

Response to Consultation on the Draft Overseas Pension Schemes (Miscellaneous Amendments) Regulations 2012

We are a firm of advocates practising in Guernsey and regularly advise on issues arising from pension arrangements established or administered from Guernsey. Based on our experience and interaction with our clients, we are writing to you in response to HMRC's invitation to consult on the Draft Overseas Pension Schemes (Miscellaneous Amendments) Regulations 2012 (the "**Draft Regulations**") issued by HMRC on 6 December 2011. These Draft Regulations are to be read in the context of the Draft Memorandum to The Overseas Pension Schemes (Miscellaneous Amendments) Regulations 2012 (the "**Draft Memorandum**"), issued by HMRC on 20 December 2011. We understand that the consultation period closes on 30 January 2012 and should be grateful if you would accept this letter as our contribution to the consultation process.

The purpose of the Draft Regulations

The Draft Memorandum states at paragraph 2 that the purpose of the Draft Regulations is to ensure that '*savings are used to provide an income in retirement as intended when the regime was introduced in 2006*'.

The last sentence of paragraph 4.2 states that '*Changes are being made to the legislation to ensure that the system is being used to support pension saving*'.

Clearly then, of primary concern to HMRC in introducing these changes, is that they should facilitate the use of pension savings to provide an income during retirement, rather than being capable of being commuted to a lump sum beyond a limit stated by HMRC to be acceptable (i.e. 70% of a member's UK tax-relieved scheme funds). This is something that Guernsey's pension providers actively promote through pension products established in Guernsey and is in keeping with the approach to commutation taken in the Income Tax (Guernsey) Law 1975 as amended (the "**Law**"), as explained below.

Achieving the stated purpose

HMRC have proposed a number of changes to the QROPS regime in the Draft Regulations.

In most instances, the proposed changes are likely to support HMRC's stated aims. Extending the reporting period will allow HMRC to monitor payments made from QROPS for longer and thereby encourage the making of permissible payments for a longer period than at present. Extended reporting obligations are likely to discourage abuse of the system by those planning to make unauthorised payments as soon as the current five year reporting period expires. The increased level of information to be provided to HMRC by both the member and the scheme administrator, is likely to enable HMRC to check that QROPS are being used for their proper purpose. However, given that there have been no reported instances of abuse by scheme administrators in Guernsey, we query the effectiveness of introducing such additional reporting requirements for all jurisdictions, including those such as Guernsey, which have a track record of compliance with HMRC's QROPS regulations that is already underpinned by its domestic system of personal taxation. A targeted implementation of enhanced and extended reporting, is likely to be a more effective tool for HMRC in their efforts to combat abusive practices in the same way that anti-money laundering regulations target enhanced reporting in circumstances of higher risk.

Intention behind New Condition 4

We anticipate that the proposed introduction of new Condition 4 will have serious (and possibly unanticipated) implications both for existing members of QROP Schemes and for individuals who plan to move from the UK and wish to transfer their UK tax relieved pensions overseas. Of primary concern to such individuals is that their pension savings are placed in a safe, well-regulated jurisdiction, which has the necessary expertise to support

pensions-related services. Indeed, it is for these reasons that Guernsey has established a reputation as a market leader in the field of pension provision. However, if new Condition 4 were adopted, Guernsey would, for the reasons set out below, effectively cease to be available to such savers. It therefore appears to us that a consequence of new Condition 4 would be to deprive UK pension savers of the choice of a safe and well-regulated savings environment, thereby severely restricting the freedom of movement of capital which the QROPS regime was designed to facilitate. Furthermore, if new Condition 4 were implemented, it would not, in itself, promote the stated purpose of ensuring that pensions savings are used to provide an income in retirement.

New Condition 4

New Condition 4 provides that any exemption on the taxation of benefits available to QROPS members must also be available to local members.

In Guernsey, as with many other jurisdictions including the UK, individuals are taxed on the basis of their residence. In Guernsey, residents are taxed on their worldwide income (including pensions income). Individuals who are not resident in Guernsey are not charged tax in Guernsey on their Guernsey source pension income. Such non-residents would, however, be liable to tax on such income in accordance with the laws and practices of their own country of residence. This approach, referred to as “effective taxation”, is adopted in many jurisdictions and not merely in relation to pension income. Indeed, the UK adopts this approach in its implementation of the EU Savings Directive (2003/48/EC) in respect of remittance based UK resident non-domiciled individuals in receipt of various forms of income (referred to as interest in that Directive). This is also the approach followed by the OECD Model DTA (which is generally adopted by the UK in its own DTAs) in relation to pensions (i.e. a member would be taxed in his State of residence not in the State of source of that income). Furthermore, this approach was endorsed by Deloitte as the “*international consensus of movement towards taxation in country of residence*” as part of its contribution (the “**Tax Study**”) to the Independent Review of British Offshore Financial Centres (see Annexure E to the Foot Report, commissioned by the UK Government).

The Tax Study stated that “*The international consensus (in practice more than in theory) is increasingly that individuals should primarily be taxed on investment returns in their country of residence.... This general movement towards taxation in the country of residence is reflected by the trend in tax treaties to move away from the imposition of withholding taxes and towards interest and similar articles giving sole taxing rights to the lender’s country.*” The Tax Study went on to say that “*Taxation in the country of residence can only be effective if information can readily be obtained from countries from which income is sourced. OECD member countries have taken a variety of approaches to promoting increased information exchange and there is a sense that measures such as those outlined below are likely to become more widespread*”.

The Foot Report was published in 2009 and since then Guernsey has been actively engaged in the international arena and now has, or is in the process of signing up, TIEAs and Mutual Assistance Agreements with approximately 34 countries, with a number of other jurisdictions currently in discussion. This shows Guernsey’s on-going commitment to effective exchange of information in support of the international movement towards taxation in the country of residence.

Guernsey’s tax laws already treat both resident and non-resident individuals in the same way for the purposes of taxation, i.e. subject to taxation in accordance with the laws of the jurisdiction of residence. If new Condition 4 were implemented, Guernsey, along with other offshore jurisdictions which provide QROPS, would need to implement changes which could either render a non-resident subject to double taxation on the same pension income, where relief is not available under a bilateral agreement, or render residents at an advantage over non-residents by conferring an exemption from tax on pension income in Guernsey, whilst non-residents are subject to taxation in their country of residence. In this way, implementation of new Condition 4 could result in the introduction of an element of discrimination, with the result that UK pension savers will be forced to move their pension savings to jurisdictions which do not provide for effective taxation. Such jurisdictions may well have an

unregulated pensions/savings environment where the integrity of the savings and pension infrastructure falls far short of the quality and protection afforded to schemes administered in Guernsey. Furthermore, members from the UK who may prefer their pension savings to be invested in the UK economy with a sterling base for currency, may find that moving their pensions to other jurisdictions exposes them to other markets and currencies, which do not suit their needs or expectations. Indeed, if HMRC's intention behind the proposed changes is indeed to encourage the use of pension savings to provide retirement income, they would effectively reduce the number of jurisdictions in which this can be done safely and within a framework where, as in the case of Guernsey's current tax regime, unrestricted commutation of pensions is prohibited (other than on the limited grounds of triviality).

This is because QROP Schemes established in Guernsey must specifically provide that 70% of scheme funds are used to provide an income for life. Compliance with this and other requirements of pension schemes for both Guernsey and non-Guernsey residents, is monitored through the approval process set out in the Law. It is a requirement of tax approval in Guernsey that schemes do not permit commutation exceeding 30% of scheme funds. This limit needs to be adhered to throughout the life of the scheme (as well as, of course, any lower limit applicable in the UK). This means that benefits drawn from the balance of the funds is taken as income – which is what HMRC is seeking to emphasise as being the stated intention behind the 2006 regime.

This restriction applies to Guernsey administered schemes, irrespective of whether a member is resident in Guernsey or not. This replicates the approach under English law in relation to the way English law provisions apply to QROPS. We therefore query how new Condition 4 would strengthen what is already a clear and robustly enforced prohibition against unrestricted commutation of pensions administration in Guernsey?

Reporting and application of unauthorised payments provisions to a QROPS which does not comply with New Condition 4

We request clarification of the following areas of uncertainty should new Condition 4 be introduced in its proposed form on 6 April 2012:

- a. What will be the reporting obligations for a QROPS which, as at 6 April 2012, ceases to meet the conditions to be a QROPS? HMRC has confirmed that the scheme administrator will have to “*inform HMRC of the sums left in the scheme that were transferred from a UK registered pension scheme and to which member they relate... and members of a pension scheme that is no longer a QROPS will be able to remain as members and receive a pension paid from the sums transferred without incurring member payment charges.*”
- b. However if a member wishes to take a loan after 6 April 2012 or take a commutation lump sum, for example, will he/the trustee need to report these ‘payments’?
- c. Will the Member Payment Provisions apply to funds paid from formerly compliant QROPS (for example, loans or commutation payments)? Is this dependant on whether the member was non-UK resident on the date of the transfer from the former compliant QROPS and was so non-resident for the preceding five tax years?
- d. Please confirm that, apart from meeting the requirements set out in (a) above, all other reporting requirements will therefore cease to apply with respect to payments made from the former compliant QROPS after 6 April 2012. Also, please confirm that the mere presence of UK Transferred Funds in a formerly compliant QROPS, whether paid out or not, will not give rise to the possibility of unauthorised payments applying to the formerly compliant QROPS after 6 April 2012 and its status will not be affected by the period during which the member is resident outside the UK i.e. all pre-6 April 2012 QROPS reporting and payment restrictions are lifted for the formerly compliant QROPS after 6 April 2012.
- e. Would a member of a pension arrangement which ceased to be a QROP on 6 April 2012 because of non-compliance with the Draft Regulations be able on or after 6 April 2012 to transfer without penalty or sanction his pension to a new savings arrangement which does comply with the Draft Regulations?

Conclusion

In summary our comments are as follows:

1. Whilst we understand that the introduction of the enhanced and expanded reporting requirements set out in the Draft Regulations will assist HMRC to police better potential abusive pensions activities, we would recommend that such enhanced reporting requirements are applied on a targeted, jurisdictional risk-assessed basis.
2. We would urge HMRC to consider withdrawing the proposed introduction of new Condition 4 in its entirety as it will not in itself achieve the stated purpose of the Draft Regulations.
3. If, notwithstanding the observations above, HMRC is committed to the introduction of new Condition 4, we would recommend deferring its introduction until clear guidance is available on the issues mentioned above and the ramifications of the proposed changes for pension savers in existing QROPS, so that they have time to assess how best to manage their pension savings going forward.
4. Finally, we would recommend that grandfathering provisions are incorporated into the Draft Regulations so that it is clear that existing QROPS are not in any way prejudiced by new Condition 4. Without such grandfathering provisions existing savers may be prejudiced in respect of payments and reporting obligations following 6 April 2012, through no fault of their own, but due to changes introduced by HMRC which are punitive and disproportionate in their implementation for Guernsey administered QROPS.

We trust that these comments will be taken into account in the consultation process.

Yours faithfully

Carey Olsen

Please note that this is only intended to provide a very general overview of the matters to which it relates. It is not intended as legal advice and should not be relied on as such.

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