Where Should Expats In The USA Place Their Pension?

British expats resident in the US may be tempted to place their retirement savings in overseas pension schemes. But would they be better off with a UK-based scheme?

By Philip Teague

For a long time now, the appropriate use of Qualifying Recognised Overseas Pension Schemes (QROPS) for British expats who are resident in the US has been in debate. Some see it has a credible solution while others say that the risks far outweigh the benefits.

QROPS are a legitimate pension solution to a great many British expats but a good quality adviser should always consider the impact of the expat's residency and how the local tax laws will affect the benefits of a QROPS. What may work very well for an expat in Portugal may be completely different to one in the US.

The April budget and a recent announcement regarding how death benefits from a UK pension are taxed certainly improve the argument to use a UK-based solution but let's look at the two in more detail.

Income

- From a QROPS:

Assuming the QROPS is based in Malta, income can be paid gross and taxed federally and by the state (if applicable) in the US.

- From the a UK pension:

The double taxation treaty between the UK and US clearly defines how distributions can be taxed. The expat would apply for a NT (No Tax) tax code and then gross income payments can then be taxed federally and by the State (if applicable) in the US.

Death Benefits

- From a QROPS can be paid to any chosen beneficiary free of tax.
- From a UK based pension:

Pre-retirement benefits can be paid to any chosen beneficiary free of tax. Post retirement, benefits can be paid free of tax as long as the individual is under age 75. Over 75, benefits can be paid as a lump sum taxed at the beneficiary's marginal rate of tax.

Access

- From a QROPS:

QROPS legislation only allows 30% of the fund to be taken as a lump sum. The remaining 70% must be used as an income.

- From a UK pension:

Since April 2015 there has been no limit on the amount of the fund you can access.

Risks

- From a QROPS:

Many believe a transfer into a QROPS when the individual is a US resident is a taxable event. Malta, which is a commonly used QROPS jurisdiction, has signed up to the Foreign Account Tax Compliance Act (FATCA). The QROPS trustees are obliged to report to the IRS, information about you and the QROPS and which may lead to tax charges for the transfer itself and the compliance of the underlying investment assets. The investment assets much be structured in a way that they are IRS compliant so they do not classed as a Passive Foreign Investment company (PFIC) which incurs 30% withholding taxes.

- From a UK pension:

UK-based pensions utilise the double taxation treaty and are clearly defined as qualifying from an IRS point of view. The tax treaty has been in operation for many years so it is tried and tested. Another key point is that UK based pensions are excluded from FATCA reporting so there are no worries of incurring withholding taxes due to the compliance of the underlying assets.

Summary

QROPS can be a good solution, but for British expats in the US the risks are just too much to outweigh the benefits.

The recent changes to UK pension legislation have greatly improved the death benefits and access to retirement funds. There are UK pension which are designed for Britons in the US and we expect the market for these products to increase rapidly now that this type of option is relevant and very attractive.

- *Philip Teague is managing director, Alexander Beard Expat & Emigration Division*

alexander beard
Expat & Emigration Division

British and now living in the US? Don't get caught out by FATCA!

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