in most cases be subject to Guernsey income tax by virtue of the deceased Member or the death beneficiary having been resident in Guernsey at some point since the scheme was entered into. Recipients who are not resident in Guernsey at the time of payment may also be subject to tax in their jurisdiction of residence, subject to the terms of the applicable double tax treaty.

(c) If the scheme continues as a standard discretionary trust, the Guernsey Revenue Services could seek Guernsey income tax at 20% on the whole fund at the time of death but only if the Member or death beneficiaries are (or have previously been) resident in Guernsey. The tax position of the trustees and the beneficiaries receiving discretionary distributions will be as outlined above (where the Member dies before drawing benefits).

(d) There could potentially be an immediate Guernsey income tax charge of 20% on the value of the Pension Fund if it is transferred back to the Member's estate but only if the deceased Member or the death beneficiary have been resident in Guernsey at some point since the scheme was entered into.

UK tax position in respect of death benefits

Generally, pension or annuity payments made to a UK resident death beneficiary would be subject to income tax under the pension income provisions at rates of up to 45%.

However, if the Member has died before reaching age 75, pension death benefits will not be taxable as pension income. Potentially, such amounts could be taxable under the Transfer of Assets Abroad relevant income provisions in the hands of a UK resident death beneficiary, although one of the motive defences may apply.

The tax treatment of a lump sum payment made to a UK resident death beneficiary (if the Member was aged 75 or more on death) will be broadly as outlined in the Benefits section above in relation to the Member. However, a lump sum payment made to a death beneficiary could potentially be taxable as pension income as a "relevant lump sum" if Member Payment Charges no longer apply to the scheme *and* if the beneficiary is resident in the UK (or if the beneficiary is resident outside the UK but the Member was UK resident immediately before their death). This residency condition would equally apply to an amount paid as income withdrawal. Any amount treated as a relevant lump sum, may be eligible for a 25% deduction in line with the tax-free amount afforded by a UK registered pension scheme.

If the Member dies on or after age 75 and the Residency Condition is satisfied, the lump sum death benefit will be subject to Member Payment Charges at the UK resident recipient's marginal rate.

If the Member dies before reaching 75, the amount that can be taxed as a "relevant lump sum" is reduced by the amount of any lump sum death benefits providing these are paid with two years of death. In addition, a lump sum payment that would have been treated as income withdrawal if the scheme had been a UK registered pension scheme, will not in most cases be taxable as pension income, if paid within two years of death.

ACCOUNTS

Accounts for the QROPS (or former QROPS) must be prepared annually as at the 31st December and a signed copy submitted to the Guernsey Revenue Service. There is no requirement by law to have the accounts audited.

The trustees are also required to provide the Member with an annual statement within 6 months of the calendar year end detailing: gross contributions made during the year; information on the investment return or loss; statement of all Member Bourne Charges; the RATS financial position and the performance and value of its investments; the procedure for making complaints; where the RATS is not yet paying a pension then details of the methods for calculating benefits and benefit illustrations under certain assumptions; where the RATS is paying a pension then details of total payments made during the year and when pension increases are to be made.

TRANSFERS TO UK SCHEMES

A 10% transfer charge is potentially payable in Guernsey on the transfer of funds out of a Guernsey pension scheme to a scheme outside of Guernsey or to an unapproved Guernsey scheme.

Historically, the 10% charge has not applied to transfers made to UK registered pension schemes, however following the 2019 Budget changes, such transfers will only be exempt from the charge if the Member is resident in the UK.

There will be an exemption from the charge if the Member has not at any time been resident in Guernsey (i.e. since the creation of the pension scheme).

CONTACT FOR FURTHER INFORMATION

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GENERAL DISCLAIMER

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