In last month's Aries Insight, we looked at Department for Work and Pensions legislation in respect of transfers of money purchase ("MP") pension benefits. This month the topic is the same, but considers the other branch of Government most keenly interested in pensions: Her Majesty's Revenue & Customs ("HMRC").

Recognised Transfers

The principal HMRC concern with pensions is preventing abuse of the tax relief attached to membership of registered pension schemes ("RPS").

HMRC's pensions legislation does not tend to ban activities outright; a shift since 2006's 'A-day'. Instead it sets out conditions for 'authorised payments'. If a pension scheme makes an 'unauthorised payment', it has not breached the legislation per se. Rather, the tax treatment of the payment is different (i.e. worse) than if the payment had met the conditions to be authorised.

Transfers are one of the more straightforward payment types in this respect. To be a 'recognised transfer', and therefore an 'authorised payment', benefits in an RPS must be transferred to either:

- another RPS; or
- a qualifying recognised overseas pension scheme ("QROPS"): a scheme established outside the UK that agrees to abide by certain HMRC rules.

The transfer cannot be made to another person's fund. It must be held in the receiving scheme in connection with that member.

Broadly, pension benefits enjoy tax exemptions in the accumulation stage and are taxed on decumulation. HMRC fears those tax-advantaged benefits being moved outside the tax regime to then be withdrawn tax-free. RPS and QROPS are subject to the same (or similar) rules, so HMRC does not feel the need to discourage transfers to them.

If a transfer is received from an arrangement that is not a 'pension scheme' (in the general sense of the term), then it is technically a contribution and may qualify for tax relief. A bona fide transfer-in does not qualify for tax relief in this way, even if received from a scheme under which contributions or accrual did not qualify either.

Once in decumulation (i.e. after the benefits are put into payment), there are a few more conditions for recognised transfers.

For scheme pensions (usually a 'defined benefit' but occasionally paid by occupational schemes from MP benefits) the extra conditions for recognised transfers are:

- must not be a partial transfer,
- the receiving scheme must also provide a scheme pension, and
- the replacement pension cannot be at a lower rate than the original (besides to reflect reasonable administration costs from the transfer).

A transfer of annuities between insurers is not a recognised transfer because it does not involve a RPS. However, there are restrictions to such transfers:

First, the replacement benefit has to be of the same type i.e. scheme pension for scheme pension, 'nominees' short-term annuity' for nominees' short-term annuity. The other condition is that the annuity rate cannot decrease except in narrow, prescribed circumstances.

Transfers of drawdown pension or flexi-access drawdown funds can be recognised provided:

- the receiving arrangement does not already contain funds (i.e. the transfer has to create a new pot),
- the whole of the drawdown fund is transferred (i.e. partial transfers are not possible), and
- the replacement benefit must be like-for-like (i.e. a transferred flexi-access drawdown fund must provide flexi-access drawdown, a transferred nominee's flexi-access drawdown fund must provide nominee's drawdown and so on).*

  **An exception is that members transferring capped drawdown funds can elect instead for flexi-access drawdown.*

A new, replacement scheme pension / drawdown fund is a slight legislative headache. For example, provisions exist to prevent:

- the member becoming entitled to a new pension commencement lump sum,
- a guarantee period being extended, or
- the next pension increase exceeding the 'permitted margin' (i.e. because the increase from the beginning of the scheme year would equate to the entire pension).

Due Diligence

Even before the emergence of pension scams made due diligence on receiving arrangements essential, HMRC had expected ceding schemes to carry out reasonable checks (which are not prescribed) as to whether they are bona fide RPS or QROPS. If the ceding scheme is unsure of an RPS's status, it can ask HMRC for confirmation. If HMRC identify any concerns they will give the receiving scheme 45 days to clarify, so it could take a long time to receive confirmation. Requesting an extension to any statutory deadlines might be appropriate.

Due diligence is perhaps more important for QROPS. Again, the level of checks are left to the ceding scheme's discretion, but at a minimum HMRC expects a check that the purported QROPS is on the published *Recognised Overseas Pension Schemes Notification List* ("ROPS list") no more than one day before making the transfer. A copy of the list should be kept on file.

Allowances

For 'annual allowance' purposes, MP benefits credited from a transfer are not included in any 'pension input amount' ("PIA") because, for MP arrangements, the PIA is the total of any tax relievable pension contributions paid by or on behalf of the member, plus any employer contributions. If contributions are made in respect of a member before they transfer out later in the same tax year, that PIA arises under the ceding rather than receiving arrangement.

For 'lifetime allowance' ("LTA") purposes, a transfer is only a 'benefit crystallisation event' ("BCE") and tested against the allowance if it is a transfer to a QROPS (unless the member is age 75 or over). These are BCE number 8. If an overseas arrangement is not a QROPS, a transfer to it is an unauthorised payment instead.

Transfers received from QROPS (or former QROPS) of benefits in payment, or designated for drawdown, result in BCEs when they are put into payment / designated for drawdown again. This contrasts with the situation where the transferring scheme is a UK RPS and the replacement benefits are not treated as a BCE to prevent double-counting.

The usual requirements for BCEs apply (e.g. informing the member within three months of the event of the percentage of the standard LTA used up by the event).

Disclosure Requirements

A further, transfer-specific requirement from HMRC for ceding schemes is to provide, within three months of the transfer, a statement to the receiving scheme showing the total percentage of the standard LTA used up by BCEs relating to the sums and assets transferred. This is a blanket requirement, not just for when the transfer itself is a BCE. It includes earlier BCEs in the scheme and any that occurred in any earlier schemes before transfer to the ceding scheme.

If the member had accessed their benefits 'flexibly', meaning they are subject to the money purchase annual allowance, the ceding scheme must also provide the receiving scheme certain confirmations within 31 days of the transfer (or learning of the flexible access, if later).

HMRC only need to be notified of individual transfers if they are an unauthorised payment (the usual reporting requirements apply) or if the transfer is to a QROPS. For the latter, HMRC expects an Event Report (on form APSS262) with details about the transfer within 60 days.

There is a further report expected on a transfer to a QROPS if the BCE 8 exceeds the individual's LTA, meaning a charge is due. The details should be included in an accounting for tax return submitted no later than 45 days after the end of the quarter-year in which the LTA charge arose.

Transfers of annuities and drawdown funds carry additional information requirements outside the scope of this Insight.

Protection

Another major area of legislation is around 'protection'. When tax legislation changes, individuals may be able to maintain an entitlement to benefits under the earlier rules. These protections can be lost on transfers where certain conditions are not met. It is therefore important to ensure that members are aware if this is the case before transferring.

Two examples of such protections are entitlements:

- to take a pension before the normal minimum pension age of age 55;
- to take more than 25% of the value of pension savings as a pension commencement lump sum.

These two share the characteristic that protection is not lost in a 'block transfer', which is a transfer that must:

- involve at least two members of the same ceding scheme;
- be made to the same receiving scheme;
- be part of the same transfer agreement; and
- not be a partial transfer.

If and when the Government lowers the standard LTA, members may be able to protect a higher personal LTA. For 'enhanced protection' or one of the various 'fixed protections', any transfer will lead to their loss unless the transfer meets the conditions for a 'permitted transfer'; conditions which include:

- The transfer must be made to a RPS or recognised overseas pension scheme (not necessarily a QROPS, though its not "qualifying" would create other problems as explained above).
- Any MP benefits transferred must provide MP benefits in the receiving arrangement.
- The cash equivalent of any DB or cash balance rights transferred to a MP arrangement is actuarially equivalent to the benefits given up.

Transfers to Overseas Arrangements

HMRC has always been nervous about transfers abroad. More than twenty years ago, their consent was required for every such transfer. This is no longer the case, but extra conditions apply.

A transfer to a QROPS is a benefit crystallisation event ("BCE"), number 8, so the transfer value is tested against the member's LTA. A transfer to an overseas pension scheme that is not a QROPS is an unauthorised payment, so is not a BCE.

The information requirements for a transfer to a QROPS are more extensive than for transfers to RPS. Prior to transfer, the ceding scheme must disclose certain information and requirements to the member within 30 days of receiving the member's instruction to make the transfer. For their part, the member must provide the ceding scheme certain information within 60 days of that same instruction.

After the transfer, the ceding scheme must provide information to:

- The QROPS within 31 days of the transfer;
- HMRC within 60 days of the transfer (on form APSS 262)*; and
- The member within 90 days of the transfer.

**This is in addition to the information HMRC require where the BCE 8 results in the member exceeding their LTA, which must be provided no later than 45 days after the quarter-year end.*

Much of this information concerns the 'overseas transfer charge', a 25% charge levied on transfers to QROPS unless the:

- member is resident for tax purposes in the country the receiving QROPS was established in;
- member is resident for tax purposes in a country within the European Economic Area ("EEA"), or in the United Kingdom (including Gibraltar), and the QROPS was established in the EEA or in Gibraltar;
- QROPS is set up by an 'international organisation' (i.e. a formal institution like the United Nations) that employs the member;
- QROPS is an occupational pension scheme and the individual works for an employer participating in that scheme; or
- QROPS is an 'overseas public service pension scheme' and the individual works for an employer participating in that scheme.

Transfers-in from Overseas Arrangements

Transfers received from an overseas pension scheme have one main, additional consideration. Provided the transferring scheme is a recognised overseas pension scheme, (again, not necessarily a 'qualifying' one) then the member can apply for an enhancement to their personal LTA called a 'recognised overseas scheme transfer factor'. It aims to prevent members having to test benefits against the LTA that have not benefitted from UK tax relief.

There is no provision requiring schemes to inform members of this option, but it is recommended.

If the member had put their benefit into payment in a QROPS, as mentioned before, the replacement crystallisation in the UK scheme is a BCE.

Contracting-out

Happily, restrictions on the transfers of protected rights were revoked on 6 April 2012. These requirements would probably have needed their own Insight!

Did you find this Aries Insight useful?

If so, please share it with your colleagues and let them know that more information is available from the *Aries Pensions System*.

If you have any suggestions for topics that you would like to see covered in a future Aries Insight, then please let us know.

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