For professional advisers only

Adviser factsheet

nucleus

March 2024
nucleusfinancial.com

Pensions transfers – an overview

A transfer is the movement of an individual's accrued pension rights from one scheme to another. The receiving scheme then becomes responsible for paying the individual's benefits.

A recognised transfer is where:

- the receiving scheme holds the funds to provide benefits in respect of the individual; and
- the funds are transferred to either another registered pension scheme or a qualifying recognised overseas pension scheme (Qrops)

(Finance Act 2004)

Recognised transfer

Only recognised transfers are allowed between approved schemes.

A recognised transfer is an authorised payment, so no tax charges or sanctions apply to recognised transfers. Transfers usually don't count towards the annual allowance.

Benefits in payments (such as drawdown) may be transferred, but there are extra conditions that must be met if the transfer is to be a recognised transfer.

Right to transfer

The Pension Schemes Act 1993 gives individuals the right to transfer accrued benefits without tax penalties, but there are rules. In addition, DWP legislation outlines that stakeholder pension schemes must accept any transfer in. However, other schemes are not required to do so.

Transfers in

Transfers and the annual allowance

Transfers from one defined contribution scheme to another don't count towards the annual allowance (including MPAA or tapered annual allowance).

If the receiving scheme is either:

- a defined benefit scheme; or
- a cash balance scheme

Then, if the transfer value is greater than the closing value the difference counts towards the annual allowance.

Transfers from schemes with safeguarded rights

Any client who transfers from a scheme with safeguarded rights to a money purchase scheme after 6 April 2015 must have received regulated advice if the value of safeguarded benefits is worth more than £30,000. Safeguarded benefits are defined as benefits that are not money purchase or cash balance benefits. This includes defined benefits, guaranteed pensions including guaranteed minimum pensions (GMPs) and guaranteed annuity rates (GARs).

If an individual transfers from a private defined benefit (final salary) scheme to a money purchase scheme, and if the value of their benefits is £30,000 or more then they must receive regulated financial advice. (Individuals would still have to receive advice if the value of all their benefits is £30,000 or more – even if they only transfer part of the benefits worth less than £30,000.)

Providers of money purchase schemes may decline to accept transfers if the advice to the client is not to transfer, but the client goes ahead with it as an 'insistent client'.

Clients cannot transfer out of unfunded public sector defined benefit schemes (although transfers out of funded public sector pension schemes (such as the local government pension) are allowed).

Transfers and protections

Lifetime allowance protections

Lifetime allowance protection could be lost on any transfer made from an individual's existing pension arrangements that is not a 'permitted transfer' (these usually are transfers between money purchase arrangements, or transfers from a defined benefit scheme to a money purchase scheme).

Scheme specific protection

These are protections of special conditions the member enjoyed before 6 April 2006 (A-day):

- Tax-free cash of more than 25%.
- An earlier retirement age than 55.

These protections are generally lost on transfer, unless the transfer is part of a 'block or buddy' transfer. This applies whether the scheme is winding up or not. There are some general rules individuals must follow for block or buddy transfers to keep their protection:

- All the member's pension assets must be transferred from the old scheme to the new scheme (within a reasonable timescale) – no partial transfers are allowed.
- There must be two or more members transferring at the same time. (The 'buddy' or other member doesn't have to have protections.)
- The individual must have been a member of the new pension scheme for less than 12 months (unless they were a member before 6 April 2006, and only had contracted-out rights).

As there is only one member in a Section 32 policy, the conditions for a block transfer can't be met, and any protections may be lost on transfer.

If an existing scheme is winding up it's also possible to make a block transfer by transferring the whole of a member's benefits to a Section 32 plan, even though it's a single member arrangement and not possible to transfer in with a buddy.

Transfers in from overseas schemes

Transfers can be made into UK pension schemes from overseas schemes.

If no UK tax relief has been received on the benefits so far built up, it would be unfair if the transferred amount were to use up the member's available lifetime allowance. Instead, the member can apply to HMRC for their lifetime allowance to be increased, or 'enhanced', by an appropriate factor, from the date of the transfer. They can only claim an enhancement for the duration they were outside the UK.

The member must claim this enhancement no later than five years after 31 January following the tax year in which the transfer is made, and register the amount with HMRC. This enables HMRC to verify the amount claimed.

This enhancement is not available to members transferring back to the UK from an overseas scheme where the benefits where built up in the UK (i.e. had previously transferred from the UK to a Qrops) –and further benefit crystallisation events will occur when these funds are used to draw benefits in the receiving UK scheme.

Transfers out

To be a recognised transfer, the pension benefits must be transferred to a UK registered pension scheme or to a Qrops. Otherwise, it would be treated as an unauthorised payment. Transfers can also (in specific circumstances) be made to the pension protection fund (PPF) or financial assistance scheme (FAS) and not be treated as an unauthorised payment.

Tax is due on any unauthorised payment – there are three separate tax charges:

1. Unauthorised payments charge – income tax charge of 40% (regardless of whether the member is a basic rate or higher rate taxpayer). This is usually paid by the member or the sponsoring employer.
2. Unauthorised payments surcharge – an additional income tax charge of 15% may be due if the unauthorised payment is higher than a certain amount. This is usually paid by the member or the sponsoring employer.
3. Scheme sanction charge – income tax charge of 40%, based on the value of the payment. The rate may be reduced to as low as 15% where the unauthorised payments charge has been paid. The scheme administrator pays this.

If the individual requests a transfer to a Small Self Administered Scheme (SSAS), then it is the scheme administrator's responsibility to carry out due diligence to make sure the SSAS scheme is a bona fide scheme, and one recognised by HMRC.

Transfer of drawdown pensions

It is possible to transfer pension assets held under a flexi-access drawdown or capped drawdown to another pension scheme. This includes a dependant's, nominee's or successor's drawdown pensions.

However, to be a recognised transfer all the sums or assets of the drawdown fund must be transferred at the same time. Otherwise it would be an unauthorised payment.

These rules must be followed:

- New arrangement – the transfer must be to a new arrangement that holds no other sums or assets.
- On a like-for-like basis – a transferred flexi-access drawdown must provide flexi-access drawdown. Likewise, a transferred capped drawdown must provide capped drawdown (which means the individual can transfer without triggering the money purchase annual allowance). However, as part of the transfer process the individual can tell the scheme administrator of the receiving scheme that they wish the funds to be designated as a flexi-access drawdown fund.
- Pre-6 April 2006 drawdown funds – drawdown funds built up before A-day must be kept in a separate arrangement from other scheme funds and cannot be merged with any other drawdown funds.

Tax treatment after transfer

The transfer is not a BCE 1 (designation of drawdown), nor is there any entitlement to a tax-free cash lump sum.

Transfer of capped drawdown

Where the member hasn't chosen to switch to flexi-access drawdown, the new scheme will pay a capped drawdown pension. The maximum drawdown pension has to be calculated on the same basis as the old scheme, and so the drawdown pension year, the three-year reference period, the basis amount, and the nominated date will all continue on the same basis as if no transfer had taken place.

Transfers to a Qrops

A recognised transfer can be made to a qualifying recognised overseas pension scheme (Qrops). To be a Qrops, a scheme must meet four incremental definitions:

4. The scheme must be a pension scheme. If the scheme is not designed to provide benefits in respect of retirement, ill-health, death or similar circumstances, then it is unlikely to be a Qrops.
5. The pension scheme must be an overseas pension scheme as defined by legislation.
6. The overseas pension scheme must be a recognised overseas pension scheme (Rops) as defined by legislation. If it fails to meet Rops conditions it cannot be a Qrops.
7. Finally, the recognised overseas pension scheme must become a Qrops as defined by the legislation.

This area is complicated and subject to ever-changing rules. The client is responsible for ensuring the scheme meets the conditions to be a Qrops, and cannot rely on scheme administrators to carry out these checks for them. If the scheme is not a Qrops then the transfer will be an unauthorised payment and tax will be due.

Schemes must notify HMRC they qualify as a Qrops. However, a letter from HMRC with a Qrops number is not confirmation the scheme is or will remain a Qrops – it simply shows the scheme manager has notified HMRC that the scheme meets Qrops qualifications. Similarly, inclusion on the published list of schemes is not a guarantee that the scheme is or will remain a Qrops.

Benefit crystallisation event 8

A transfer to a Qrops before the age of 75 is a benefit crystallisation event (BCE8), with the value of the transfer tested against the individual's lifetime allowance. A lifetime allowance charge may be due on the transfer (at a rate of 25%).

Qrops transfer tax

HMRC is continually clamping down on 'non-genuine' transfers. In a further move, in the Spring Budget 2017, it proposed new legislation to introduce a 25% tax on non-genuine Qrops transfers. The tax applies to all requests to transfer from 9 March 2017, and is deducted by the scheme administrator. Even if it's not liable at the date of transfer, the tax can still become due in the next five years if a subsequent 'non-genuine' transfer is made. This will stop 'bouncing transfers'.

The Qrops transfer tax doesn't apply if:

- The member is resident in the same country to where the Qrops was established.
- The member is resident in an EEA country, and the Qrops is established in an EEA country.
- Qrops is set up by 'international organisation'.
- Qrops is an overseas public service pension scheme.

Qrops is an occupational pension scheme and the client is an employee of the sponsoring employer.

Residual balances

Transferring all of an individual's rights out of a scheme usually ends that scheme's involvement with them. However, there are circumstances where payments relating to the individual are made later into the scheme - for example, where dividends are received after the transfer out has happened. A scheme might also find that it holds extra funds for the individual without there actually being a payment in - for example, where there had been a valuation error which is then corrected.

These types of funds are called a 'relevant accretion' and will normally be paid to the receiving scheme as a residual balance. However, if the receiving scheme is unable, or unwilling, to receive these additional funds, the balance may be paid as a one-off small lump sum to the individual. It will be treated as an unauthorised payment if:

- there has been a recognised transfer out to another registered pension scheme or to a Qrops;
- after that transfer, there was a 'relevant accretion' in the scheme for the individual;
- a payment is made to the transferred individual which extinguishes their entitlement to benefits under the original scheme (which could have reasonably been known about at the time);
- the payment is made six months after the relevant accretion happened; and
- the payment does not exceed £10,000.

The 'relevant accretion' cannot to a contribution into the scheme nor a recognised transfer in.

If you only read one thing

- Only recognised transfers are allowed between schemes. These are authorised payments, so no tax charges or sanctions should apply.
- Individuals have the right to transfer accrued benefits without tax penalties but there are rules. Stakeholder pension schemes must accept any transfer in, but other schemes are not required to do so.
- Scheme-specific protections (for tax-free cash of more than 25% or an early retirement age) may be lost on transfer unless two or more people are transferring from and to the same scheme at the same time.
- Clients who transfer from a scheme with safeguarded rights must receive regulated advice if the value of the safeguarded scheme is worth more than £30,000.
- Transfers from one defined contribution scheme to another don't count towards an individual's annual allowance.
- Individuals can apply to HMRC for an enhancement to their lifetime allowance for any transfer in from some overseas pension schemes.
- Pensions can only be transferred to another UK registered pension scheme or a Qrops, otherwise tax charges will be applied.
- Transfers can be made to a Qrops, which is a BCE. There is a 25% tax charge on non-genuine Qrops transfers.

0383.06
03/2024