

FINANCIAL MARKETS CONDUCT BILL

SUBMISSION ON EXPOSURE DRAFT

Names of Submitter: Michael Reason – barrister and
Gregory Rathbun chartered accountant – directors of Super Trustee Fund

		<p>The Submitters are directors of Super Trustee Limited, the trustee of Super Trustee Fund (STF) a registered superannuation fund.</p> <p><u>Background</u></p> <p>STF is a New Zealand registered Superannuation Fund and UK Qualifying Recognised Overseas Pension Scheme (QROPS). The UK QROPS rules are the tax rules contained in the UK Finance Act 2004 which permit the UK tax free transfer (migration) of a UK regulated pension fund to an overseas retirement scheme that agrees to operate according to UK rules.</p> <p>What is a QROPS?</p> <p>There are various ‘hurdles’ a scheme has to overcome before HMRC will recognize it as a QROPS. A QROPS needs to meet the conditions to be:</p> <ul style="list-style-type: none">• an overseas pension scheme and• a recognised overseas pension scheme and finally• a qualifying recognised overseas pension scheme. <p>If a UK pension transfer is made to a scheme that is not a UK registered pension scheme or a QROPS, the transfer will be an unauthorised payment resulting in tax penalties.</p> <p>An overseas pension scheme</p> <p>Briefly:</p> <ul style="list-style-type: none">• can’t be a registered pension scheme. Equally well, a registered pension scheme can’t be an overseas pension scheme and• has to be established outside the UK (‘established’ usually means where its registered office and main administration is) and• must be regulated as a pension scheme in the country or territory in which it’s established. If there is no body to regulate it, the scheme must be either:• established in the European Union or in Norway, Iceland or Liechtenstein or
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		<p>It must be:</p> <ul style="list-style-type: none">• open to all residents and• established in a country or territory where there is taxation of personal income from which relief is not available in respect of the contributions made to pension schemes or all or most of the benefits are subject to taxation or the scheme itself is subject to taxation on its income and gains and is of a specified kind and• approved, recognised or registered by the relevant tax authorities or if there is no system for this, it must be able to pass the '70%' rule referred to below.• This last way of satisfying the condition was introduced to allow Australian schemes to continue to be able to be recognised as QROPS after changes to the taxation of Australian schemes introduced on 1 July 2007. A complying Australian superannuation plan is currently the only specified kind of scheme. <p>An international organisation (such as the United Nations or the European Union) can establish a scheme outside the UK. To be regarded as an overseas pension scheme, such a scheme only has to meet the '70%' rule and allow benefits to be paid before the normal minimum pension age only if the member is in ill-health.</p> <p>The conditions can be found at:</p> <p>Registered Pension Scheme Manual pages 14101030, 14101035, 14101036, 14101037</p> <p>A recognized overseas pension scheme</p> <p>Briefly:</p> <ul style="list-style-type: none">• has to be established in a country which is in the European Union, Norway, Liechtenstein or Iceland, or• has to be established in a country or territory with which the UK has a Double Taxation Agreement that contains exchange of information and non-discrimination provisions, or• must provide that• at least 70% of the funds transferred will be used by the scheme manager to provide the member with an income for life ('the 70% rule'),• the retirement benefits payable to the member from the transfer funds are payable no earlier than normal retirement date (unless on ill-health grounds), and• membership of the scheme is open to people resident
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in the country or territory in which it is established.

The conditions can be found at:

Registered Pension Scheme Manual page 14101040

A qualifying recognised overseas pension scheme

Briefly:

has to notify HMRC that it's a recognised overseas pension scheme and have provided evidence of that if required and

- must promise to tell HMRC if it stops being a recognised overseas pension scheme and
- has to tell HMRC the name of the country or territory it's established in and
- has to provide any other evidence HMRC need and
- has to promise to give HMRC certain information on making payments in respect of certain scheme members and
- must not have been excluded by HMRC from being a QROPS.
- To notify HMRC, the overseas scheme manager can use form APSS251 which has been designed to help.

The full conditions can be found at:

Registered Pension Scheme Manual page 14101050

Recognised transfers to QROPS

Other points:

- an important point is that unlike a recognised transfer between two UK registered pension schemes, a transfer from a UK scheme to a QROPS is a benefit crystallisation event. So if the amount of the transfer is over the relevant lifetime allowance (currently £1.8m being reduced to £1.5m from 6/04/12), a lifetime allowance charge will be levied. However, because the payment is not to the individual, the rate charged is 25%, not 55%, despite the fact that it involves a lump sum. There will be no effect on the annual allowance as it isn't a contribution (although all payments made in the pension input period up to the date of transfer will)
- some overseas schemes (for example schemes in the USA) may not accept the transfer value
- the UK scheme administrator must report the transfer to HMRC (they would also have to report a non-

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		<p>recognised transfer)</p> <ul style="list-style-type: none">• the QROPS scheme manager must agree to tell HMRC when they receive the fund or pay benefits from the transferred fund or if they transfer the fund again. Any payment or transfer which wouldn't have been an authorised payment or recognised transfer from a UK registered pension scheme will suffer the normal tax penalties (see below)• a transfer to a QROPS is not itself a chargeable event for inheritance tax (IHT) purposes if the individual remains UK domiciled. However there will be periodic IHT charges on the current fund value every 10 years and exit charges on any payments of capital out of the scheme• if the transfer contains Protected Rights, there are other things the UK scheme has to do before the transfer can go ahead. It has to:<ul style="list-style-type: none">○ get written confirmation from the member that he understands that the overseas scheme might not give the same degree of protection○ take reasonable steps to check that, where the QROPS is an occupational scheme, the member is actually employed by that employer○ take reasonable steps to check that the member has received a statement of what benefits the transfer value will provide in the QROPS. <p>Non-recognised transfers</p> <p>A non-recognised transfer may result in the following tax penalties:</p> <ul style="list-style-type: none">• an unauthorised member payment charge of 40% of the transfer value• if all unauthorised payments in a 12 month period are more than 25% of the fund value, an unauthorised payments surcharge of 15% of the transfer value will be payable by the individual• the registered pension scheme will have to pay a scheme sanction charge of 40% of the transfer value. If the scheme administrator has deducted the member's tax charge from the transfer payment and paid the tax charge to HMRC on the member's behalf, the scheme administrator may reduce the amount of the scheme sanction charge by the lesser of 25% and the amount of member's tax charge deducted as a proportion of the transfer payment• if the amount of non-recognised transfers exceed 40% of the scheme's assets, it could be de-registered with a
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de-registration charge of 40% of the scheme's assets.

Transfers from overseas schemes

In this case, a transfer is coming from a pension scheme which is not regulated and taxed by HMRC to one that is. Almost all pension transfers from overseas pension schemes to UK registered pension schemes are allowable and treated in a similar way to recognised transfers. However a registered pension scheme isn't obliged to accept the transfer.

Overseas transfers into registered pension schemes aren't recognised transfers. However they aren't unauthorised payments either as unauthorised payments can only come from UK registered pension schemes. The transfer doesn't count as a contribution and therefore doesn't get tax relief but also doesn't count against the annual allowance, nor is it a benefit crystallisation event (BCE) so it doesn't trigger a test against the lifetime allowance at time of transfer. However it will count against the lifetime allowance when a BCE does occur, unless it comes from a recognised overseas pension scheme.

If the transfer is from a recognised overseas pension scheme, the individual's lifetime allowance can be enhanced by the same percentage as the transfer value bears to the standard lifetime allowance at time of transfer. This recognises the fact that the transferred funds haven't received any tax advantages from HMRC. An individual has up to 5 years from 31 January following the tax year in which the transfer is made to claim this enhancement by registering it with HMRC. It's important to note that this enhancement is only available if the transfer is from a recognised overseas pension scheme – if it is not a recognised scheme, the enhancement can't be claimed.

General

UK policy on the transfer of UK pension funds includes that a UK resident or former resident person may transfer their pension fund to a QROPS and they do not need to be

- a. non-UK resident to be entitled to do so, nor
- b. resident in the country where the scheme operates (which means there is no compulsion to transfer to the country of residence). See in section 3 of the

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following linked article:

<http://www.hmrc.gov.uk/pensionschemes/newsletter3.htm>

The UK pension regime encourages saving for retirement by permitting a deduction from taxable employment income of UK resident individuals and largely exempts the income of pension funds. Unlike New Zealand superannuation schemes, UK pension schemes restrict the lump sum for a personal scheme to 25%, this being tax free to a UK tax resident. There are a range of exit options where the 25% can be exceeded. Benefits which become available on retirement between 55 and 75, require the balance to be taken as a pension, to be used to acquire an annuity or to be managed in an account that generates an income with the pension or annuity or income subject to taxation, generally in the country of residence.. Earlier access ages are available for sports persons

The incentive to save using a New Zealand superannuation fund (other than the lock-in preventing member benefits prior to retirement) is largely related to the New Zealand employer as there is no tax advantage to make pension contributions. Accumulations are taxed at 33 and 28% unless the scheme is a PIE (although the trustees capital development management and marketing may be deductible from members fund income for tax purposes) however distributions (with complying trust beneficiary income treatment) are not subject to NZ tax.

There is UK tax relief for continuing contributions to a non-UK scheme when a migrant becomes UK resident

The NZ and UK tax treatments of UK pension and NZ superannuation saving are therefore complementary. There is an incentive to save and accumulate in the UK, transfer and receive the member funds from NZ. The tax treatment is less advantageous for members saving and accumulating in NZ, transferring and then receiving a pension or annuity in the UK.. However there can be UK tax complications if a UK pension fund is transferred to New Zealand and then the member returns to the UK especially if the fund has been used to

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		acquire residential property or chattels such as art, antiques or wine as investments.
Part 4 and schedule 3	Governance of financial products	
[insert rows]		<p>113 Additional initial and ongoing registration requirements for superannuation schemes</p> <p>(1) Every superannuation scheme must meet the following registration requirements in addition to those in section 111:</p> <p>(a) it must be a trust established and governed by a trust deed that is interpreted and administered in accordance with New Zealand law; and</p> <p>(b) its purpose must be to provide retirement benefits directly or indirectly to individuals; and</p> <p>(c) it must restrict participation, in its conditions of entry of scheme participants and in the way those conditions are applied, to persons who meet the New Zealand criteria set out in subsection (2); and</p> <p>(d) it must restrict redemptions or withdrawals, under the trust deed and in the way that the trust deed is applied, to redemptions or withdrawals for retirement purposes except in defined circumstances (for example, financial hardship or ceasing employment); and</p> <p>(e) it must not be registered as a KiwiSaver scheme.</p> <p>(2) The New Zealand criteria are that the person, at the time of becoming a participant,—</p> <p>(a) is, or normally is, living in New Zealand, or is an employee of the State services (within the meaning of the</p>

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		<p>State Sector Act 1988) who is—</p> <p>(i) serving outside New Zealand; and</p> <p>(ii) employed on New Zealand terms and conditions;</p> <p>and</p> <p>(iii) serving in a jurisdiction where offers of superannuation scheme membership are lawful; and</p> <p>(b) is a New Zealand citizen or is entitled, in terms of the Immigration Act 2009, to be in New Zealand indefinitely.</p> <p>And Schedule 3</p> <p><u>Submission</u></p> <p>The whole of s 113 (2) (the provision) might be reconsidered. The provision seems to be a response to negative publicity New Zealand has received as a QROPS jurisdiction due to the well publicized practice of some NZ schemes linking with non-NZ financial advisors of “cashing out” UK pension funds following transfer once the member has been non-UK resident for five years.</p> <p>The practice has been reported to be prevalent in Spain and other parts of Europe where many UK individuals go to retire. Since 2007 especially, individuals have seen their Spanish house prices fall sometimes below the value of their mortgages, their interest rates have risen and with costs of living rising, without income or savings and cash running out their UK pension fund has been their last remaining asset. In many cases Spanish based advisors have recommended transferring the UK pension fund to NZ and (as they have been 5+ years non-UK resident) having the NZ superannuation fund immediately cash it out even when the member is below the age of retirement.</p> <p>This is considered to be contrary to the purpose of retirement savings which should not be used to pay current mortgage charges to stave off housing repossession and contrary to the</p>
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		<p>intention of UK's QROPS regime (summarised above). Rather a pension fund should be used to provide for living costs when extraneous financial decisions have been resolved.</p> <p>This practice has been possible because the New Zealand restriction on the payment of funds to members is regulated only by the definition of superannuation scheme – a scheme established “principally for the purpose of providing retirement benefits”.</p> <p>The Government Actuary (GA) consulted on its policy concerning retirement (and the right of a superannuation fund to allow members to withdraw) via newsletters 47, 48 and 49 dated March, June and October 2000 that used to be on the ISU web site but are no longer available on the FMA site. Copies of the ISU newsletters are attached. The GA's reported interpretation in newsletter 47 was reported to be unpopular in newsletter 48 and in newsletter 49 a proposed percentage based test was withdrawn as follows.:</p> <p>I am persuaded after considering the submissions made on Newsletter 47, and other advice, that a numerical approach is unlikely to be as helpful as I had initially thought it could be. I will however continue to require trustees to demonstrate that they are operating schemes in compliance with the principal purpose (that is, the schemes are in fact principally providing benefits when retirement occurs from paid labour force participation or, in the case of employer sponsored schemes, on permanent cessation of employment with that employer), and accordingly particular matters that will be considered are:</p> <ul style="list-style-type: none">- The extent of “on demand” payments, by relation to annual contributions and accumulated entitlements, and taking into account frequency of payments per member;- The ages at which “on demand” payments are being made;- Marketing material supplied to potential members;- Operational policy guidelines set down by trustees for the exercise of discretions conferred on them by the deed governing the scheme; together with any other matters that may be relevant to a particular case. <p>NZ members were reported to have considered super funds akin to savings should be able to have whenever they want. In practice employer schemes are paid out in a lump sum at the end of the employment whatever the age. For the GA to criticise the cashing out of transfers to non NZ residents simply</p>
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		<p>because they were not NZ resident would have been inconsistent and could have been met with a charge of discrimination on the grounds of ethnic or national origin including nationality or citizenship and breaches of s.19 Bill of Rights Act 1990 and of s. 20 and 21(g), 21B, 22, 44 and 70 of the Human Rights Act 1993..</p> <p>Kiwisaver rules permit funds of a member who has ceased to be NZ resident to be paid out whatever the member’s age; less tax credits Nevertheless to be a super scheme a scheme must be established principally for the purpose of providing retirement benefits and the official retirement age (when state super becomes payable) is 65 and the GA allowed super schemes to carry on the practice of cashing out UK pension schemes while it was the regulator. When the FMA became the regulator it was reported to have pressurised a fund understood to be mainly used for cashing out non-NZ members who were reported to have announced that they would not accept new members. When a kiwisaver scheme openly offered cash outs on their web site they were reported to have been pressurised by the FMA and the home page was altered.</p> <p>Rather than clarifying when cashing out is allowed, the NZ policy response in s 113 of the FMC bill is to limit scheme membership – in line with Kiwisaver – to NZ residents with the right to reside in NZ. This seems to be a heavy handed policy response. We consider that the active enforcement of the existing retirement policy is sufficient to prevent abuse of superannuation by non-NZ cash out advisors.</p> <p>The New Zealand policy regarding the alleged abuse of the UK pension regime should not result in the creation of a New Zealand regime that is more rigid than the UK one which the New Zealand policy is meant to protect.</p> <p>The provision does not correspond to the UK rules as the UK Registered Pension Scheme Manual RPSM13103010 states:-</p> <p>“...membership of a registered pension scheme is open to</p>
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		<p>anyone regardless of where they are resident or of where their employer (if any) is resident. Nor is there any restriction on the amount that can be contributed by an overseas resident individual or by an employer in respect of them. But relief from UK income tax may not be available, or may be restricted on such contributions in certain circumstances.”</p> <p>Overseas resident members of a UK registered pension scheme are subject to the annual and lifetime allowances and their associated charges (see RPSM13103040), and to other charges under Part 4, such as the unauthorised payments charge (see RPSM04104500).</p> <p>The UK regime entitles individuals who are not resident in the UK to retain membership of registered pension schemes. It is possible that during periods of non UK residence, contributions may be made to, or benefit rights accrue within, the registered pension scheme that does not attract UK relief. Obviously non-residents may wish to save for their retirement. Their chosen place of residence may lack suitably regulated investment vehicles. The UK position allows them to be admitted to membership with no gain and no loss to the UK tax base but their membership mutually benefitting them and the local finance and investment industry.</p> <p>It is unclear why New Zealand does not wish its finance industry to offer its services to non-residents wishing to be members of a managed fund structure. Section. 113 of the FMC bill may require an amendment to the Human Rights Act 1993 permitting discrimination on the grounds of being resident in New Zealand or not but that this would not be desirable. Residents of many countries have cause to fear their own government’s powers of sequestration and less well regulated or non-existent finance markets. Such individuals have legitimate demand for financial products outside their home country.</p> <p>When a member of a UK or other non-NZ scheme becomes resident in NZ they will generally become subject to the NZ Foreign Investment Fund rules which deem the non-NZ fund to be paying an income to the member calculated according to</p>
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		<p>their fund capital value. The NZ Transitional Resident rules postpone liability to tax on non-NZ income for the first four years of NZ residence. After that there is a positive incentive for the NZ resident to migrate their UK pension fund to an NZ superannuation or Kiwisaver fund which will generally be taxable on actual accumulations at the member's personal tax rate. It appears that only this aspect of the NZ QROPS industry is intended to survive. That the FIF rules apply to overseas pension funds of NZ residents is not well known. The NZ IRD might consider lobbying the UK HMRC to require UK pension funds with members resident in NZ for 4 years or longer to disclose the effect of the NZ FIF rules to members.</p> <p>Kiwisaver does not technically comply with UK QROPS rules because contributions to the scheme qualify for an NZ tax credit (or income rebate) and QROPS rules prohibit this.</p> <p>See: UK SI 2006/206 s 2(2)</p> <p>“Primary condition 2</p> <p>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–</p> <p>(a) tax relief is not available to the member on contributions...”</p> <p>Member benefits including pensions received from Non-Kiwisaver superannuation schemes do enjoy “tax relief”. New Zealand pensions are generally paid as lump sums and are generally exempt. Non-Kiwisaver superannuation schemes do not receive an NZ tax credit on contributions. They are QROPS compliant. Kiwisaver schemes are not. However a 2009 letter from HMRC to the NZ Government Actuary exists to say that the Kiwisaver tax credit is not an issue for HMRC. Superannuation schemes are self-administering whereas Kiwisaver contributions are channelled through the NZ PAYE system. Kiwisaver schemes do not permit retirement until 65 whereas superannuation schemes have a more flexible</p>
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		<p>interpretation of retirement and eligibility to receive benefits; in line with the UK registered pension scheme retirement age of 55.</p> <p>We do not understand the rationale for s 113 of the FMC bill. It's not referred to in the explanatory material accompanying the exposure draft other than to say that there are proposals intended to be similar to Australian law although the proposal is not similar to the rules concerning Australian Complying Superannuation schemes.</p> <p>It is notorious that the commissioner of the NZ IRD has declared that he would like Kiwisaver to be the only NZ retirement savings product presumably because of the cash-out abuse of superannuation however the PM has plans for NZ to become an international finance hub. At present a superannuation scheme can elect to become a Portfolio Investment Entity (PIE) if it satisfies the eligibility criteria which will allow non-NZ resident members to enjoy a zero income tax rate on non-NZ sourced income.</p> <p><u>Submission Conclusion</u></p> <p>It would seem to be preferable to delete highlighted reference to the New Zealand criteria from s 113 and schedule 3 applicable to non-kiwisaver superannuation schemes and rather than restricting membership to require members to adhere more closely to the existing requirement that the principal purpose of a scheme is for saving for retirement. In 2000 the Government Actuary tried to put a percentage figure on what "principally for the purpose of providing retirement benefits" meant but then withdrew this interpretation saying a numerical approach was unlikely to be helpful.</p> <p>The QROPS cash out business and the negative publicity it attracts could be dealt with by a clear statement of policy by the FMA to the effect that in general (say) 40% of a members fund may be withdrawn prior to financial hardship, ceasing employment or age 55 and that adverse consequences would apply to schemes that did not comply.</p>
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