What is next for QROPS?

The development of the QROPS market has taken a somewhat unpredictable path since the launch of the products in 2006, but what does the future hold and what exactly are HMRC looking for?

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In light of recent statistical information obtained by Concept from HMRC, which shed new light on the QROPS world, what is next for QROPS?

The introduction of QROPS in April 2006 seems a distant memory, but could anyone have predicted the path QROPS has taken since then? I very much doubt it. The gripping factor has been an active HMRC, making enquiry into various jurisdictions and plans, and taking action.

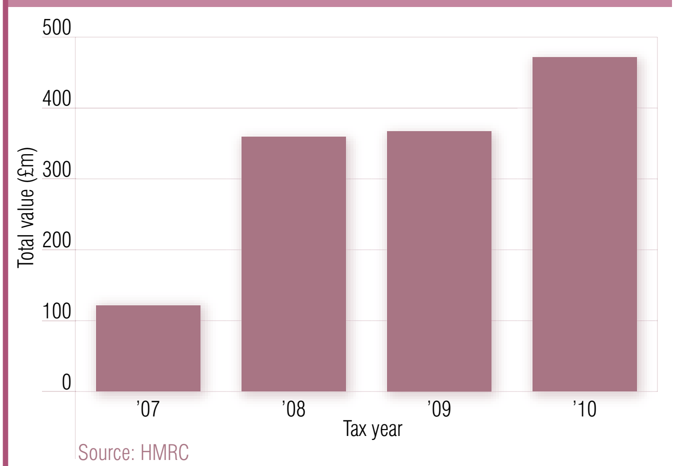
The difficulty is that we are all somewhat in the dark as to what exactly HMRC want. The one time I have witnessed full interaction with HMRC on QROPS issues in public was in 2009, when a key official from pensions policy presented at a London conference.

The talk and slides gave a great indication as to HMRC's position. They were quite happy, in general, with their regulations which clearly have been put together with some effort and met their policy objectives to:

- Remove obstacles for an internationally mobile workforce
- Make it easier for people leaving the UK permanently
- Meet international obligations

Interestingly, even by early 2009, HMRC said they were surprised at the interest in QROPS. The bar chart below illustrates each year's transfers into QROPS from figures provided by HMRC to Concept.

Value of funds transferred into QROPS



With aggregate transfers approaching £1.5bn, it is not an insignificant market (although compared with other mature markets, QROPS is in its infancy), but certainly one HMRC will continue to observe. So what are they looking for?

Singapore case

In the 2009 conference, HMRC described the failing characteristics of a QROPS plan, where the main activity was receiving transfers from the UK and most or all members lived in a different country. Furthermore, the country of establishment had no significant private pension industry.

It is interesting to consider how specific that presentation was – prepared in light of what, at that time, were the recent events in Singapore. Particularly, if you then look at the judgement of 20 May, 2011, where the Singapore office of Equity Trust claims were heard in the High Court. Equity lost that hearing on two questions, Judge Hodge QC concluding on one, that the plan was not genuinely accessible to Singapore residents.

Action on abuse

This is just the first round, but it shows the determination of HMRC. It also shows that the QROPS regulatory framework meets HMRC requirements – they would have amended them by now if not.

Be mindful that the regulations provide for retrospective amendment, as has already occurred when in 2008 amendments were made to 'correct' the IHT position, missed in the 2006 drafting. For those with an interest in retrospective legislation and HMRC, the case of Huitson will make frightening reading. That avenue exists as perhaps the final recourse to HMRC should they feel the need to halt abusive plans and plug tax leakage.

So, expect further action against abuse where it arises, although the form that action takes will vary. There is no doubt in my mind that HMRC have been watching the never-ending media 'bun fight' on QROPS with some interest. Particularly those taking enormous risks and promoting what we all know is 'abusive' as acceptable. The fact is some members will eventually end up back in the UK, or be in countries with helpful (to HMRC) tax agreements.

The effect on the QROPS market place has been to drive the majority of the business to prudent jurisdictions and providers. This trend will surely continue. The pie chart (right) shows the market share for the main jurisdictions in 2011, based once again on figures provided to Concept by HMRC.

To interpret the data, you need to understand that there are two distinct markets in the QROPS world. One market, Australia, is used entirely by individuals moving to that jurisdiction. There are then jurisdictions that are dominated by third jurisdiction type business, such as Guernsey, Isle of Man and Malta.

There is also New Zealand, which deals with a combination of transfers. Many of the QROPS transfers received by New Zealand will actually be in respect of people moving to New Zealand. Unfortunately, many will also be only short-term users, encashing their pensions. When those people end up back in the UK, which surely many will, the new HMRC QROPS investigations group will be there waiting for them.

Prudent jurisdictions

So back to the main question – what is next?

Prudent jurisdictions are the winning business model and should continue to thrive. The Isle of Man's 50c regulations were a great step forward. They removed their handicap over taxes (except perhaps the VAT on fees). However, concerns over 50c remain, and the fact QROPS transfers out are at times being blocked by the Isle of Man authorities is, unfortunately, sending out completely the wrong signal.

The whole HMRC enquiry over 50c and the 70% rule has been damaging and is not over. HMRC enquiry and uncertainty are not the ingredients for a good QROPS business model. The Manx market share in the pie chart bears witness.

For those technically minded, one of my concerns with use/abuse of the 70% rule centres on the regulations contained in Schedule 34 FA2004, see also SI2006/207. Usefully summarised in RPSM13102190, in particular indented paragraph one. Essentially, payments made are always deemed to be paid out of the tax relieved fund first.

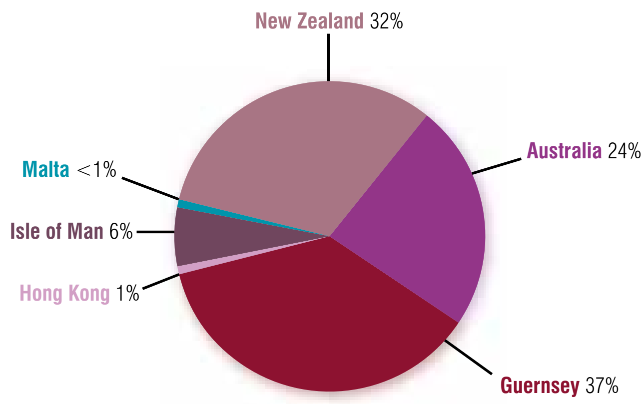
A game changer

In our correspondence with HMRC, we have had confirmation that it simply does not matter what we deem has occurred; HMRC will always deem any funds paid out as first coming from the tax relieved fund. Parking 70% of the tax relieved fund and doing what you like with the rest plus growth is therefore, in my opinion, a non-starter – you are stuck with the usual payment rules like everyone else.

With New Zealand's QROPS future uncertain, and draft regulations effectively stopping third country QROPS being tabled, we can expect a change in the game. New jurisdictions willing to take the risks and fill the 'encashment' route may appear. I expect overall the prudent jurisdictions will increase their market share. The Isle of Man and Guernsey could be the main beneficiaries.

Any question like, what is next for QROPS, must contain some discussion on QNUPS. Some product providers I talk to think QNUPS will be as big as QROPS, perhaps bigger. There certainly are benefits in a properly constructed QNUPS and, so long as they are promoted correctly, there should be a good market. HMRC are not giving tax relief on the contributions, so the immediate danger is removed.

QROPS market share 2011



Source: HMRC

Danger ahead

If sold overtly as an IHT avoidance plan, and contributions are made without limit (and thus beyond anything that would reasonably occur by way of normal contribution to a pension), there may be trouble ahead. I say ahead, because the claims often made may well not be tested until death of the member. At that stage HMRC will then quite possibly enquire as to the bona fides of the scheme. If it is not a pension in their eyes, perceived IHT benefits may vanish.

I understand the first cases of QNUPS are being examined by HMRC following death of members, and therefore we will soon understand more.

In summary, QNUPS will, in all likelihood, be a sister product to QROPS. Fees for QROPS will continue to fall as volumes increase and competition comes to bear. For the consumer it is looking good. For the adviser and provider it is an increasingly competitive market with tightening burdens of regulation. The winners will be the specialists, those with scale and those willing to take a long-term prudent view. IA

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IA KEY POINTS

Guernsey currently has the largest share of the QROPS market (37%), with the highest number of QROPS transfers received. It is likely the more prudent jurisdictions, such as Guernsey, will continue to grow and consolidate their position.

The uncertainty surrounding the QROPS industry in New Zealand is another example of how 'blurring the lines' of the regulations for QROPS may result in short-term gains, but could have repercussions.

The QROPS market is becoming more competitive, and as a result, fees will continue to fall and providers will need to ensure their offering and service levels meet growing expectations and industry standards.