AURORA

Qualifying Recognised Offshore Pension Scheme

QNUPS and DOWNS

Qualifying Non-UK Pension Schemes (QNUPS) are rapidly becoming the latest area of note in the QROPS/Offshore pension world, but do they offer the Inheritance Tax (IHT) benefits that are being heavily promoted?

Where did QNUPS come from?

The term QNUPS effectively came into being in 2008 when the Inheritance Tax Act 1984 (IHTA84) was amended by the insertion of a new clause from the Finance Act 2008 [“qualifying non-UK pension scheme” inserted into IHTA84 by FA2008 s 92, Sch 29, para 18(8)]. The only relevant addition to the legislation since then occurred in early 2010 with a clear definition of what comprised a QNUPS. However, the essential changes occurred in 2008 and most notably had retrospective effect as the amendment took force from 6 April 2006 (“A” Day).

The reason behind these amendments and the retrospective legislation was the correction of mistakes/omissions made in the “pensions simplification” drafting released on “A” Day. This correction was publicly confirmed in the Pre Budget Report of 2007 where HMRC’s intention to extend the existing IHT treatment to QNUPS and with effect from “A” Day, was stated.

QNUPS has therefore had a messy creation, missed out in the original legislation in 2006, corrected in 2008 and then a long wait to early 2010 for the statutory definition of a QNUPS to be made [SI 2010/51 effective 15 February 2010].

SI 2010/51 is remarkably similar to the SI that every trustee completes in achieving QROPS status with HMRC, the critical difference in this context being that a scheme that meets the general criteria but has not sought “approval” from HMRC still meets the lesser QNUPS test. As an example a scheme which could be a QROPS but has not gone to HMRC to get its qualifying status agreed can meet the QNUPS criteria and would be called a ROPS (a QROPS without the Qualifying “Q”).

That is an important difference because getting that Q in front of a ROPS scheme entails agreement with HMRC to report certain events to them. And so a ROPS has the potential advantage of not needing to report to HMRC but still gets the potentially beneficial IHT treatment as it meets the QNUPS criteria.

What then are the promoted IHT planning benefits?

The use of a ROPS to shelter client assets from IHT and the lack of reporting requirements to HMRC are frequently cited.

A quick search of the internet should show a number of advisers/providers promoting QNUPS and their use to remove assets from a person’s UK estate and shelter them from IHT. In many cases the amount of the potential contribution suggested is “without limit”. Given that very many typical clients will still be UK domiciled that is a very attractive claim but on this point great caution should be exercised.

Firstly, before getting technical, if that were true it would be one of the greatest tax loopholes ever created and anyone who has a fancy can remove any proportion, even 100%, of their estate outside their liability to IHT?

If only life were that easy and of course it seems no mention is made of a number of difficulties not least the anti-avoidance provisions existing in IHTA84. There is sometimes great play on the fact a ROPS has no reporting to HMRC and in others the possibility of returning or lending large proportions of the fund, unlike any “normal” pension. However, the ROPS still has to meet the criteria HMRC requires. Perhaps not right now, but at some point – and probably it will be the Executors on death. So someone will still need to establish the bona fides of the scheme to HMRC to get the QNUPS approval, if at that time the scheme doesn’t look and smell like a real pension plan, assessments will surely be raised.

Promotion to UK residents

Other issues arise with such schemes being promoted to UK residents or people returning to the UK. A matter all advisers must take into account as even the most determined expat may return to the UK on death of a spouse, birth of grandchildren or perhaps ill health issue. If a member of a ROPS is or becomes UK resident the pension trustee/administrator may not be required to report to HMRC but the member certainly does under the UK self-assessment regime.

Also, one has to remember that the charges that arise on death are not exclusively IHT. In fact IHT is often the smallest part of the liability. The substantial elements are Income Tax charges, such as the charmingly named "special lump sum death benefits charge". An estate containing a UK tax relieved pension fund, whether in a QROPS or ROPS, of a UK resident individual will not be able to avoid those charges. Those charges only fall away when you can establish a current period of non UK residence exceeding five full UK tax years.

QNUPS contributions

So let us look in more detail at adding contributions to a QNUPS offshore and without UK tax relief.
For anyone contemplating such arrangements that are UK resident or may become so in the future there seems little point. Why would anyone wish to take capital out of their estate and contribute without tax relief in order to save, say, 40% IHT after death but pay income tax on receipt of pension benefits in life potentially at 50%. If the answer to that is don't pay out benefits just accrue them to death at whatever age, well, in that case you've probably failed the criteria for QNUPS, indeed for a pension generally.

Making additional contributions to a proper pension scheme is surely a reasonable thing to do and therefore if you are offshore making such contributions, without tax relief, into a QNUPS (and in a reasonable way) there is potential to receive favourable IHT treatment.

Careful consideration needs to be taken to give up assets over which you have free disposition and put them into a restrictive pension structure where you have to abide by rules and do not have free access to the funds.

Reasonableness

Reasonableness is the key, placing any significant part of one's estate into such a plan is going to be extremely hard to justify and as stated previously may fall foul of anti-avoidance provisions in IHTA84. These safeguards appear to have been overlooked by certain promoters. They are there to counter abuse and perhaps they may be used if limitless contributions to QNUPS are made. To stand any real chance of receiving IHT benefits it may be necessary to be able to demonstrate the reasoning behind the QNUPS for pension provision and the contributions into it. If the only reason you have is to try and gain a tax advantage, all does not bode well. Recent case law clearly demonstrates HMRC's determination in preventing tax leakage through unintended loopholes or artificial constructions to achieve tax advantage.

In the recent Huitson case a well known planning arrangement was attacked retrospectively when legislation was amended. The case hinged on a tax avoidance scheme marketed by a firm of tax consultants. The Court did not support a taxpayers view that his human rights had been breached when effected by "retrospective" legislation that HMRC introduced to counter the widespread tax planning opportunity. Hence, HMRC remain able to claim taxes back to the start of the arrangement. The Court concluded that the government was entitled to change tax law retrospectively to squash artificial arrangements.

There has also been recent new precedent on UK pensions and IHT avoidance, extending the "spreading tentacles" of IHT liability. The Case involved a lady who discovered she was terminally ill with less than a year to live. Rather than taking benefit before death from her pension the member chose not to vest their pension. UK rules provide that an unvested pension falls outside the IHT net. But HMRC claimed the IHT and won as they showed the person knew they were soon to die and whilst a great simplification of the Courts findings, pensions are not to be used as an estate planning tool.

Limitless contributions to QNUPS, especially if you cannot demonstrate a good reason, in pension planning terms, why you are making the contributions, is thus an area fraught with danger.

Whilst the extension of IHT benefits to QNUPS and in particular a QROPS with a standard UK tax-relieved fund, is warmly welcomed, the potential abuse that may be visited using ROPS is worrying. If the general anti-avoidance provisions don't worry you then consider HMRC's view on pensions, their dislike of their use for estate planning and their general attack on tax leakage involving artificial constructions to gain tax advantage.