SOVEREIGN
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Pensions Update

Issue 7 (June 2014)

Sovereign's pensions newsletter

Why Isle of Man for QROPS?

Which QROPS jurisdiction makes the best home for a UK pension transfer? It would be a significant error to assume that all jurisdictions are the same or to assume it's just about pensions legislation. It is also about a jurisdictions' political and economical commitment, the levels of available expertise and the ability to deliver. Other important factors include investor protection, dispute mediation and international standing.

Most commentators acknowledge that this choice really depends on the circumstances of the client because QROPS planning is a highly personalised area. However, when one considers the history of the QROPS market and the relatively short lived success of some jurisdictions or products, it is worth taking a closer look at the foundations of one of the more successful offerings.

Arguably the most reliable "third country" QROPS option has been the Isle of Man Personal Pension. Approved under Part 1 of the Isle of Man Income Tax Act 1989, Isle of Man Personal Pensions operate within a pragmatic and established framework. This comfortably complies with HMRC's QROPS conditions and shares many of the characteristics of the UK SIPP regime.

Financially astute clients may wish to self-direct their investments and this is possible through an Isle of Man QROPS but prohibited in certain other jurisdictions. Commercial property investment is also possible.

Having outlived its brasher younger brother – the Isle of Man 50C QROPS – and having seen Guernsey come and go as a viable QROPS jurisdiction, clients can be confident that their money is in a safe place. This, coupled with the oversight of the Isle of Man Insurance and Pensions Authority (IPA), the island's small but growing number of international tax agreements – including the UK – and the ease of dealing with International life offices makes the Isle of Man a compelling option.

UK manufacturing sector pensions – regular health checks required

Members of defined benefit pensions provided by companies in the manufacturing sector should keep a close eye on the financial health of their pension scheme.

According to the UK's Pension Protection Fund (PPF), the manufacturing sector accounts for 44.8% of schemes waiting to board the pensions lifeboat. This is despite manufacturing companies representing only 30% of all UK companies with defined benefit pensions and only 12% of the UK's GDP.

For many businesses, defined benefit pensions are an unwanted legacy. This is particularly true for UK manufacturers as they battle to compete in the global markets against lower labour and production costs.

The Sovereign Art Foundation

The image at the top of this newsletter: "Child in Red" by Haris Purnomo, 2007 Sovereign Asian Art Prize Public Vote Winner
A charity raising money to help disadvantaged children using the arts as rehabilitation, education and therapy. www.SovereignArtFoundation.com

Pension suitability reports

The constantly changing pensions landscape means that pension suitability reports can quickly fall out of date. Sovereign offers a complimentary report review service. The report should be submitted through the Sovereign/PenTech International Financial Adviser Support (IFAS) portal www.pentech.im/ifas and PenTech will feedback comments and suggestions.

Maximum Capped Drawdown pensions

With the maximum Capped Drawdown pension now set at 150% of the UK Government Actuary's Department (GAD) rate, QROPS members have significant scope for accelerated income withdrawals. Based on the current 15-year UK government bond yield of 3%, a 55-year-old can draw a maximum pension of 7.2% p.a. A member commencing drawdown at age 65 could draw 8.85% p.a. and a whopping 10.35% p.a. from age 70.

Although it may be tempting to take advantage of the greater flexibility, it is important to consider the pension in the context of the individual's retirement portfolio. Where the QROPS is likely to be the main source of retirement income, it is critical that withdrawals are sustainable. This generally means selecting an annual pension some way below the maximum available.

Although the scheme administrator is bound to review the maximum pension at least every three years, this is no guard against the erosion of the pension fund. It is vital that the member and their adviser review withdrawals at least annually, accounting for investment performance and the member's risk appetite.

Retirement benefit quotations and projections are available via the Sovereign/PenTech IFAS portal.

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New Lump Sum Death Charge Calculator

Those familiar with the market leading Sovereign/PenTech International Financial Adviser Support (IFAS) portal may have noticed a new addition. A Special Lump Sum Death Charge (LSDC) Calculator has been added to the existing suite of tools. This allows advisers to compare the LSDC implications directly between a QROPS and a SIPP in cases where the member dies as a UK tax resident.

The new tool also calculates how many years it will take for the LSDC to fall away altogether. The calculation is accompanied by a useful "output" document. This can be used to support the adviser's recommendation when meeting with a prospective client.

If the QROPS member dies and is not UK tax resident and has not resided in the UK in any of the last five complete and consecutive UK tax years, the LSDC does not apply at all. This compares favourably with a SIPP, where the LSDC – currently applied at a rate of 55% – continues to apply in full.

Following the UK budget, the 55% rate of the LSDC is subject to review and may be reduced, but remains an important planning consideration. Details of the budget changes and proposals can be found on the factsheets section of the IFAS portal.

Double Taxation Agreements — The devil is in the detail

With a growing international workforce, many expatriates have built up pensions overseas. This can make retirement planning particularly complex, especially in respect of the individual's tax position.

The existence of a Double Taxation Agreement (DTA) between the pension source country and the member's country of residence is a key consideration. Where a DTA is in place, this can remove the possibility of the individual being taxed twice on the same income and also define which country holds the taxing rights to the pension. However, the devil is in the detail and the adviser must drill deeper into the provisions of the agreement.

The UK is a good example. Although it has one of the largest networks of DTAs in the world, not all of its DTAs afford relief to pensions. Those that do may have several qualifying conditions, including that the UK pension is both remitted to and taxed in the other country. It should be noted that UK government pensions are commonly ineligible for relief, especially where the recipient is a UK national.

Where relief is applied for, it will usually be necessary to submit evidence of the individual's new tax status and residence. This may include an official stamp from the tax authorities in the country where the client now lives.

For the more itinerant worker, a Gibraltar-based pension may prove attractive. There is no reliance on DTAs because of Gibraltar's low rate of source taxation (2.5%), which makes it an extremely portable solution.

Alternatively Malta has a large schedule of over 60 DTAs and may offer a tax treaty where the UK doesn't – the United Arab Emirates being a good example.

Please view the pensions Fact Sheets on the Sovereign/PenTech IFAS portal for more information, including our Malta DTA quick reference guide.

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