The Overseas Transfer Allowance: a new feature of the Overseas Transfer Charge

The abolition of the lifetime allowance (LTA) charge from 6 April 2023 opened a window in which transfers to QROPS could be made without any 'excess charge'. The abolition of the LTA from 6 April 2024 closed that window by putting a new allowance put in place. This Aries insight looks at how it works.

Savings in registered pension schemes (RPS) work on the "EET" (exempt, exempt, taxed) basis: contributions are exempt from tax (subject to the Annual Allowance and in some cases the member's earnings), investment growth is normally exempt from tax, but the benefits at the end are mostly subject to tax.

If you like, the UK pension saver 'makes a deal' with HMRC to have 'tax-privileged' pension benefits, under which tax breaks are enjoyed while saving, in return for paying tax on the benefits.

Sometimes a UK pension saver might move abroad to work or retire. Part of the 'deal' is a limit on the amount of these tax-privileged pension savings that may be transferred out from the UK tax system. There is also a restriction on the type of overseas pension scheme that may receive them. They can only be transferred to a scheme that meets Qualifying Recognised Overseas Pension Scheme (QROPS) conditions. (Transferring them to a scheme that does not meet QROPS conditions attracts a hefty tax charge.)

Until 5 April 2024, the Lifetime Allowance (LTA) served as an overall limit on the amount of tax-privileged pension benefits that a member could accrue. LTA excess was subject to a special tax charge, with very few exceptions. The LTA's main duties were to limit the amount of tax-free lump sums that could be taken and the amount that could be used to provide a pension. But it also served to limit the amount of benefits that could be transferred to a QROPS.

The LTA breathed its last at the end of 5 April 2024, of course.

Now, from 6 April 2024, we have a new allowance which limits the amount of certain member lump sums (which are mostly tax-free lump sums), and tax-free lump sum death benefits, that may be paid. These are the Lump Sum Allowance (LSA) and the Lump Sum and Death Benefit Allowance (LSDBA). There is no special tax charge for exceeding these limits, though. Any LSA/LSDBA excess is simply subject to income tax.

But the LSA/LSDBA do not serve to limit the amount that may be transferred to a QROPS. That job falls to another new allowance that operates independently of the LSA/LSDBA. It is called the **Overseas Transfer Allowance** (OTA).

There is a special tax charge for exceeding the OTA, but it is not a new one. The OTA has been added to the existing **Overseas Transfer Charge** (OTC) legislation, and any OTA excess is subject to the 25% OTC.

How the OTA comes into play under OTC rules

In simple terms, the OTC rules apply when a 'UK Tax-relieved fund' is transferred to a QROPS.

Transfers to QROPS from RPS are of course in scope of the OTC rules. But transfers to QROPS from non-UK schemes that have received UK tax relief on contributions (Relieved Relevant Non-UK Schemes (RRNUKS)), and transfers known as 'onward transfers', are also in scope.

Onward transfers are transfers to QROPS of UK tax-relieved funds from a QROPS / former QROPS that relate to a prior transfer from an RPS or RRNUKS (the 'original transfer'). But this is only where the onward transfer is made within a five-year period following the original transfer.

HMRC provides guidance on the operation of the OTC in its guidance on transfers to QROPS.

From 6 April 2024, there is effectively a two-stage approach to employing the OTC rules. Stage two is where the OTA comes in – but while stage two will probably be reached in most cases, it won't be reached in all of them.

Stage one is to see if the transfer is excluded from the OTC because an exclusion condition is met. In broad terms, the exclusion conditions are:

- the QROPS is established in the same country or territory as that in which the member is resident;

- the QROPS is established in any European Economic Area (EEA) state or Gibraltar while the member is resident in the UK or any EEA state;

- the QROPS is an occupational pension scheme where the member works for a sponsoring employer of that scheme;

- the QROPS is set up by an 'international organisation'. Not every multi-national organisation is an 'international organisation' for this purpose, however. For example, the United Nations is, but a multi-national company is not. (Your favourite global fast-food chain is not an 'international organisation', sorry!)

"Resident" here means 'resident for tax purposes', naturally.

If no exclusion is met, the full transferred value becomes subject to the OTC at a rate of 25%, and there is no need to move onto stage two. In other words, the OTA will not come into play (although the transfer will still use up an equivalent amount of the OTA – see 'What uses up a member's OTA?' below).

Even if an exclusion would be met, a member can sabotage themselves by failing to provide the transferring scheme administrator with all the prescribed information within 60 days of the transfer request. Here the exclusions would not apply. The OTC would be due on the full transferred value. The OTA would not come into play, but the transfer would still use up an equivalent amount of OTA.

But if the member played ball with the information requirements and an exclusion is met, then the OTC does not arise at this stage, and now it is necessary to employ stage two. The OTA is now 'in the game'.

Stage two is to 'test' the transferred value against the member's available OTA. The member's available OTA is established, and the transferred value is compared with that (very much like the old 'LTA test'). If the transferred value exceeds the member's available OTA, then the OTC becomes due on the excess amount. This transfer would also use up an equivalent amount of OTA, of course.

What is the amount of the OTA?

The member's OTA amount is the same as the member's LSDBA amount. This means that most people will have an OTA of £1,073,100.

But if the member has an enhanced LSDBA (for example, because they have Fixed Protection or Individual Protection) their OTA will have the same, larger value as their enhanced LSDBA.

For example, a member with Fixed Protection 2014 has an enhanced LSDBA of £1.5m rather than the 'standard' LSDBA of £1,073,100. Consequently, they have an OTA of £1.5m rather than £1,073,100.

See HMRC's guidance for details of when a member's LSDBA may be enhanced.

A member's OTA cannot be increased directly by way of a ROPS enhancement factor (where a transfer to an RPS is made from a ROPS or QROPS), or a Non-UK Residence enhancement factor. However, these enhancement factors may enhance a member's LSDBA, and such a member's OTA (being the same amount as their LSDBA) would then have the same, enhanced value.

What uses up a member's OTA?

Currently, a member's available OTA upon the making of a transfer is the amount of the member's OTA, less the following:

- The total transferred value of all transfers to a QROPS made on/after 6 April 2024 (but before the transfer in question) that were in scope of the OTC rules; and

- (if a benefit crystallisation event (BCE) *of any kind* occurred for the member before 6 April 2024)100% of the member's 'LTA previously used amount'.

  (The LTA previously used amount is the amount of LTA used up, as at the end of 5 April 2024, by all BCEs in respect of the member. It is a feature of the 'standard calculation' of available LSA and LSDBA where the member has had a BCE. See HMRC guidance for more information.

This means the OTA is used up by the transferred value of all post-5 April 2024 transfers to QROPS that are in scope of the OTC rules. This is whether the OTC arose in respect of that transfer or not, and whether there was an 'OTA test' at that transfer or not.

It also means the OTA is used up by the full value of the member's LTA previously used amount (if any). This is even if the member had not made a transfer to a QROPS before 6 April 2024. Furthermore, there is no disregarding of any amounts crystallised at age 75 BCEs.

Known issues with the 'available OTA' provisions

The previous section gives the current position for calculating available OTA, but we know it is going to be adjusted because HMRC has said so. HMRC announced in April's Pension Schemes Newsletter 158 that it intends to correct two known issues. One relates to 'double counting', while the other relates to 'no counting' (double or otherwise)!

The 'double counting' issue affects transfers of drawdown funds.

A member's OTA is reduced by all of a member's LTA previously used amount, regardless of the type of BCE(s) that used up LTA for the member. If a member designated amounts to drawdown between 6 April 2006 and 5 April 2024, this would have been a BCE1, and it would have used up some LTA. Hence, that member's LTA previously used amount accounts for the amounts designated to drawdown.

But as things stand today, if that same member transfers their drawdown fund to a QROPS on/after 6 April 2024, this will use up an amount of that member's OTA, even though their OTA is also reduced by their LTA previously used amount (which has already accounted for the drawdown fund). That member's drawdown fund would effectively be double counted for OTA purposes.

The 'no counting' issue relates to pensions - and not just drawdown funds - that came into payment before 6 April 2006 ("pre-commencement pensions"), whether they are being transferred or not.

If a member has a pre-commencement pension and has had a BCE, then immediately before the member's first BCE there would have been a notional BCE at which the pre-commencement pension was deemed to have used up some LTA. This means their LTA previously used amount accounts for their pre-commencement pension, and by extension so does their OTA.

But if a member has a pre-commencement pension yet has *not* had a BCE, then there has not been a deemed BCE to use up any LTA, and the calculation of the member's available OTA will not take it into account. A 'no BCE' member's pre-commencement pension is currently not counted for OTA purposes.

HMRC intends to make rules to provide that drawdown funds are not 'double counted' against the OTA, and to ensure that pre-commencement pensions are not overlooked when a member's available OTA is established. These amendments will almost certainly have retrospective effect from 6 April 2024. HMRC says affected members may wish to delay their transfer to a QROPS until these amendments to legislation are made, though it is not clear when that might be.

The OTA can be a feature after a transfer from a registered pension scheme to a QROPS

It is possible for an OTC to later become reclaimable if it was applied to a transfer to a QROPS that met no exclusions. This can happen if the member's circumstances change in a period of five years after the original transfer and an OTC exclusion would have been met if the changed circumstances had applied at the time of that original transfer. For example, the member might relocate to become resident in the country/territory in which their QROPS is established – if they had been resident there at the time of the original transfer, the 'same country' exclusion would have been met.

If the original transfer occurred on/after 6 April 2024, then the OTC becoming reclaimable brings the OTA into play for that original transfer. (In essence, stage two of the OTC approach mentioned earlier now needs to be employed for that transfer.) The original transferred value would be 'tested' against the member's available OTA at the time, and the OTC would become due on any excess above the available OTA.

Putting this another way, it is theoretically possible for a member to pay an OTC, for that OTC to later become reclaimable, and for the member to then pay another OTC on the same transfer because it exceeded their available OTA. It would not mean a higher tax charge is due though. An OTC on the whole transferred value will never be less than an OTC paid on the excess over the OTA.

Note it is not possible for an OTC to become reclaimable if it was paid because the OTA was exceeded.

Summary of key points

The OTA is a feature of the OTC rules and applies to transfers to QROPS made on/after 6 April 2024 that are subject to those rules.

A member's OTA has the same value as their LSDBA; if their LSDBA is enhanced, their OTA has the same value as their enhanced LSDBA.

If the OTA is exceeded by a transferred value, the excess is subject to the 25% OTC, but only if the transfer is not already subject to the OTC.

The OTA is used up by all of the member's LTA previously used amount (if any), and all transfers to QROPS in scope of the OTC rules and made on/after 6 April 2024 (whether or not there was an OTA test, and whether or not an OTC was due, at the time of the transfer).

From 6 April 2024, a transfer to a QROPS is free from UK tax only where both an OTC exclusion is met, and the member has sufficient available OTA to cover the transferred value.

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