Australians with UK pensions – Issues on withdrawal, transfer and post-transfer

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Synopsis

UK law attempts to impose reporting obligations and sometimes UK tax liability where there is UK sourced pension money held in an Australian super fund.

Jeremy Gordon examines who has such responsibilities, what events might trigger them and hence what enquiries of the member need to be made.

Jeremy also considers the hurdles facing those who want to transfer their UK pension benefits into the Australian superannuation regime, and the potential pitfalls for members and their advisers. Jeremy gives a typical scenario of how a large UK pension fund might be transferred over 7 years in tranches, with the final tranche intentionally exceeding the non-concessional contribution cap.

It not surprising that efforts have been made to find alternatives to such transfer plans. Jeremy briefly considers one of these which has recently found favour – direct withdrawal, but he warns that the risks probably outweigh the benefits.

In this paper UKSPM means "UK sourced pension money". That is, money which was built up in a UK pension scheme and transferred to a QROPS. The expression is not known to UK law; this is intentional and means it can be used for our purposes without fear of change.

HMRC is Her Majesty's Revenue and Customs.

ROPS is a Recognised Overseas Pensions Scheme, meaning a non-UK scheme which satisfies all the requirements of the relevant regulations.[1] *In particular that pension benefits are not payable to the member until age 55 or formally retired due to ill-health.*[2]

QROPS is a Qualifying Recognised Overseas Pensions Scheme, that is to say a ROPS which has notified HMRC that it is a ROPS and has given the required undertakings.[3]

Jeremy keeps his migrants and ex-pats page up to date with information and news in this area: Pension transfer to Aus: main issues for UK migrants (directdocs.com.au)

References in this paper to legislation is to the amended versions as they apply at the time of the paper.

1 That is, the *Pension Scheme (Categories of Country and Requirements for Overseas Pension Schemes and Recognised Overseas Pension Schemes) Regulations* 2006 (as amended).
2 That requirement is in pension rule 1 in section 165 of the *Finance Act* 2004.
3 Section 169(2) *Finance Act* 2004.

UKSPM held in an SMSF

What are the obligations of members and scheme managers?

Note that an adult member of an SMSF who is of sound mind will always be a "scheme manager". An administrator of an SMSF will also be a scheme manager.

- the member (*as a taxpayer*) must pay any UK income tax which arises, either from a taxable withdrawal from a QROPS[4] or because of an unauthorised payment[5]
- both the member and the scheme manager are liable under the applicable UK law to pay the UK overseas transfer charge if it arises[6]
- there are self assessment obligations which means that the taxpayer and scheme manager (if liable) must inform HMRC that tax is owed and not the other way round
- the scheme manager of a QROPS or former QROPS must report events to HMRC, pursuant to the information regulations[7]
- the scheme manager of a QROPS will have undertaken on form APSS251 to report events to HMRC and to pay the overseas transfer charge if it is due[8]
- the member will have undertaken on form APSS263 to pay tax arising on a taxable transfer (that is, an unauthorised payment)[9]

Please note:

This is a list only of the most likely obligations which arise in practice.

Obviously, people ask from a practical point of view whether the obligations are enforceable, how HMRC could find out about a reportable event etc. Although there is some reference to enforceability later in the paper, the main aim of this section of the paper is simply to alert you to the obligations. Many members of the SMSF Association will be obliged in any case to respect the obligations for reasons of compliance. It is outside the scope of this paper to consider practical issues such as enforcement in detail.

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4 In practice, for an Australian tax resident this would be a non-pension lump sum payment (Uncrystallised Funds Pension Lump Sum) which the UK would seek to charge to tax under Schedule 34 of the *Finance Act* 2004 applying section 636A(1A) of the *Income Tax (Earnings and Pensions) Act* 2003. There is no attempt to tax a pension payment, which is consistent with Article 17 of the Australia-UK Double Taxation Convention signed in 2003 which provides that pensions are taxable only in the resident state (in this case, Australia).

5 The most likely unauthorised payment will be a transfer from a QROPS to a non-QROPS when this is not yet allowed, or the purchase of taxable property like an investment property with the UKSPM.

6 This is governed by sections 244 to 244N of the *Finance Act* 2004.

7 The aptly named *Pension Schemes (Information Requirements - Qualifying Overseas Pension Schemes, Qualifying Recognised Overseas Pension Schemes and Corresponding Relief) Regulations* 2006.

8 Note that these undertakings must be given by the scheme manager, otherwise the fund will not be a QROPS. This is a trap because sometimes the undertakings are not given by the correct person or persons.

9 Form APSS263 is completed by the member when making a request to a UK pension scheme to transfer to a QROPS.

Who is Scheme Manager?

This is important because UK law imposes obligations and in some cases tax liability upon the scheme manager of a QROPS or former QROPS.

The definition is very wide:[10]

> in relation to a pension scheme, means **the person or persons administering**, or **responsible for the management of**, the pension scheme

This shows that a number of people could be scheme manager at the same time.

For an SMSF, clearly the trustee(s) would be scheme manager, that is to say an adult member of the SMSF who is of sound mind.

But also, day to day administrators of an SMSF will also be scheme manager.

Professionals advising the administrators would probably not be.

It can be noted that HMRC has no formal registration system for scheme manager of a QROPS or former QROPS, like it has for the UK equivalent of "scheme administrator" or for practitioners who are authorised to deal with the day to day affairs of a pension scheme.

Instead, HMRC keeps a record of who is the scheme manager for a QROPS or former QROPS based on who has completed the form APSS251 (notification of ROPS).

But an administrator of an SMSF, even if not named on the form, will technically also be scheme manager despite not being recorded by HMRC as such.

Bearing in mind a scheme manager has obligations and may also have a tax liability in certain circumstances, the result may seem somewhat alarming and possibly oppressive. However, it is explained by the fact that the UK has tried to define the scheme manager as widely as possible to ensure that there will always be a person responsible out of all the various global superannuation structures.

In the case of an SMSF which is or was a QROPS, the administrators will be aware of their obligations and potential liability and can make arrangements accordingly.

In the case of an SMSF which is not a QROPS and which was never a QROPS, but which might contain UKSPM (for example if UKSPM was legitimately rolled into the SMSF by a member), luckily an administrator of the SMSF (and who is scheme manager on that basis) will have no obligations to HMRC and no potential liability to UK tax.[11]

The member would however, have such obligations and tax liability, so if the administrators advise members about such matters they would need to know about the UKSPM and other details to be able to give such advice.

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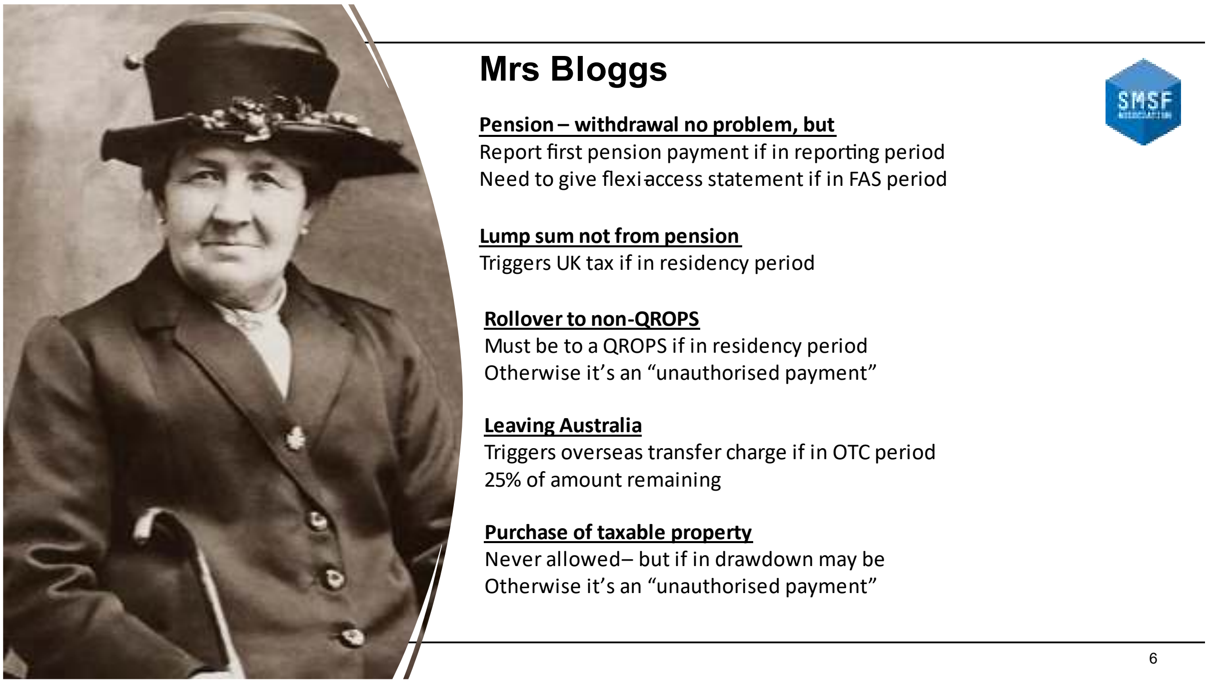
10 Section 169(3) of the *Finance Act* 2004.

11 This can be seen more clearly from the tables below.

Enquiry triggers for scheme managers

These are the member requests where there is UKSPM held in a QROPS or former QROPS which may require further enquiries:



To assist Mrs Bloggs, we will need to apply the "periods" properly. Unfortunately there are four different periods which might apply and even more unfortunately three of them can revive if the client has returned to the UK and become a tax resident.

In Mrs Bloggs case, she wants to go to the UK for two years to look after her sister. She will therefore be a UK tax resident over that time and most of the periods affecting her UKSPM will revive.[12]

The possibility of the period reviving in this way means that even after a legitimate rollover of UKSPM to a fund which is not a QROPS, and which has never been a QROPS, the UKSPM may come under UK rules again.

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12 See the RDR3 statutory residence test at: https://www.gov.uk/government/publications/rdr3-statutory-residence-test-srt also search for some helpful flowcharts available online.

The four periods which apply

The residency period[13]

This relates to the period in which UK tax and transfer rules might apply to UKSPM in a QROPS or former QROPS.

For transfers before 6 April 2017 ("**5 year rule funds**"):

> They apply if, when the payment is made, the member –
>
> is resident in the UK or was resident in the UK in the current tax year or in any of the 5 tax years immediately preceding the current tax year

For transfers on or after 6 April 2017 ("**10 year rule funds**"):

> They apply if, when the payment is made, the member –
>
> is resident in the UK or was resident in the UK in the current tax year or in any of the 10 tax years immediately preceding that year or
>
> 5 years has not passed since the transfer

Note that because the period is considered back from the payment, **it can revive**

The FAS (flexi-access statement) period[14]

This relates to the obligation of the scheme manager of a QROPS or former QROPS to give a flexi-access statement to the member if it appears that the member has flexi-accessed the UKSPM (and has not had such a statement before).[15]

The period is 5 clear tax years back from the first pension payment made by scheme manager from scheme holding UKSPM (could be nearly 6 years) – **can revive**

The OTC (overseas transfer charge) period[16]

This relates to the period within which, if a member of an Australian QROPS containing post 9 March 2017 UKSPM leaves Australian tax residency, the 25% overseas transfer charge will apply.

The period is 5 clear tax years from the date of transfer from UK pension scheme (could be nearly 6 years).

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13 Paragraph 2 of Schedule 34 of the *Finance Act* 2004.

14 Reg 3AA(7) of the *Pension Schemes (Information Requirements - Qualifying Overseas Pension Schemes, Qualifying Recognised Overseas Pension Schemes and Corresponding Relief) Regulations* 2006.

15 You can search for "Pension Tax Manual flexi-access statement" for what should be said in the statement.

16 Section 244A of the *Finance Act* 2004. Search for "Pension Tax Manual overseas transfer charge" for details.

The reporting period[17]

Please search for "Pension Tax Manual QROPS report to be made to HMRC" for details of the reporting obligations and reporting period.

This relates to the obligation of the scheme manager of a QROPS or former QROPS to report certain events to HMRC.

For:

(a) payments to a member (if pension, only the first such payment need be reported);
(b) transfers to another fund;
(c) overseas transfer charge arising by member's change of tax residency;[18]

the reporting period is 10 linear years from the date of the transfer from the UK pension scheme, **provided that** the residency period also does not apply (if the residency period applies because it has revived, then the reporting period will be extended as well) – **so this reporting period can revive**.

For:

where the scheme manager becomes aware that a member with UKSPM has a new residential address different from the country where the QROPS is established.[19]

the reporting period is 5 clear tax years from the date of transfer from UK pension scheme (could be nearly 6 years).

For:

change of fund details[20]

whilst there is still UKSPM in the fund, the reporting period is 10 linear years from the date of the transfer from the UK pension scheme, **provided that** the residency period also does not apply (if the residency period applies because it has revived, then the reporting period will be extended as well) – **so this reporting period can revive**.

For:

cessation of QROPS status[21]

the period is continuous (it never ends)

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17 *Pension Schemes (Information Requirements - Qualifying Overseas Pension Schemes, Qualifying Recognised Overseas Pension Schemes and Corresponding Relief) Regulations* 2006.
18 Regs 3(3) and 3(3A).
19 Reg 3(2C), with section 244A(4) of the *Finance Act* 2004.
20 Reg 3C.
21 Reg 3B.

More detail about liability of members and scheme managers of QROPS (or former QROPS) and of non-QROPS

These tables show the obligations of a member of an Australian superannuation fund containing UKSPM, and the obligations of a scheme manager of a QROPS, former QROPS or non-QROPS.

A non-QROPS is a fund which is not a QROPS and which has never been a QROPS.

Note that in the following tables a member of an SMSF will also be a scheme manager (unless represented in the fund). So such members will have dual responsibilities (both as member and as scheme managers).

Direct liability for tax under UK law

This is where UK law attempts to charge tax irrespective of the tax residency of the taxpayer. In practice, enforcement could be by raising an assessment and pursuit through the UK courts, with the resulting judgment being enforced in Australia via reciprocal arrangements.[22]

Liability	Member (*as member*)	Scheme Manager of QROPS/former QROPS	Scheme Manager of non-QROPS
UK income tax on taxable lump sum paid to member	✓	×	×
Unauthorised payment charge (40%) (rollover or taxable property)	✓	×	×
Unauthorised payment surcharge (15%) (unauthorised rollover)	✓	×	×
Unauthorised payment surcharge (15%) (taxable property)	×	×	×
25% overseas transfer charge on member's change of residence (post 9 March 2017 money)	✓	✓	×

22 *Foreign Judgments Act* 1991 (Cth).

Reporting obligations (within "reporting period") under UK law

This is where UK law attempts to impose reporting obligations directly (through UK law) upon members of Australian superannuation funds, and scheme managers of QROPS or former QROPS. There is no attempt to impose those obligations on a scheme manager of a non-QROPS (that is, a fund which has never been a QROPS).

One form of sanction for failure to report is removal of the fund from the list of notifying ROPS. On that basis the fund would cease to be a QROPS.

Another sanction is a daily fine for failure to report following the giving of a deemed information notice, but the provisions capable of enforcing this may be broken.[23]

Event	Member (*as member*)	Scheme Manager of QROPS/former QROPS	Scheme Manager of non-QROPS
The first pension payment	×	✓ to HMRC	×
First flexi-access (flexi-access statement)	✓ to UK schemes	✓ to member	×
A non-pension (lump sum) payment	×	✓ to HMRC	×
Rollover of UKSPM to QROPS	✓ to fund	✓ to HMRC and QROPS	×
Rollover of UKSPM to non-QROPS	×	✓ to HMRC	×
Purchase of taxable property	×	✓ to HMRC	×
Member moving away from Australia (post 9 March 2017 money)	✓ to fund	✓ to HMRC	×
Change of QROPS status address etc	×	✓ to HMRC	×

23 Under Part 7 of Schedule 36 of the *Finance Act* 2008 (penalties), as applied by Reg 5 of the *Pension Schemes (Information Requirements - Qualifying Overseas Pension Schemes, Qualifying Recognised Overseas Pension Schemes and Corresponding Relief) Regulations* 2006.

Obligations through undertakings (forms APSS251/263)

UK law requires undertakings to be given by the scheme manager of a ROPS before it will be a QROPS.[24]

These undertakings are given on form APSS251, which is the form completed by a superannuation fund notifying HMRC that it is a ROPS.

As we have seen, in the case of an administered SMSF, both adult members of the SMSF who are of sound mind, and administrators will be scheme managers, but there is nothing which suggests that all scheme managers need to give the undertakings. In practice it is probably sufficient for the members to give the undertakings.

Members also give undertakings on form APSS263 requesting a UK pension scheme to transfer UK pension benefits to a QROPS.

Neither the undertakings in form APSS251 or APSS263 are well worded, and it may well be that they are unenforceable because it is difficult to identify any consideration for them, or any intention to be legally bound by them.

Undertaking	Member (*as member*)	Scheme Manager of QROPS/former QROPS	Scheme Manager of non-QROPS
To pay UK tax on rollover of UKSPM to non-QROPS	✓ to HMRC (APSS263)	×	×
To report member moving away from Australia (post 9 March 2017 money)	✓ to fund (APSS263)	✓ to HMRC (APSS251)	×
To pay tax arising from member moving away from Australia (post 9 March 2017 money)	✓ to HMRC (APSS263)	✓ to HMRC (APSS251)	×
To report change of QROPS status address etc	×	✓ to HMRC (APSS251)	×

24 Section 169(2) of the *Finance Act* 2004.

Should UKSPM in an SMSF be kept segregated?

Some administrators will find it convenient to segregate UKSPM for the purpose of reporting to HMRC. But there is no legal requirement to segregate. The report is triggered by an event, and if calculations are required, they can be done retrospectively.

It is sometimes suggested that within an Australian superannuation fund, if UKSPM is mixed with Australian sourced money then HMRC will regard any withdrawals as coming from the UK money first. I think this is incorrect. It ignores the fact that UK legislation cannot extend to control a non-UK resident's use of their money sourced from outside the UK: it can only apply to the UK sourced money.

However, UK regulations now set a priority of payments and transfers from UK sourced pension money, depending on how and when it got into the fund and the nature of the withdrawals.[25] The provisions are complex and advice may be needed. In practice, the priority rules will only be a concern where a member has pre-9 March 2017 UK sourced pension money and later UK sourced pension money. And they apply even if this earlier and later money is held across more than one fund.

The aim of these provisions is to stop people avoiding the overseas transfer charge on leaving tax residency of the country in which the non-UK pension fund holding the UKSPM is resident, but they have the unfortunate effect of converting some innocent transactions into unauthorised payments.

In a nutshell, the priority rules deem a rollover to come from later money first. This means that where the member wishes to rollover the earlier money to a non-QROPS because it is outside the residency period, the deeming provisions are capable of converting this innocent transaction into an unauthorised payment because the rollover is deemed to come from the later money first.

Another problem can arise if the member wishes to withdraw the later money first because they are leaving Australia. The priority rules with deem any such withdrawal as coming from the earlier money first. Unexpectedly therefore the overseas transfer charge will apply despite the member’s efforts to withdraw the money affected by that tax.

So, enquiries which may be made on enquiry trigger (see Mrs Bloggs above)

Whether the member’s account holds any money which originated from a UK pension scheme (UKSPM).

If so, **when** it was transferred from the UK pension scheme.

When member was **last UK tax resident**.

Whether across all Australian superannuation fund accounts, member holds both **earlier** (pre-9 March 2017) and **later** UKSPM (see just above for the importance of this).

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25 The *Pensions Schemes (Application of UK Provisions to Relevant Non-UK Schemes) Regulations* 2006 as amended (the most recent amendment applying from 6 April 2018).

Transferring UK pension money – hurdles and opportunities

Here we examine the reasons for wishing to transfer UK pension money into Australia and the hurdles placed in the way of this, by the UK and the Australian rules.

Many UK migrants and ex-pats considering whether to transfer their UK pensions will be deterred by the considerable difficulties caused by the Australian rules, in particular the fact that a UK pension transfer is not a rollover and so the non-concessional contribution caps apply. Yet this rule has little or no reason. Having regard to the enormous amounts involved which could only benefit the domestic economy, in my opinion it should be relaxed.

Natural desire to bring UK pension benefits into Australia:

- wish to bring pension “home”
- ease of management and control over investments
- greater investment choice and returns
- freedom from exchange rate fluctuations
- tax benefit

The tax benefit

The tax benefit arises from the fact that contributions to a UK pension scheme in accumulation phase are deductible for income tax purposes, and neither the contributions nor the fund’s income are charged to tax. Instead, tax will be charged on withdrawals.

But if the member moves to Australia and transfers the UK pension benefits into the Australian superannuation regime, such withdrawals can be tax free.

The UK limits the annual contributions which are tax deductible to £40,000 per annum (reduces to £4,000 per annum after the member starts to withdraw) and limits the total value of pension which can be accumulated without an additional tax burden, by the Lifetime Allowance of £1.073m, although some members will have a higher limit than this.

Transfer statistics

Since 2006 UK permitted transfer of UK pension money to a QROPS, a total of 132,500 transfers to QROPS have been done, with a total of £12bn transferred.

Australian QROPS account for over 60% of funds on the list of ROPS maintained by HMRC.

On this basis, Australia has had approximately 80,825 transfers totalling £7.3bn since 2006.

Australian tax on the transfer

The growth in the UK pension fund since the member became Australian tax resident is taxed as Applicable Fund Earnings (AFE).[26]

[26] Division 305 of the *Income Tax Assessment Act* 1997.

The QROPS restrictions

The UK government recognises that genuine migrants from the UK and ex-pats returning to their countries will want to transfer their pensions with them, and so the QROPS regime was established in 2006.

But the UK attempts to reduce abuse by those wishing to transfer their UK pension benefits offshore and "retire" early, by restricting transfers from a UK pension scheme to another superannuation regime in the following ways:

- the transfer must be Qualifying Recognised Overseas Pension Fund (QROPS)[27]
- the member transferring must not be able to access benefits below age 55 (which is the age below which the UK prohibits access to pension benefits) or having retired on the ground of ill-health (certified by two medical practitioners)[28]
- in practice in Australia this means that the transferring member must be age 55 or over[29]
- other QROPS criteria – Australia is favoured in the regulations and deemed to comply with one of the conditions[30]
- QROPS should be established in the country where the member resides[31]
- In practice, usually the receiving fund must be on HMRC's list of notifying ROPS[32]
- In the case of defined benefit schemes:
    - compulsory advice about loss of safeguarded benefits is required for transfers over £30,000[33]
    - public sector unfunded schemes are not transferrable any more[34]
    - extra paperwork is now required to try to avoid scams[35]
    - but transfer values are still very high because of low interest rates

27 Section 169(1)(b) of the *Finance Act* 2004.

28 Reg 3(6A) of the *Pension Scheme (Categories of Country and Requirements for Overseas Pension Schemes and Recognised Overseas Pension Schemes) Regulations* 2006.

29 See why this is so here [Australian QROPS: what happened on 6 April 2015 (directdocs.com.au)](directdocs.com.au).

30 Schedule 1 of the *Pension Scheme (Categories of Country and Requirements for Overseas Pension Schemes and Recognised Overseas Pension Schemes) Regulations* 2006.

31 This would not prohibit a transfer, but the overseas transfer charge of 25% would otherwise apply: section 244B of the *Finance Act* 2004.

32 Although this is not obligatory it provides the sending scheme with some comfort that the receiving scheme is a QROPS (HMRC does not warrant that this is the case however, simply because the scheme is in the list).

33 Section 48 of the *Pension Schemes Act* 2015.

34 This was by an amendment to section 95 of the *Pension Schemes Act* 1993 taking effect in April 2015.

35 This has gradually increased over the years, culminating in the *Pension Schemes Act* 2021 and regulations expected soon.

Some UK quirks

- the law is made more complex because it covers not only UK pension schemes contributed to by UK residents who then move to Australia (the usual case) but also overseas pension schemes contributed to by a migrant to the UK (migrant member relief) resulting in a UK tax-relieved fund
- in some schemes there may be no right to transfer where member is aged a year before normal pension age[36] so this should be checked with the administrators of the scheme
- a UK defined contribution pension fund will be in drawdown to the extent of 3 times a Pension Commencement Lump Sum (colloquially known as "tax free cash") taken from it, and then the part of the fund in drawdown will be indivisible[37]
- it is essential that a UK pension fund in drawdown is transferred into an arrangement in which no other sums or assets are held, otherwise the transfer will be an unauthorised payment.[38] This can be achieved within an Australian superannuation fund by having a segregated account to receive the incoming money (if permitted by the fund's trust deed).[39]

Some Australian quirks

The main quirk, which presents an enormous hurdle in many cases, is that a transfer from a foreign superannuation fund into an Australian super fund is not a rollover, but is a non-concessional contribution. It is therefore subject to the non-concessional contribution caps. This also means that the work test will need to be satisfied for certain age groups and that no such transfer can be done after the age of 75.[40]

The fact that a transfer from a foreign superannuation fund is not a rollover appears to be an accident. One day hopefully, it might be altered. This could be achieved quite easily by excluding a transfer from a foreign superannuation fund (as already defined) from the definition of contribution in sub-regulation 1.03(1) of the *Superannuation Industry (Supervision) Regulations* 1994. If this change happened, growth in the transferring fund since Australian tax residency could still be taxed as Applicable Fund Earnings by making it clear in Division 305 of the *Income Tax Assessment Act* 1997 that a lump sum received from a foreign superannuation fund includes a rollover from a foreign superannuation fund.

Another quirk, which also appears to be an accident of legislative drafting, is that unless a pension is taken at the same time as a lump sum from a foreign superannuation fund, then the whole of the growth loads into a partial transfer (or part lump sum) from the fund instead

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36 The statutory right is limited to this: section 95(1A) of the *Pension Schemes Act* 1993. The normal pension age will vary from scheme to scheme and could be as young as age 55. In practice, schemes will usually permit transfers well beyond that age and there may not be an age limit at all.

37 Reg 12 of the *Registered Pension Schemes (Transfer of Sums and Assets) Regulations* 2006.

38 Reg 12 of the *Registered Pension Schemes (Transfer of Sums and Assets) Regulations* 2006.

39 Per ATO TD 2014/7.

40 In the 2021 budget it was proposed that the work test would be abolished.

of in the same proportion as the lump sum to the whole fund.[41] This rule can seriously catch out Australian tax residents who personally withdraw a UK pension commencement lump sum from a UK pension scheme. A UK pension scheme will generally contact a member when they turn 55 and will offer such a pension commencement lump sum, which can be up to 25% of the amount in the fund, and describe it as “tax free” cash. It is therefore very tempting, and often the Australian tax consequences are overlooked.

Example:

> Joe (an Australian resident) has a UK pension pot of £400,000 in a money purchase (defined contribution) scheme. This was worth £310,000 when he first became an Australian tax resident, so the AFE is £90,000. On his 55th birthday he withdraws 25% "tax free" cash of £100,000 from the UK pension pot leaving the rest in cash. In Australia the whole £90,000 is charged to tax, payable by Joe at his marginal rate. The remaining pension pot of £300,000 held by the UK pension scheme no longer contains any AFE, however.

In the above example, Joe might have been expecting to pay Australian tax on one quarter of the AFE (£22,500) but he finds he has to pay the tax on the whole of it (£90,000) at his marginal rate of tax.

The rule that AFE is loaded into a partial transfer interferes with proper planning of a transfer into an Australian super fund because it can unexpectedly wipe out most of the AFE.

Example:

> Hazel (an Australian resident) has a UK pension pot of £400,000 in a money purchase (defined contribution) scheme. This was worth £310,000 when she first became an Australian tax resident, so the AFE is £90,000. She establishes an SMSF as a QROPS to receive all the UK pension pot. In year 1 she has £10,000 non-concessional contribution cap spare, so she transfers this amount from her UK pension fund into her QROPS. Unexpectedly, all the AFE is loaded into the £10,000 but the AFE is limited to the amount of the transfer. Hence the remaining AFE is wiped out. This means that the remaining pension pot of £390,000 held by the UK pension scheme no longer contains any AFE.

In this example, although Jennifer did not intend to avoid tax on the wiped out AFE, this is the result of what has happened. Probably under Part IVA of the *Income Tax Assessment Act* 1936 she would be required to treat the remaining pension pot as still containing AFE of £80,000.

Where the transfer is made to an Australian super fund instead of being paid directly to the member, then it is regarded as a lump sum received by the super fund. But the AFE is still added to the member’s assessable income unless the member makes an election under section 305-80 for the tax to be paid by the receiving fund at 15% instead. This is done on form NAT 11724, and since the member can specify how much of the AFE should be added to the fund’s assessable income it is possible to spread the AFE to suit member’s taxable income.

But due to another quirk in the legislation, the election under section 305-80 can only be made if the member has no further interest in the sending fund after the transfer. There seems to be no reason for this rule, yet it has the potential to create an unexpected tax

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41 See ATO Interpretive Decision 2012/48 (this can be compared with 2012/49).

liability for a member who did not realise that the election could not be made in those circumstances.

Example:

> Scott (an Australian resident) has a UK pension pot of £400,000 in a money purchase (defined contribution) scheme. This was worth £310,000 when he first became an Australian tax resident, so the AFE is £90,000. Scott establishes an SMSF as a QROPS fund and transfers £150,000 from the UK pension scheme into the QROPS. He limits the transfer to £150,000 in order to keep within his available non-concessional contribution cap. At the end of the tax year Scott wishes to elect on form NAT 11724 that the SMSF pays tax on the AFE of £90,000 at 15%, but on looking at the form he realises it can only be completed if he had no further interest in the UK pension scheme after the transfer. Instead, he has to pay tax on the £90,000 at his marginal rate.

One consequence of electing on form NAT 11724 that the receiving fund pays tax on the AFE is that the amount added to the assessable income of the receiving fund does not count towards the non-concessional contribution cap. Hence in many transfer plans the first step is to transfer the AFE + $330,000. Such a transfer will trigger the bring forward rule, but would otherwise be within the NCC cap provided there is no further interest in the sending fund so that form NAT 11724 can be completed.

If NAT 11724 needs to be completed in the case of a partial transfer, care must be taken to ensure that there is truly no further interest in the sending fund after the transfer. This may not be the case if the member has another account in the sending fund which is not transferred. To avoid this, it will be necessary to transfer the member's other interests in the sending fund to another UK pension scheme. Sometimes a sufficiently separate account with the same scheme providers can be opened (where there is a separate trust deed or contractual arrangement). Such a separate account should have a different PSTR (Pension Scheme Tax Reference) from any other scheme in which the member has an interest. There is at least one "international" UK SIPP[42] which ensures that this is the case for sub-funds it administers. If that is not available a completely separate pension scheme will be needed for this UK to UK transfer.

[42] Self-invested personal pension.

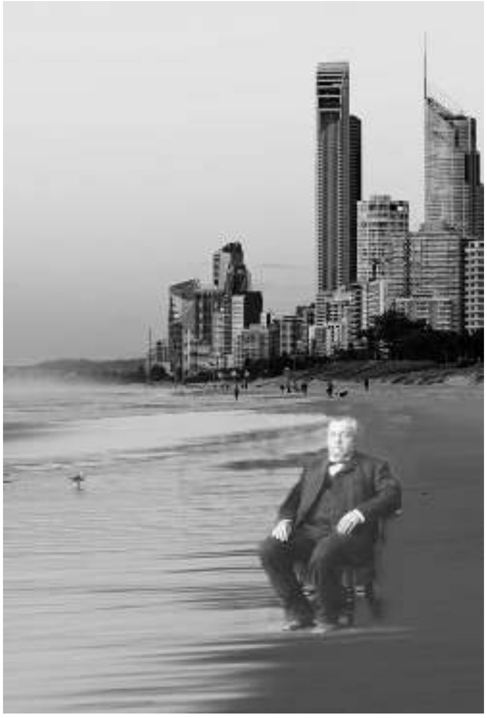
Example of Mr Bloggs

Wishes to transfer $2m currently in a UK pension scheme.

Growth since became Australian tax resident (Applicable Fund Earnings - AFE): $320,000.

Non-AFE part of the fund: £1.68m.

Is now aged 63 and wants to complete all transfers by age 70.



The following is a typical transfer plan to suit the circumstances and desires of Mr Bloggs.

Slice off the AFE

In this case there is AFE of $320,000.

The loading of the AFE into a partial transfer (as described above) provides an opportunity to maximise the amount which can be brought into the Australian superannuation regime. This is because, to the extent that the election is made under section 305-80 on form NAT 11724 for the tax on the AFE to be paid by the receiving fund, and not by the member, it does not count towards the non-concessional contribution cap.

As explained above, the AFE must be sliced off via a completely separate UK pension fund in order to be able to make the election on form NAT 11724 (so that there is no interest in the sending fund after the transfer of the AFE).

Split the remainder into tranches and take PCLS

In this case, since Mr Bloggs wants to complete all transfers by the age of 70, the plan is to reduce the overall amount to be transferred into the Australian superannuation regime after slicing off the AFE, by 25%. This is a legitimate aim because of the NCC caps. This can be done by taking 25% Pension Commencement Lump Sums (PCLS) from the amount remaining after slicing off the AFE.

Since taking a PCLS from a pension pot makes the remainder of the pension pot indivisible, it is necessary to split the pension pot into tranches prior to taking any PCLS. Then a 25% PCLS is taken from each tranche. Each PCLS will by definition be UK tax free, and since all the PCLSs are taken in year 1 immediately after the AFE has been sliced off, there will be no Australian tax to pay on their receipt either. Hence Mr Bloggs will receive $400,000 in his pocket in year 1. The fact that he has received this money will be reported to HMRC by the UK pension scheme, who will also give Mr Bloggs the flexi-access statement.

Year 1 transfers

Meanwhile Mr Bloggs has established an SMSF as a ROPS and notified HMRC on form APSS251 that it is a ROPS, and he has given the undertakings required by that form. Upon doing that, his fund is a QROPS. HMRC have placed it on the list of ROPS which it maintains.[43]

In year 1 therefore, the AFE of $320,000 together with the first tranche of $330,000 can be transferred to the QROPS. In this transfer plan, the two amounts come from two separate funds – the one holding the AFE and the one holding the first tranche of $330,000.

The fund holding the $330,000 is in drawdown and so that should be transferred first because it will go into the empty SMSF. If this cannot be done, then it should be transferred into a segregated account to avoid it being an unauthorised payment.

Before the SMSF files its annual tax return Mr Bloggs completes form NAT 11724 requiring it to pay the tax on the AFE at 15%. That is reported by the SMSF as its assessable income and the $330,000 is reported as a non-concessional contribution.

Since the transfer is done very soon after the taking of the PCLS, the effect of exchange rate differences is minimised.

Year 4 transfer

Meanwhile the second tranche of $330,000 is invested in its completely separate pension fund. Any growth in this fund between year 1 and year 4 will be additional AFE. In year 4 this pension fund is transferred to the QROPS and the sending fund is closed, enabling form NAT 11724 to be completed so that the tax on additional AFE will be paid by the QROPS and not by Mr Bloggs personally. If this is done, the AFE does not count towards the NCC cap.

Since this fund is in drawdown it should be transferred into a segregated account in the SMSF to avoid it being an unauthorised payment.

The exchange rate may well have moved between year 1 and year 4 to an extent that the non-AFE part of this transfer exceeds the NCC cap (the exchange rate at the time of receipt must always be used in the calculation of the amount transferred and the AFE). If so, the trust deed of the SMSF should be checked to ensure that receiving a contribution in excess of the NCC cap is permitted.

Exceeding the cap will result in a release authority being issued by the ATO. This raises the question whether the release authority should be satisfied from the incoming UK pension money. In this particular transfer plan this is not a difficulty because the incoming UK pension money is in drawdown and any payment from it will be "pension" and a "flexi-access drawdown" payment. The payment from the money may be reported as such to HMRC.

Year 7 transfer

In year 7 the third and final tranche will be transferred to the SMSF. This is $600,000 plus any additional AFE arising from its investment. Since Mr Bloggs wants this to be the last transfer, it will inevitably exceed the NCC cap.

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43 That list can be found here: Check the recognised overseas pension schemes notification list - GOV.UK (www.gov.uk)

From 1 July 2017 superannuation funds have been permitted to receive non-concessional contributions which exceed the NCC cap, although the trust deed should always be checked to ensure that the fund permits this.

Here the fund containing the third tranche will be closed after the transfer, enabling form NAT 11724 to be completed so that the tax on additional AFE will be paid by the QROPS and not by Mr Bloggs personally. If this is done, the AFE does not count towards the NCC cap.

Again, since this fund is in drawdown it should be transferred into a segregated account in the SMSF to avoid it being an unauthorised payment.

In practical terms, a few weeks after the fund's annual tax return for year 7, Mr Bloggs will receive an excess non-concessional contribution determination, permitting him to elect to have the excess contribution, plus a little more, to be released from his superannuation interests. On making the election (or these days, even if no election is made) the ATO will issue a release authority for the relevant amount. The question arises whether the release authority should be satisfied from the incoming UK pension money. In this particular transfer plan this is not a difficulty because the incoming UK pension money is in drawdown and any payment from it will be "pension" and a "flexi-access drawdown" payment. The payment from the money may be reported as such to HMRC.

The amount of this transfer which can be retained in the SMSF is the additional AFE plus the relevant non-concessional cap amount for that year.

Exceeding the cap in this way results in Mr Bloggs paying tax on the "associated earnings", which is a notional amount which could be earned by the SMSF on the excess contribution from the beginning of the tax year in which the excess was received up to the date of the ATO's determination. This tax is offset by an amount of notional tax which would be paid by the SMSF (assuming it is in accumulation phase) on the same excess amount over the same period. In this case, assuming an excess of $500,000, he would pay tax of about $17,000.[44]

Direct withdrawal schemes

Having regard to the difficulty of managing UKSPM held in an SMSF or an APRA regulated super fund, and the difficulty in being able cleanly to transfer UK pension money into the Australian superannuation regime, it is not surprising that some in the pension transfer industry have found other ways to satisfy the natural desire of migrants and ex-pats for their UK pension money to join them in Australia.

This has led to the direct withdrawal schemes. These exploit a possible difference in the way HMRC and the ATO may treat direct payments to the member.[45]

Typically such schemes work as follows:-

- if there is any growth in the UK pension fund since the member became Australian tax resident (Applicable Fund Earnings, or AFE), this is sliced off into another UK pension fund relying on the fact that in Australian law such growth is loaded into a partial transfer

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44 This assumes an ATO general interest charge annual rate of 7.10%, a date of 1 December for the ATO's determination, a marginal tax rate of 45% and Medicare Levy of 2%.

45 This is explained further below.

- any such AFE is transferred to an Australian QROPS and tax is paid at 15% on the AFE by the receiving fund after the member completes form NAT 11724
- the member makes a small withdrawal from the remaining money in the UK pension fund; the UK pension fund deducts UK tax from this and remits it to HMRC
- the member completes a UK tax form requesting repayment of the tax deducted on the withdrawal and asking for future payments from the UK pension fund be paid without deduction of tax (the request is that HMRC give the member a nil or NT tax coding), on the grounds that the member is not a UK tax resident and the payments are not taxable in the UK because of Article 17 of the Double Taxation Convention
- after the member is granted the NT coding a further small withdrawal is made from the UK pension fund to check that no tax is being deducted, and maybe also to establish periodicity sufficient to satisfy HMRC that periodic withdrawals were made
- a little later the member makes one or more large withdrawals of the whole of the remainder of the UK pension fund
- no UK tax is deducted from these large withdrawals because of the nil tax coding (which the UK pension fund is obliged to obey), and it would be argued that no UK tax is due because they have sufficient periodicity to be "pension" and therefore within Article 17 of the Double Taxation Convention and only subject to Australian tax
- in the UK, non-statutory clearance is sought and obtained for confirmation that this is the correct tax treatment
- in Australia the large withdrawals are reported not as pension, but as lump sums; and since all the AFE has been sliced off, there is no tax to pay
- in Australia, a private binding ruling is sought and obtained for confirmation that this is the correct tax treatment

Variations of the scheme have a Pension Commencement Lump Sum taken at some point, or the UK pension fund otherwise put into drawdown by other means. Also size and timing of the withdrawals may vary.

Although the schemes obviously advantage the member, it seems to me that the risks probably outweigh those advantages. The main risk is that should HMRC decide that the withdrawals are taxable in the UK after all, there could be an enormous tax bill to pay which would not have been incurred had the transfer route been taken instead.

I study these matters in more detail here:
https://directdocs.com.au/ozstomember.html#directws

Disclaimer - legal advice

This paper does not arise from any instructions from you and it is not legal advice given to you. You should check for yourself as to the issues discussed here. If you follow the information on this page, you do so at your own risk.

UK and Australian law in this area often changes and should be checked prior to any advice or transaction.

Disclaimer - financial product advice

This paper provides factual information only and is not intended to give a recommendation or opinion about a financial product or class of financial products. It particular it should not be taken to be advice about the prudence of establishing an SMSF in Australia and transferring to it money held in another pension scheme or in another form of investment.