Worth the advantage?

Employment Tax | Personal tax



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Anton Lane considers the commerciality of Qualifying non-UK Pensions

Key Points

What is the issue?

QNUPS have become popular structures to provide retirement benefits although where they are not established for the right reasons, the risks can be high.

What does it mean to me?

Advisers need to be aware of the risks and the increasing tougher tests for reasonable excuse.

What can I take away?

QNUPS have advantages and if advising on them it is important to consider the risks and managing reasonable excuse arguments if they could arise in the future.

'Everybody aspires to an affordable home, a secure job, better living standards, reliable healthcare and a decent pension'
Jeremy Corbyn

The definition of a decent pension may vary depending on the normal level of income received by a person and hence unapproved retirement benefit schemes were popular. Today, qualifying non-UK pension schemes appear to have gained popularity. A QNUPS is defined in ITA 1984 s 271A(1) as:

> 'a pension scheme (other than a registered pension scheme) which –
>
> 1. Is established in a country or territory outside the United Kingdom, and
> 2. Satisfies any requirements prescribed for the purposes of this section by regulations made by the Commissioners for Her Majesty's Revenue and Customs.'

The definition of pension scheme has the same meaning as FA 2004 s 150 and is broadly:

> 'a scheme or other arrangements, comprised in one or more instruments or agreements, having or capable of having effect so as to provide benefits to or in respect of persons –
>
> 1. On retirement,
> 2. On death,
> 3. On having reached a particular age,

4. On the onset of serious ill - health or incapacity, or
5. In similar circumstances.’

And, an…

> ‘overseas pension scheme means a pension scheme (other than a registered pension scheme) which –
>
> 1. Is established in a country or territory outside the United Kingdom, and
> 2. Satisfies any requirements prescribed for the purposes of this subsection by regulations made by the Board of the Inland Revenue’

On 15 February 2010, HMRC released the Inheritance Tax (Qualifying Non-UK Pension Schemes) Regulations 2010 (SI 2010/51). The regulations have effect from 6 April 2006 and set out the requirements which must be satisfied by an overseas pension scheme in order for it to be a QNUPS. It must either be:

- Recognised for tax purposes under the tax legislation of the country or territory in which it is established; or
- Established by an international organisation pursuant to section 1 of the International Organizations Act 1968.

The primary conditions are:

- The scheme is open to persons resident in the country or territory in which it is established;
- The scheme is established in a country or territory where there is a system of taxation of personal income under which tax relief is available in respect of pensions; and
- Tax relief is not available to the member (or if an employee, the contributing employer) on contributions;
- The scheme is liable to taxation on its income and gains; or
- All or most of the benefits paid by the scheme to members who are not in serious ill health are subject to taxation.
- The secondary conditions are:
- The scheme is approved, recognised or registered with the relevant tax authorities as a pension scheme where it is established (condition A);
- Where the relevant authorities have no system for approval, recognition or registering the scheme must be resident there, provide at least 70% of the

member’s relevant scheme funds for providing an income for life and must be payable no earlier than if the pension rule 1 in section 165 FA 2004 applied – normal minimum pension age (currently 55 years) (condition B).

Establishment of a QNUPS

The establishment of the QNUPS with a nominal contribution should not have had any IHT, CGT or income tax implications.

The transfer of assets to the QNUPS will be a disposal for CGT purposes and may give rise to a gain for CGT purposes.

The transfer of value to a trust by a UK domiciled person is generally a chargeable lifetime transfer for IHT purposes. IHTA 1984 contains certain provisions that prevent sums and assets held under a registered pension scheme or a superannuation fund to which section 615 (3) Taxes Act 1988 applies from certain IHT charges.

Section 12(2) IHTA 1984 therefore applies to prevent a charge arising to IHT on the transfer of assets to a QNUPS.

A QNUPs can be established as a stand-alone pension fund and contributions are not chargeable lifetime transfers.

QNUPS after establishment

Inheritance Tax (‘IHT’)

A trust established by a UK domiciled person will normally be within the relevant property regime and subject to IHT at a maximum of up to 6% every tenth anniversary. In addition, distributions of capital would be subject to IHT as exit charges.

Section 58(1)(d) IHTA 1984 excludes property held within a QNUPS from being relevant property:

> ‘ [(d) property which is held for the purposes of a registered pension scheme [,a qualifying non-UK pension sche me or a] section 615(3) scheme;] ‘

In conjunction with Section 58(2A)b:

‘ (b) property applied to pay lump sum death benefits in respect of a member of [a qualifying non-UK pension scheme or] a section 615(3) scheme is to be taken to be so held if the benefits are paid within the period of two years beginning with the earlier of the day on which the member’s death was first known to the trustees or other persons having the control of the fund and the day on which they could first reasonably be expected to have known of it.]’

Section 151 IHTA 1984 prevents the value held within the QNUPS from being within the scope of IHT on the death of the member.

Capital gains tax (‘CGT’)

The trustees of the QNUPS will be non-UK resident and therefore generally outside the scope of CGT under section 2 TCGA 1992.

Section 86 and schedule 5 TCGA 1992 can attribute gains of an offshore settlement to UK resident settlors if they have retained an interest.

Income tax

The trustees of the QNUPS will be non-UK resident and therefore outside the scope of UK income tax other than on UK source income.

Transfer of assets abroad

Section 721 of the Income Tax Act (‘ITA 2007’) applies an income tax charge on individuals with power to enjoy income as a result of relevant transactions and section 723 ITA 2007 sets out the conditions where a transferor would be regarded as having the power to enjoy income. There is an exemption from the charge to income tax (section 737 ITA 2007) where the transfer is for commercial purposes and the avoidance of tax is not the motive or one of the motives for the transfer.

Section 738 ITA 2007 defines a commercial transaction.

Settlements legislation

ITTOIA 2005 s 619 imposes a charge to income tax on the settlor of a trust where they retain an interest either directly or by virtue of their spouse of children being beneficiaries. The meaning of settlement and settlor for these purposes is:

1. ‘In this Chapter – ‘settlement’ includes any disposition, trust, covenant, agreement, arrangement or transfer of assets (except that it does not include a charitable loan arrangement), and ‘settlor’, in relation to a settlement, means any person by whom the settlement was made.
2. A person is treated for the purposes of this Chapter as having made a settlement if the person has made or entered into the settlement directly or indirectly.
3. A person is, in particular, treated as having made a settlement if the person:
    1. has provided funds directly or indirectly for the purpose of the settlement,
    2. has undertaken to provide funds directly or indirectly for the purpose of the settlement, or
    3. has made a reciprocal arrangement with another person for the other person to make or enter into the settlement’

The definitions are much wider than that contained in other legislation. However, where the contribution is commercially justified, it would not be bounteous.

Commerciality

The commercial reason to transfer assets to a QNUPS is important because in absence of a substantive reason, anti-avoidance legislation is likely to apply. The anti-avoidance provisions require for not one of the purposes for or associated with the transfer to be the avoidance of tax. It is necessary therefore to consider whether those establishing QNUPS had good commercial reasons for making transfers.

A basis of the commercial reason could be that a person who had reduced pension options would be attracted to utilising a QNUPS. A person with reduced pension options would be a person that has maximised or is unable to maximise contributions to a regulated pension. The person would have a desire to secure a pension (to provide an income stream in retirement) by placing assets in an environment that purposely facilitates a pension. An alternative proposition would be to place funds into an environment that would permit the regular payment of an income stream, which is akin to a pension.

A specific pension vehicle is not actually needed to provide retirement benefits where the level of wealth is considerable. Assets could alternatively be held to provide benefits in a period of ‘retirement’. The question will arise whether the QNUPS is chosen because commercially it was the right structure or because the

member contributing sought other advantages.

Advice provided by a financial adviser, which stipulated the QNUPS was a suitable option, adds significant evidence of commerciality. However, given HMRC's more recent approach scrutinising a taxpayer's motive, they are likely to consider more detailed information. HMRC are likely to identify potential other motives and whether any one of them were for the avoiding of tax as well as the way the transaction was advised upon and undertaken. For example, HMRC have asserted where the manner a transaction is undertaken is guided by tax advice, that advice must be a significant influence.

There is a genuine risk that HMRC will challenge the income tax position to treat income of the QNUPS as that of a UK resident transferor on an arising basis.

HMRC could challenge the treatment on the basis that the legislation was written with the intention that members utilising QNUPS would not be UK domiciled and resident individuals. If such a challenge were successful, HMRC would likely treat the QNUPS as a relevant property trust: a chargeable lifetime transfer on assets transferred into the trust, exit charges on trust capital and ten yearly principal charges.

Tax penalties and offences

The penalty regime for failed offshore tax planning has also changed and can be up to 200% for jurisdictions within category 3.

Issues may arise under new legislation introducing the Offshore Criminal Offence that was given effect from 6 April 2017 and The Criminal Finance Act 2017 that has effect from 30 September 2017.

The new criminal offences apply for the purposes of income tax and CGT only, where a person has failed to declare offshore income or gains. The offence applies to any subsequent loss of tax over a threshold amount, which will be defined in the regulations annually. The offence does not prescribe the need to prove intent for failing to declare taxable offshore income and gains. A custodial sentence may be given. The offence could apply where say, the income of the QNUPS is not included in a personal tax return and subsequently, HMRC successfully contend it should have. An offence would have been committed. Where full professional advice is sought, protection from the offence is available through a reasonable excuse

defence.

The defence of reasonable excuse has recently been tested through the courts and HMRC have provided new guidance. The defence requires advice to be provided by an appropriate specialist and to be current. In the situation, to ensure a reasonable excuse argument would be available would require regular tax advice. Furthermore, to rely on the defence the advice needs to be specific as to the tax treatment. The requirement for advice to be concise causes concern because it is unlikely that any suitably qualified adviser would stipulate a particular tax treatment. If the tax advice received cannot be specific, then reliance on a reasonable excuse argument is hindered considerably because the taxpayer would be aware that the desired tax treatment may not be afforded. As such, the risk in the event the tax treatment is disputed is the application of the offshore criminal offence.

Part 3 of the Criminal Finance Act ('CFA') legislated to provide new corporate offence for *failure to prevent facilitation of tax evasion*, which came into effect from 30 September 2017. Historically, to attribute criminal liability to a corporate body, it was necessary for prosecutors to show that the senior members of the organisation were *involved in* and *aware of* the illegal activity. Given that senior members generally constitute the Board of Directors, HMRC have historically had difficulty in attributing criminal liability to large or multinational organisations.

The new legislation seeks to change *who* is accountable for acts contrary to the law, rather than *what* is criminal. The legislation seeks to achieve this by focusing on the *failure to prevent* the crimes of those acting on behalf of the body, rather than by attributing their criminal acts to the corporation.

Prosecution under the offence could lead to a conviction and an unlimited penalty. The new offence allows criminal liability to be attributed to a corporation or partnership – without the necessity of demonstrating involvement or awareness of senior members of the organisation.

PCRT

CTAs and other professionals responsible for advising in relation to the QNUPS in the circumstances described need to consider the Professional Conduct in Relation to Taxation Rules which includes five new tax planning standards, including: 'Members must not create, encourage or promote tax planning arrangements or structures that i) set out to achieve results that are contrary to the clear intention of Parliament

in enacting relevant legislation and/or ii) are highly artificial or highly contrived and seek to exploit shortcomings within the relevant legislation.’