PENSION OPPORTUNITIES IN THE UK AND IN THE LIFE THEREAFTER!

Written by Nigel Sloam

We have all got a problem! Everybody needs income, particularly when there is more time to spend it - and there is more time now! People have increasing expectations and as result of advances in technology and medicine, one of the expectations that has grown is the expectation of life.

In parallel, increased technology has caused redundancy. Occupations have changed, and people find themselves "old and cold" by their mid-fifties. By contrast, at the other end of the scale, there are plenty of young adults across the world who have very little prospect of employment at the current time. We have a further problem, therefore, as to how to provide for the period of middle to late life, given that so many people may be out of work from time to time and retirement may be imposed and not planned for.

I think that you ought to realise that, although life expectancy across Europe has gone up by 10%, in fact, the time spent in retirement has more than doubled. It used to be the case in England and Wales that a man of 65 left employment, "came up from the pit", lived for seven years and then dropped dead! Now such a man has every prospect of living well into his eighties, and therefore we have got a considerable longer period of non income generation to be saved for. The flipside of longevity is extra cost!

Income needs to vary throughout later life, and there is now the phenomenon of "creeping retirement". People do not want to – or cannot afford to – let go and those who have been ousted from one job try to find some sort of employment elsewhere. They do not require, as used to be the case, a fixed pension. They need variable income streams.

The concept of a level pension is outmoded - and one reason for this is typified by what is happening in England and I am sure in every other country now. This is the phenomenon that one particular generation – unfortunately I am beginning to realise that it might be mine – has to cope with the support of four generations.

There are plenty of people in their sixties who are supporting an aged parent; at the same time they are looking after themselves and their spouse; they have to help out hard-up children who have learned at school and university how to nag, whilst at the same time they have grandchildren whose parents cannot support them with the necessaries of living. This may be limited to collecting children from school while the daughter in law goes to work - but more often than not grandparents also have to help pay for their grandchildren's education.

Another phenomenon which has to be paid for, which gives rise to non-standard cash flows, is the need for long-term care. In the United Kingdom, there is very little good State provision. The most average retirement homes, in the Greater London metropolis, cost £40,000 per annum - and this has to be paid for out of taxed income. Who can afford this?

On top of all this - and the gloom is unremitting - the capital cost of providing an income has, as a result of declining interest rates and increasing longevity, gone up by two and a half times, compared to what it was forty years ago in the early 1970s. It also must be remembered that £1000 per annum now is equivalent to less than £100 per annum forty years ago. To provide a gross pre-tax income of £30,000 for a man aged sixty-five and his wife now, you need a capital value of £1m today - and to save up for that, it means you need to pay around £20,000 per annum for twenty years, or £15,000 per annum for thirty years!

Therefore, to provide for retirement – or for what I call the "middle ages" – you need to deploy every cupboard of wealth - and I shall use this concept of cupboards of wealth throughout my talk.

The cupboards that are available are provision from the State, personal wealth and savings, continuing earnings, the value of any homes that one has acquired and, of course, pension arrangements. There is no one "magic" cupboard that is pre-eminent - all have to be used in the savings and extraction process, and the job for planners is to choose where, from time to time, to park the "coat hangers, shirts and blouses" and at which time from which cupboard these should be extracted.

In the United Kingdom, there have been substantial changes in pension provision. Like in every other country, our State cannot now afford what was offered in the heady post-war years – full provision in retirement.

State pension provision in the United Kingdom has been cut back. My wife is horrified that, having worked a lifetime, she is denied the prospect of taking a pension from aged sixty, which she has paid for and which was promised her by successive governments. She must wait until sixty-two. Her successors will have their pensions date put back to sixty-five, sixty-seven, sixty-eight and seventy. A twenty or thirty year old in the United Kingdom will now not get a State pension for at least forty to fifty years and their continued employment will prevent younger people from getting jobs.

We have NEST a new compulsory pensions savings scheme – sort of – being introduced in 2012 (in fact, it is between 2012 and 2016, depending on the letters in your tax code), and the initial contribution rate is 1%. That is not going to do anything massive for anybody.

In parallel, the guarantors of pensions in the defined benefit pension schemes face trouble. We have had problems with the banking sector and sub-prime mortgages but I should add that there is a further problem within the pensions and insurance sector, - resultant from pension promises which were based on incorrect longevity assumptions, and which may well not be sustained. There is, therefore, an urgent need for special savings for old age.

A main point of my talk is that the United Kingdom offers – both for its own people, for people passing through the UK and people abroad who may wish to utilise the system – several opportunities for such saving.

These result from a system of pension tax reliefs and investment freedom and diversity. We have unique tax reliefs - which I shall describe - and we have

almost unparalleled investment opportunities. We can invest our pensions in gold bars, shares, bonds and property. We are effectively only debarred from investing private pensions in residential property and assets that you can really enjoy including objets darts stamps and fine wines.

We have now new and improved drawing flexibilities with now the ability to draw on funds to meet needs as they arise and the ability to transfer pensions savings from the United Kingdom to elsewhere if it is appropriate.

We have a wide and varied range of pension providers, including the individual members themselves. The UK-registered pension regime, introduced in FA 2004 and implemented from 2006, is arguably the best on the planet - and I make the point that it is not just for UK-based workers. Maximum advantage of this regime can be taken through two specific types of contracts, known as SIPPs (Self-invested personal pension plans) and SSASs (small self-administered occupational pension schemes).

I summarise the basic tax reliefs. Registered Pension Schemes – as defined in Finance Act 2004 – can receive per individual, on a normal basis contributions of up to £50,000 per annum which can be tax relieved against personal income or against profits for Corporation Tax if paid for by an employer.
To allow for the reality that nobody can necessarily afford or pay such sums in one fell swoop and that times can be hard, there are carry-forward rules which mean that in any one year up to a further £150,000 in any one year can be paid, to make up for past deficiencies.

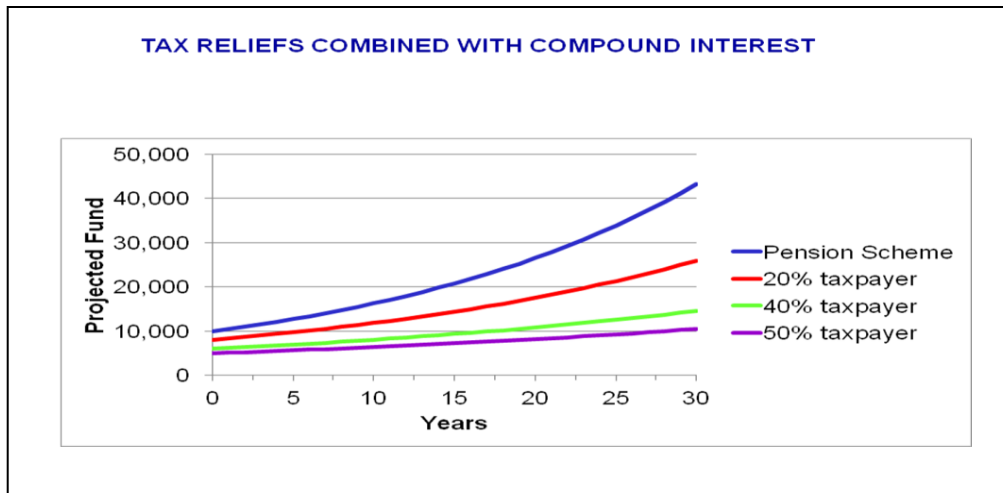
So, for somebody in the last two or three years who has not been able to make contributions, up to £200,000 per individual can be paid in any current year, depending on past history. The Registered Pension Schemes to which these monies may be contributed are not subject to Income Tax or Capital Gains Tax, and the only taxes that may have to be borne are Value Added Tax, Stamp Duty Land Tax or the taxes that cannot be reclaimed from dividends.

The model for the limit of tax relief on pension schemes used to relate to sums needed to replicate earnings in retirement. Since 2006 there has been an absolute cap on what can be saved up with full tax relief, which is called the "Standard Lifetime Allowance". People who were already in the pensions system before April 2006 may have their own personal Standard Lifetime Allowance, if they opted for Enhanced or Primary protection before 2009. We have many clients who have established, for a couple of people, funds of between £10m. and – in one case – many tens of millions of pounds. Now, the limit is currently £1.8m., and – as a result of economic troubles – will drop to £1.5m. next year. The £1.8m., however, can be preserved if you resister before 6th April with HMRC to the effect that no further contributions can be paid.

The system is, therefore, a very pure system. Funds can be accumulated tax-free, and paid for tax-free - so you get a kick-start right from the beginning, and as we shall see if you drop dead on time, accumulated funds can be applied totally tax-free. In the "unfortunate event of survival", pensions can be drawn from as early as aged fifty-five, preceded by a lump sum of 25% of what has been accumulated.

Pensions from this sort of scheme are always regarded as deferred pay by HMRC, and they are taxable as income, but they are taxed according to where the recipient lives. Pension payments do not attract National Insurance Contributions.

I think – as an actuary – I should highlight what somebody once described as "the inexorable force of compound interest". The effect of tax reliefs augments this. A 50% taxpayer, for example, aged forty, who contributes £5,000 net to a registered pension scheme, in the lucky event of an investment return of 5% per annum, will generate a fund of £43,000 by age seventy. This could provide a quarter tax-free, plus a very small pension of £2,400 p.a.- not great. The point is, however, that nearly three times as much would be needed to provide the same result outside of the pension scheme.



Therefore, as the above graph illustrates, a core reason why one should use a British pension scheme (or any other that carries the same tax reliefs) is that it is a fast-track cupboard of wealth, which makes the same underlying contributions and investments go that much further.

The graph shows by comparison the results of an initial net payment of £5,000, equivalent to £10,000 for a 50% taxpayer. It can be seen that, because of the effect of paying monies out of taxed income, with tax on investment accruals, the bottom line depicts that in a taxed environment travel is not very far, whereas the top line gives the promise of reaching heaven!

The two ideal most flexible pension schemes utilised in the United Kingdom to achieve maximum flexibility are the SIPPs and SSASs, referred to previously. They are both very similar - they are both allowed to invest in the same sorts of things (with one exception) and they provide the same sorts of benefits.

A SIPP is a pension product for just one person. You can have a group of SIPPs but they remain, essentially, a plan for an individual – a "selfish pension plan"! SSASs, on the other hand, are available for partners in a business, for families, for affinity groups, or for partners in a venture. They have to be initially founded by an employer, but once established the initial employer can bid farewell and like SIPPS can receive funds from a variety of employers and the members.

Incidentally, in the United Kingdom since 2006, the employer entities that can contribute to these sorts of pension schemes include investment companies, individuals and partners. Therefore foreign owners of UK-based property and other investment companies can organise saving through this type of UK pension scheme if paid in pension contributions, with consequent tax reliefs.

I also make the point that partners in multi-national partnerships, which have some income sources arising in the United Kingdom, whether they be resident in New York (or in Luxembourg) can still participate and benefit from the UK system, if it makes sense locally.

The flexibility of SIPPs and SSASs – unlike that of other UK pension schemes – gives great freedom. For example, private equity specialists and hedge fund operators use their pension schemes to invest their contributions and then invest these back into their own funds. There is no restriction on where investments and management is located.

Our SSASs give loans to third parties. In my office, up to June 2011, the pension funds that we administer have provided over time over £1.5bn of loans. This should be compared with the recent State-sponsored support for business through the four major clearing banks, which reportedly only gave £400m of loans last year.

In times of recession, my pension funds can "get to the bits that the banks do not reach". The pension funds that we operate give loans to their parent companies; they give loans to customers of their parent companies. We had a lighting contractor client who came to us and said he had a great order to put on his books but his client couldn't afford to pay immediately. His pension fund financed his customers, securing his company's trade and enabling an attractive investment for the trustees. These schemes can of course, give loans to third parties. They can invest in intellectual property, in commercial property, and private and quoted equity and all types of bonds.

The pension funds I am describing – the SIPPs and the SSASs – have great investment flexibility and attractions for entrepreneurs and the independent-minded. They can borrow (if they can find a lender), they can make joint investments with their owners, so at least part of an investment can be channelled into a tax-exempt format.

A pension scheme could, for example, buy a part of a property in Romania or buy 37% of an unquoted company, as a co-investor alongside the underlying client who owns the pension fund. Moreover, in the tax and investment planning process, "coat hangers" can be redistributed between various cupboards of wealth. An asset owned by an individual can be swapped at market value for cash in the pension fund, thereby releasing liquidity without necessarily triggering pension fund benefits. SIPPs and SSASs can lend up to 100% of their resources to third parties - but only SSASs can only lend to associated companies up to a limit of 50% of funds.

I have a client with a strong political interest. I suggested to him that for his family and others like them that it was a shame that they could not access their

pension funds to pay for care in old age. The Coalition Government has now passed the legislation enabling this.

Since this year, people can draw down on the entirety of their pension funds - provided that they can show that they are “off the back” of the State and have, at least, £20,000 per annum secured either through the State Pension or through insured annuity or suitable group pensions.

There is, of course, a problem with insured annuities - people do not like them! One client said to me whilst purchasing an annuity - “I hope this insurance company lives rather longer than I do”. Given, however, that many people – at present – are earning £11,000 to £12,000 of State Pension (a once off and never to be repeated figure) they only have to secure £8,000 per annum from an insurer – with a capital cost of maybe just over £100,000 – to be able to draw down on their pension fund at as and when they require.

Pensions provide useful protection against predators. There are all types of creditors, including HMRC, who would wish to attack pension resources. Since the end of 1999, these funds are immune. Even if a pension fund member becomes bankrupt or enters into a voluntary arrangement, then in most cases the pension scheme will survive intact. This is a very valuable protection.

The only major predator against whom pension protection is unavailable is a divorcing spouse or civil partner. Pension funds can be divided on divorce - they are just another asset. The good news is that a spouse can be paid for out of monies that have escaped the tax system – and thus settlements can be cheaper. Moreover, having paid off a spouse, reduced pension funding can be replenished.

One of the key attractions of the British registered pension scheme system is its use in inheritance planning. If a pension scheme member dies, prior to aged seventy-five and without having triggered a benefit, the entirety of his/her pension fund if protection has been claimed - or up to the Standard Lifetime Allowance if not - can be paid out Inheritance Tax-free to any nominated beneficiaries.

After crystallising benefits, or after aged seventy-five, different choices are available, but if the member remains in the United Kingdom there is taxation on lump sums paid on death - although benefits in pension form can be paid to dependants, subject to Income Tax. Dependants are spouses, children below the age of twenty-three; partners and can include grandchildren, aged parents, girlfriends, boyfriends and a combination of all of these!

I act for a lot of “movers and shakers” and, as a result of difficult times and the financial troubles, there has indeed been a lot of shaking recently! Following the shaking, there has been a perception that there is a need to move!

People are not static; people go to live in tax havens more and more. People go abroad because there is no work, or because there are too many restrictions in the United Kingdom. People “follow the flag” unfurled by their children, and their pension fund can follow them too!

Finance Act 2004 set up a system of approved Qualifying Recognised Overseas Pensions Schemes ("QROPS"), able to receive pension transfers from the United Kingdom. If a transfer is made other than to a UK Registered Pension Scheme or to a QROPS, then there is the inevitability of huge tax fines.

The ability to transfer to a QROPS does not depend on moving from the United Kingdom. Anyone with a UK pension has the right to transfer to a QROPS - but in particular such a move makes sense for people who have saved up in the United Kingdom and who have moved on. There will be a need and a wish to move pensions saving to a climate which is more attuned and friendly to where they will be living.

Certain overseas territories permit QROPS to pay gross to their non-residents. Chief among these are Guernsey, the Isle of Man, Malta, Gibraltar to some extent, Hong Kong and Singapore.

As my clients age, the concept of an eternal triangle is less to do with affairs of the heart but more to do with their taxation! In planning for a possible move to a QROPS – and, indeed, in everything else – one has to ask, where were the initial funds located? Where were they generated? Where does the beneficiary now live? - and where should funds be moved to, to maximise benefits?

Different answers will be given according to the various different scenarios that emerge. If there was an "Ideal QROPS Exhibition", the star exhibits would mirror what is available in the United Kingdom but superimpose the benefits of the local territory.

If gross roll up of investment income is desired with similar tax-free cash sums benefits to the UK, then three QROPS territories, Guernsey and the Isle of Man merit immediate consideration! In these tax-free sums of funds may be paid as opposed to the UK's 25% limit.

In a "Super Ideal QROPS" location, there would be 0% Income Tax deducted at source. Furthermore, on death, an ideal QROPS would enable tax-free distribution. In fact, provided that the member has been non-resident out of the United Kingdom for five full tax years, UK rules permit QROPS to pay out pension funds in their entirety without any UK taxation.

All of this is dependent on the rules of both the selected "QROPS-land" and the territory of residence. Each and every territory has its own nuance. So, for example, if somebody moved from the United Kingdom to France, if pension rights were transferred to a Guernsey QROPS Guernsey, after five years of non-residence, would pay out death benefits tax-free there and in the UK - but France would tax the proceeds.

Shakespeare put the problem very well: "To QROPS or not to QROPS? - That is the question." For a resident of Monaco or of Dubai, where there are no relevant double tax treaties with the United Kingdom, then United Kingdom pension rights should probably be transferred to an appropriate QROPS-land. Instead of having UK Income Tax deducted at source, the QROPS can then provide pensions tax-free.

In Israel, for the first ten years of residence, there is a local concession. All foreign income may be drawn tax free in Israel. This does not work effectively with a British pension scheme because in Israel declared pension income is tax-exempt. Therefore, the UK-Israel double tax treaty does not apply and a UK sourced pension will suffer UK tax at source. Therefore a move to QROPS land is desirable.

For Swiss residents – with the new *forfait* rules – transferring to a QROPs is better than remaining in the UK. On the other hand, if a member of a UK pension schemes moves to the United States, France or Spain, it is arguably better to stay in the UK scheme and take advantage of the benefits of the double taxation agreement.

Clients living in Portugal or Cyprus have very low taxation on UK-source pensions. In Cyprus there is a flat 5% per annum income tax charge for that resident for over six-months. In Portugal we have clients paying very low tax percentages on their UK-sourced pensions. Therefore "not to QROPS" is probably the correct solution in these territories!
An English Prime Minister once said of another land, "It is a far country of which we know nothing". QROPS are also far-off pensions of which we know little!

The clients we have, who are members of SSASs and SIPPs are used to being trustees of their own pension funds. Even given the tax benefits available on transfer it is potentially very dangerous to yield the trustee role to unknown third parties. Expert advice is very clearly needed. Many of the schemes on offer commercially are simply not fit for purpose, particularly for high-net-worth individuals.

The factors that need to be considered are cost, where the QROPS is located, who is the provider? Does the client have a direct involvement? It is possible, in a QROPS, to appoint a protector mechanism – just as you can with other trusts – to give the client or his representatives real veto powers over the two crucial discretions: the discretion of where to place the monies and who gets it on death. 95% of QROPS providers will not let this occur and therefore, if one is acting for clients to whom this may be important, there is a restricted field.

Finally, I would like to deal with what, surprisingly, is a relatively little known further pension-saving route – Qualifying Non-UK Pension Schemes ("QNUPS"). These have to be established outside the UK, both by definition and practice, if all the potential advantages are to be obtained

It should be realised that although the Registered Pension Scheme may be considered as a perfect "jewel" it is a relatively small gem. A QNUPS can serve as a top-up pension vehicle which, if established in the right territory, can enable an individual to take advantage of gross roll up on saving - which I have said is a vital tool to enable the bill for old age to be met.

QNUPS were essentially defined in statute in 2003 and 2004, though not by that name. They have become attractive because of clarification given in a Statutory Instrument issued in February 2010. They are pension schemes, and must be treated as such! Any use as specific Inheritance Tax planning vehicles or schemes will, in my view, negate their effectiveness.

They are not registered pension schemes; they are not subject to the Standard Lifetime Allowance. They are not restricted by UK rules, they are simply limited by the rules of the individual territories in which they can be established.

They work on the following basis. Contributions made into the scheme by an individual do not receive tax reliefs. They need to be justifiable. In my opinion an actuary is needed to assess reasonable funding levels and the reasonable contributions to provide for benefits.

What should be the right pension level? For a sixty-five year old male who spent £200,000 a year, living in the United Kingdom –a one-off contribution or contributions in stages to fund up to £9,200,000 could be justified. So there are huge opportunities for QNUPS savings.

Why should monies be directed to QNUPS? The answer is that these are frameworks which (a) do not attract Inheritance Tax on the monies contributed and (b)which are indicated by the cited February 2010 Statutory Instrument as not attracting Inheritance Tax on any distributions on death. Depending on the territories of establishment (i.e. Guernsey, Isle of Man, Malta) no taxes on income and capital gains are levied on funds accruing within a QNUPS.

QNUPS are not treated as relevant property, and their proceeds are exempted from UK Inheritance Tax (but are not necessarily immune from similar taxes in other jurisdictions). That is to say, an individual can put money aside into this pensions framework, which rolls up tax-exempt and which can be used to provide income resources - if needed - during later life. On the other hand QNUPS funds do not form part of the contributor’s estate.

Pension-drawing within a QNUPS may, however, be compulsory at some stage from aged seventy-five. If the member is resident, at that time, in a territory which taxes pensions then he/she will have to pay income tax, possibly on monies which were contributed from taxed income. This is a disadvantage – but of relatively small moment.

QNUPS are very suitable for high-net-worth individuals who are on the move. We have had three sad cases where clients have moved abroad, lost their UK residency, lost their UK domicile and then got sick. As a result of either medical needs or their children’s requirements our clients were brought back to the United Kingdom for treatment and to die.

That process, in the end, negated all the thought that had gone on beforehand and all the years of previous planning were destroyed. Two pension vehicles which able currently to save and sustain a freedom from Inheritance Taxes are QNUPS - and UK Registered Pensions in certain circumstances.

QNUPS are available, not just for people who live overseas and who might return one day to the United Kingdom. They also appear to be useful and relevant for UK residents.

In summary, we have a variety of pension scheme formats, based in the United Kingdom or deriving from UK legislation, which can be used to great advantage

by International Tax Planners. More fundamentally, the actuarial point that I am making to everybody is that – be you ever so rich, be you even a tax adviser – you are likely to need to make proper pension provision. In the United Kingdom we have the fittest vehicles for this purpose.

The above text is based on a presentation given by Nigel Sloam at the annual conference of the International Tax Planners Association (ITPA), which took place in the Hilton Hotel in Luxemburg on 17 October 2011.