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AXIS FINANCIAL GROUP

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UK Citizens - Cashing in on Cashing Out

Every year, nearly half a million[1] tourists visit our shores. And, with our strong economy, relaxed lifestyle and favourable weather, tens of thousands choose to move permanently Down Under – particularly from the UK. With Australia remaining a popular immigration choice for our UK counterparts, both governments have had to re–address the rules regarding the transfer of overseas pensions. This Informer highlights these rules and the issues that need to be considered.

So where the hell are ya?

Gone are the days when convicts were banished from the UK as punishment for their crimes.

Australia is now a popular migrant choice for thousands of citizens from the UK[2]. So much so, that the rules regarding overseas pensions have been significantly overhauled to allow for the transfer of these monies into Australian super funds.

However, there are still some fundamental differences between each Government's retirement system. This Informer provides the basics of what you need to know before cashing in on cashing out.

UK pension rules

Let's look first at the main tax rules regarding UK pensions:

- an annual tax concessional contribution cap of £225,000;
- tax–free lump sum payouts of up to 25% of the account balance (provided the fund allows it);
- a Lifetime Allowance (LTA) cap of £1.65 million (similar to our redundant Reasonable Benefits Limit);
- tax–free transfers of money up to the LTA from a UK fund to a Qualifying Registered Overseas Pension Scheme (QROPS).

Transferring to QROPS

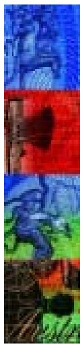
When money is transferred from the UK into a QROPS, its value in British pounds is frozen as at that date.

If the value is less than the LTA, there is no tax payable on the transfer. However, if the amount exceeds the LTA, then tax of 25% is payable on the excess.

Transfers to non–QROPS are subject to heavy tax penalties. The transferred amount is taxed at 40% and an additional 15% tax is applied, if the total value of the pension is in excess of 25% of the amount being transferred. In short, it's not advisable to transfer to a non–QROPS.

Once the money is in a QROPS, you're free to transfer to another QROPS as you please. However, as with any fund transfers/rollovers, you should check for exit fees and insurance you might lose.

For your information, you can download a list of QROPS at:
www.hmrc.gov.uk/pensionschemes/qrops.pdf



Australian super rules

The main tax rules you need to consider when transferring into an Australian QROPS are:

- the eligibility criteria for making contributions (see below);
- ensuring the transfer amount falls within the annual cap for non–concessional contributions (ie currency fluctuations can greatly affect the balance);
- how super is taxed before and after age 60 (ie tax–free after 60 and taxable before this age).

Arguably, the most important point here is the annual contribution cap. UK transfers are treated as non–concessional contributions. The annual non–concessional contribution cap for 2008/09 is $150,000 pa per person.

However, if you're under 65, you can bring forward this amount over three years and make a total contribution of $450,000 in one financial year. If this option is chosen, then no further non–concessional contributions can be made in the next two years.

The timing of the transfer can be tricky when you factor in currency fluctuations and the length of time it can take to administer the transfer. Therefore, seeking expert financial advice is highly recommended.

Criteria for making contributions

Another major consideration before you can transfer UK pension money into a QROPS is whether you meet the Australian contributions criteria. These are:

- you must be under 65 years;
- if aged between 65 and 74, you must meet the work test (ie gainfully employed for at least 40 hours over 30 consecutive days during the same financial year);
- if aged 75 and over, no transfers can be accepted.

The UK five year rule

As if these criteria weren't enough, there are additional tax rules that both Governments impose when transferring UK pension money out.

The UK imposes the five year rule, which refers to how long a person has been a non–UK tax resident.

Of importance here is that the five years relates to the UK financial year, which starts on 6 April.

This has implications on when you transfer money over to Australia, given that our annual contribution limits increase in line with our financial year start date of 1 July.

Five or more years

If the length of time is five or more years, then any payments or transfers from the QROPS are only subject to Australian super and tax laws. For example, if you're 60 or over, you can take your money tax–free or if you're terminally ill, you can cash in your super.

Less than five years

If the amount of time is less than five years, then UK tax rules apply and the following criteria must be met prior to any QROPS payments:

- the person must meet minimum UK retirement age (ie 50 years, rising to 55 after 6 April 2010);
- 25% of any lump sum payments are tax–free;
- the balance must be taken as a lifetime annuity from a life company or as an income stream that complies with UK law.

In other words, potential UK tax liabilities must be satisfied prior to the benefits falling under Australian super legislation.

The Australian six month rule

So that's the UK side of things. Just to add more complexity to the situation, Australia has its own timeframe rule relating to tax – the six month rule.

The six month rule refers to the length of time a person has been an Australian resident.

If the transfer of UK money to a QROPS is within six months of the person becoming an Australian resident, then no tax is payable. The money is invested as a non–concessional contribution and is subject to the annual cap.

However, if the transfer occurs after this six month window, then any earnings growth on the pension since departure will be taxed.

Strangely enough (and very unlike the ATO), the amount of tax applicable can actually be elected by the individual. If no election is made, the growth component will be taxed at the person's Marginal Tax Rate (MTR), which can be up to 46.5% (including the Medicare Levy).

Alternatively, you can elect to have the taxable amount treated as a taxable contribution within the super fund. In this case, the growth component would only be taxed at 15%. Naturally, this would be a better option for those on higher MTRs.

The tax payable can be deducted from the transferred amount, with the remaining non–growth component tax–free.

You should also note that the **entire amount must be transferred** over if you're taking advantage of the six month window. In other words, staggered transfers can't occur.

Case study

Let's apply the transfer rules to Joe Smith's situation:

- Aged 55 with a UK pension worth $600,000;
- $66,000 of the total amount is growth, since Joe became an Australian resident two years ago;
- Joe's Marginal Tax Rate is 46.5% (45% plus the 1.5% Medicare Levy).

Strategy options

Joe has two options open to him:

1. Transfer the whole amount this financial year;
2. Transfer his super in two stages:
    - $499,500 this financial year ($49,500 growth) and take advantage of the three year bring–forward contribution cap rule; and
    - the balance of $128,266 in three years' time*.

**assumes earnings of 5% pa.*

Strategy 1

Transfer $600k before 30 June 2009

Remember that $66k of the $600k is growth. Therefore, the sums work out as follows:

- $450,000 is invested as a non–concessional contribution;

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- $84,000 (ie $600k – $66k = $534k, $534k – $450k = $84k) is taxed at 46.5% and counted as a non–concessional contribution;
- $66,000 (growth) is taxed at either Joe's' MTR of 46.5% or as a taxable contribution at 15%.

Strategy 2

Transfer $450k before 30 June 2009

- $450,000 will be tax–free and invested as a non–concessional contribution;
- $49,500 will be growth and taxed at Joe's MTR.

Transfer the balance in 2011/12

- $84,000 will be tax–free and count as a non–concessional contribution;
- $44,266 will be growth and taxed at either Joe's MTR or 15%, as elected.

In Joe's case, adopting strategy 2 would be the best choice, as he'll pay considerably less tax. Take a look at what we mean:

	Strategy 1 Whole Amount Transferred	Strategy 2 Staged Transfer
Tax on non–concessional contribution	$84,000 x 46.5% = $39,060	Year 1 – $450,000 = $0 Year 4 – $84,000 = $0
Tax on growth	$66,000 x 15%* = $9,900	Year 1 – $49,500 x 46.5%* = $23,018 Year 4 – $44,260 x 15%** = $6,640
Total tax	**$48,960**	**$29,658**

Source: Asteron
** Assuming Highest Marginal Tax Rate*
*** Assuming Member elects taxable contribution option.*

As you can see Joe would save $19,302 in tax by transferring his pension in stages.

Issues to consider

There are numerous issues to consider when transferring UK pension money into a QROPS. Here's a recap of what we've highlighted and some additional considerations:

- the UK Lifetime Allowance cap;
- the double tax implications of the UK five year and Australian six month rule;
- monitoring currency fluctuations to avoid paying unnecessary tax or exceeding contribution caps;
- confirming exit fees and administrative and processing fees aren't cost–prohibitive;
- ensuring you meet the Australian contribution criteria;
- ensuring the Australian QROPS meets or exceeds the benefits of the UK pension scheme.

Ask AXIS

As you can see, the issue of transferring overseas money into an Australian QROPS is a complex matter. So it's essential to obtain qualified, financial advice from those specialising in this area.

If you need advice, we recommend contacting Pension Transfers Direct on (08) 9485 1064 or visiting their website at:- www.agoodmove.com.au

In the meantime, if you have any queries about this Informer, please feel free to contact our Advisory Group or Technical Services team on (08) 9426 5800 or 1800 111 299 or email us at: mail@axisfg.com.au.

[1] *Australian Bureau of Statistics, Short-term Visitor Arrival Estimates, Australia May 2008, June 2008.*
[2] *Australian Bureau of Statistics, Migration Australia 2006–07, March 2008.*

If you have any questions regarding the information in this bulletin, please contact your adviser:

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