Jupiter
TRUSTEES LIMITED

A GUIDE TO

RETIREMENT ANNUITY TRUST SCHEMES ("RATS")

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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, which are now no longer available in Guernsey. These can be structured either as a bespoke individual plan or as a multi-member scheme.

Guernsey RATS were previously governed by the Retirement Annuity Trust Scheme Rules which were established by the Guernsey Financial Services Commission ("GFSC") in 2010. In 2017 the law governing fiduciary businesses in Guernsey was amended which introduced specific regulation by the GFSC of pension 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") which revoked and replaced the previous rules. The Pension Rules cover the formation, governance and administration all pension schemes in Guernsey.

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.

Where a Guernsey resident individual wishes to transfer a UK based pension plan to a RATS, the scheme will require approval by HMRC as a Qualifying Recognised Overseas Pension Schemes. 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")".

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 RATS is a discretionary pension scheme trust set up under Guernsey law as a tax efficient method to hold assets (the "Pension Fund") designated 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 (the "death beneficiaries") can include the Member's spouse, dependants and family members.

A key 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. Furthermore, 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 death beneficiaries or provide pension benefits 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.

A RATS is afforded a wide range of investment options, including investment in most stock market financial instruments and funds, private companies and property, subject to certain conditions.

A RATS is also 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 repaid 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 and to avoid any personal liability on individual trustees, a professional Guernsey corporate trustee is usually appointed.

Any change to the trustees must be notified to the Guernsey Revenue Service within 30 days of the change.

APPROVAL

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

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

All new RATS 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.

CONTRIBUTIONS BY MEMBERS

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 RATS 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 RATS 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 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

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

Inward transfers from Guernsey (or overseas) pension schemes do not usually require prior approval from the Guernsey Revenue Service.

However, for inward transfers of funds in excess of £50,000 from a defined benefit pension scheme, there is a requirement that the trustees of the receiving scheme obtain a report from a suitably qualified person (typically an actuary) 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 report must be provided to the Member and the trustees of the transferee scheme.

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.

Transfers of UK registered pension funds are only possible without punitive Member Payment Charges applying where the recipient scheme is a Qualifying Recognised Overseas Pension Scheme.

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 RATS offers a large degree of flexibility over investments and is able to invest in a diverse range of assets, including property. There are a number of potential tax implications related to investment in UK residential property which would need to be considered and specific advice should therefore be sought if this area of investment is being considered.

A RATS scheme approved under section s157A of 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 Guernsey Revenue Services in relation to Guernsey RATS approved under s157A of the Law 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 RATS; part ownership is not permitted.

Property may either be purchased at its market value by the trustees or contributed "in specie" into the RATS 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.

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 anticipated level of growth and the income that will be generated by the investment is sufficient to service the debt.

Typically RATS will be licensee directed, which means that the corporate trustees have the responsibility for the investment of the Pension Fund. The scheme must produce a Statement of Investment Principals which covers the scheme's policy on: the kinds of investments to be held; the balance between different kinds of investments; the levels of risk; the expected return on investments; and the liquidity and realisation of investments.

It is also possible that the Member may self-direct the investments and strategy of the scheme. This is known as the "Member Directed investment approach" and is governed by the Pension Rules. The scheme deed will need to be drafted in such a way to allow a Member Directed investment 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 be deducted from the Pension Fund ("Member Bourne Charges"). 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. 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.

BENEFITS – PENSIONS, LUMP SUM PAYMENTS & TRIVIALITY

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.

Pension benefits:

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 Revenue Service.

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 Revenue Service.

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 Employees Tax Instalment ("ETI") Scheme.

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. In certain circumstances, as outlined further below, full commutation of the Member's fund may be possible.

A proportion of the lump sum amount will be free of Guernsey income tax. With effect from 1 January 2020, the maximum tax-free amount in relation to Guernsey tax relieved funds 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. The lump sum in excess of this limit would be subject to Guernsey Income tax at 20%.

If the RATS contains funds transferred from a pension scheme outside Guernsey which was approved and was of a similar nature to a s.157A scheme, the flexibility rules introduced from 2 October 2015 can permit access to lump sums in excess of 30% of the Member Fund. Although a requirement for a pension scheme obtaining approval under s.157A 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, s. 157A (12) of the Law allows flexibility in relation to pension funds derived from certain pension schemes in other jurisdictions.

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.

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% if 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 Pension 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 Pension 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 Pension Fund value is in excess of £50,000.

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 in respect of the above options will be as follows:

(a) There will no charge to Guernsey Income tax on payment of a lump sum 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. For 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.

(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 after having commenced drawing benefits, the Guernsey tax position in respect of the above options will be as follows:

(a) The payment of a lump sum will be subject to a Guernsey Income tax charge at the rate of 20% if the Member has been Guernsey resident at any time since the scheme was entered into.

(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 are likely to seek Guernsey income tax at 20% on the whole fund at the time of death. The tax position of the trustees and the beneficiaries will be as outlined above (where the Member dies before drawing benefits).

(d) There will be an immediate Guernsey income tax charge of 20% on the value of the Pension Fund if it is transferred to the Member's estate.

ACCOUNTS

Accounts for the RATS 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.

IF THE MEMBER LEAVES GUERNSEY

If the Member wishes to transfer their pension fund to their new country of residence, the payment may be made to an approved scheme in another jurisdiction.

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.

Alternatively, the Member's Pension Fund may remain within the Guernsey RATS. Benefits taken from the Pension Fund will remain potentially subject to Guernsey Income tax due to the Member's previous residence connection. 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.

IMPLICATIONS OF UK RESIDENCE OF A MEMBER

A change in residence of the Member can impact not only their personal tax position but that of the RATS. Holding UK assets can also have tax implications for the trustees.

<u>Income tax position of the RATS:</u>

The Guernsey resident trustees may be subject to UK income tax in relation to any UK source income that is received. 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. In contrast, UK rental income will be taxable irrespective of the residence status of the Member or death beneficiaries.

The term "beneficiaries" in this context is extremely wide and includes not only the Member but also the beneficiaries who can only receive benefit after the member's death.

Subject to the above, the trustees of a RATS 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.

The rate at which UK income is taxed in the hands of the trustees is dependent on whether HMRC determine the RATS 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 based 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 RATS 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.

Capital gains tax position of the RATS

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.

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".

The term "overseas pension scheme" is defined by the Pension Schemes (Categories of Country and Requirements for Overseas Pension Schemes and Recognised Overseas Pension Schemes) Regulations 2006 (Statutory Instrument 2006/206). Assuming the RATS meets the definition of an Overseas Pension Scheme, any gains realised in the RATS will be outside the scope of 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 UK land or property interests in an underlying company of the RATS as the property would not be held "for the purpose" of the overseas pension scheme. Therefore, any gains realised in relation to 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 domiciled) or 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 RATS is not a "settlement".

Therefore, neither a UK resident Member nor any UK resident death beneficiaries of a RATS should be subject to UK CGT in relation to gains realised in the RATS.

Inheritance tax position of the RATS

A scheme which is an Overseas Pension Scheme will generally 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 thier 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 RATS as no "gift" has been made (i.e. the contribution was 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).

Tax position of Member:

Lump sum payments made to a UK resident Member can potentially be subject to UK income tax as pension income if the amount is within the definition of a "relevant lump sum".

The taxable amount of the relevant lump sum is the amount of the lump sum payment, reduced by the following:

1. The value immediately before 6 April 2017 of any rights to specifically receive benefits by way of lump sum payments. This includes rights to a lump sum that could have been exercised as at 5 April 2017 (or could have been if the Member had met certain conditions e.g. age).

2. For a scheme that satisfies the definition of an Overseas Pension Scheme, the amount that would not have been liable to tax as pension income if the scheme had been a UK registered pension scheme. Most typically, this will relate to Pension Commencement Lump Sums in respect of which the "permitted maximum" is tax free (usually 25%) and Uncrystallised Funds Pension Lump Sums, in respect of which 25% is tax free.

Therefore, a lump sum payment could be partially taxable as pension income (as a "relevant lump sum"). The amount of the lump sum payment that is not treated as a relevant lump sum will not be taxable as pension income. Potentially, any amounts not taxed as pension income could in certain circumstances be taxed under the Transfer of Assets Abroad relevant income provisions (as referred to earlier). However, it is likely to be the case that one of the defences against this charge will apply.

It is also the case in respect of an Overseas Pension Scheme that any lump sum payments that would have constituted "income withdrawal" if the scheme was a UK registered pension scheme, will be taxable as pension income in the hands of a UK resident Member.

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. 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 are both satisfied by the RATS being approved under s157A of the Law.

With regard to the "Open to Residents Test" in relation to a single member RATS, 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 refer to 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 multi-member Guernsey RATS who has become UK resident (or potentially a UK resident member of a single member RATS) 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 if he is the original provider of the funds (i.e. the "settlor" or "transferor") These are outlined below.

The Settlement Provisions

These provisions can apply to treat income arising in a trust as the income of the settlor. In respect of a UK resident settlor these provisions potentially apply in relation to worldwide trust income (depending on the settlor's domicile position). In respect of a non-UK resident settlor 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).

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 RATS.

Transfer of Assets Abroad

These rules could potentially apply a charge to a UK resident Member of UK income tax in respect of income arising in an underlying offshore company of the RATS (providing that income is not subject to UK corporation tax, which UK rental income will be). Any UK income arising in the RATS at trust level that is not taxable under the Settlement Provisions above could also 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 there is 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 their 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.

Loans to UK resident members

Making loans from a RATS to a UK resident Member may have a number of potential UK tax implications which need to be considered.
The tax treatment of the loan interest paid to the scheme will depend on whether the interest is treated as having a UK source and there are a number of factors which HMRC will consider in determining this.

The primary factor is the residence of the debtor (i.e. the Member). Other key factors include the location of the debtor's assets (as potentially these could be called upon in the event of a default on the loan) and the location of any security taken over the loan.

If the interest is considered to have a UK source, the Member will potentially be obliged to deduct basic rate UK income tax (i.e. 20%) from the interest when it is paid to the trustees of the RATS and pay that tax over to HMRC, unless the interest is regarded as "short" interest (i.e. for a period of less than 12 months).

However, under the terms of the UK/Guernsey Double Tax Treaty, UK source interest paid to a Guernsey resident pension scheme is only taxable in Guernsey and is therefore exempt from UK withholding tax. This treaty relief does have to be claimed and loan interest can only be paid without the deduction of tax if a Direction Notice has been issued by HMRC. A Direction Notice can be obtained through the Certified Claim Route or the Double Taxation Treaty Passport Scheme, the latter having been introduced to simplify the process. The trustees of the pension scheme would be required to apply to HMRC to become a "passported lender" and the borrower (i.e. the Member) is then required to notify HMRC of the "passported loan" in order to obtain the necessary Direction Notice confirming that no tax is to be deducted from the loan interest payments.

The trustees of a RATS will be subject to UK income tax on the UK source interest income received, at the Rate Applicable to Trustees of 45%, with credit for any basic rate tax withheld by the Member.

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.

Potentially, loans could be made from an underlying offshore company, wholly owned by the RATS, which would limit any tax exposure on the loan interest to the basic rate tax withheld by the Member. However, there could be other tax implications and specific advice should be sought.

<u>UK tax position in respect of death benefits</u>

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.

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This guide is intended as a brief summary of Retirement Annuity Trust Schemes and their use. All references to taxation are based on our understanding of current taxation legislation and practice and may be affected by future changes in legislation and the individual circumstances of the Member. It is very important that specific professional taxation and other advice is obtained before establishing any Trust. Jupiter Trustees Limited cannot accept any responsibility for any loss arising from any inaction or action taken due to any content of this guide and will not be liable for any omissions or errors contained within this guide.

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