

## Update

# Pension liberation – An ongoing challenge for the industry

Can a pension scheme member access her pension savings before retirement? Under any normal circumstances, the answer is No. However, “pension liberation” schemes – or scams – continue to attract many consumers.

Many of these are troubled people in difficult financial straits who see their pension savings as a source of badly-needed short-term cash, while some others are wealthy individuals who are prepared to pay high taxes and commission fees in order to access their savings early.

According to official figures, pension liberation arrangements were confirmed to have received transfers amounting to nearly £200m of savers' money by the end of 2011. Outside of this official figure, much more has probably been paid over to dubious companies and individuals who operate in a twilight world which has repeatedly attracted the attention of the regulators, the courts and, on occasion, the police.

A joint **warning** against pension liberation schemes was issued by the Pensions Regulator, the FSA and HMRC in February 2012, and the **FSA** continues to counsel consumers against getting involved in such arrangements. In addition, it has recently been announced that HMRC has set up a dedicated counter-fraud and avoidance team to deal with the problem.

### Background

In order to encourage retirement saving, pension schemes in the UK enjoy significant tax privileges. Contributions to pension schemes are tax-deductible, and the schemes themselves are exempt from income and capital gains taxes. Only the final pension paid out on retirement is subject to tax, in the same way as any other form of income.

A pension liberation scheme is a mechanism whereby a pension scheme member can be granted access to their accumulated pension savings before retirement. The normal minimum retirement age for retirement laid down by law is 55.

Depending on how it is structured, pension liberation is not necessarily illegal. However, it is often accompanied by illegal practices, and it will trigger tax charges which the member must declare and pay to HMRC. For example, where a pension liberation scheme involves an “*unauthorised payment*” under the pension tax legislation, it may be subject to an unauthorised payment charge of 40% plus an additional surcharge of 15%.

When these tax charges are taken together with the high levels of “commission” that are payable to the scheme organisers, pension liberation schemes represent a very expensive way of getting access to cash, at the cost to the member of poverty in retirement. The FSA has **described** the practice, with some understatement, as “*unlikely to be suitable for most consumers*”. In addition, firms offering pension liberation are often based in unregulated overseas jurisdictions, thereby denying consumers an important layer of protection.

Pension liberation – which is also known as “pension unlocking” and “pension loans” – has been a recognised phenomenon since at least the 1990s. The predecessor of the Pensions Regulator, OPRA, warned about the practice as long ago as 2002. Between 2003 and 2006, the FSA took enforcement action against a number of IFAs in relation to unsuitable pensions unlocking advice. Despite this, the practice has never fallen out of fashion, and the current economic hardship has done nothing to reduce demand for it.

### **How pension liberation works**

A pension liberation scheme typically involves a pension scheme member transferring his benefits out of an ordinary work-based pension scheme into a bogus scheme, which may be set up in the name of a non-existent employer. The member is then paid a share of his pension savings, often in the form of a loan, with the rest being kept as “commission”.

As noted, if HMRC finds out that the member has done this, it will impose a charge to tax. The combined effect of the “commission” and the tax bill could reduce the money actually retained by the member to just 30% of his original pension pot.

An example of a pension liberation scam in operation is provided by the case of *Dunne v Revenue & Customs* [2007]. The unfortunate Mr Dunne transferred his benefits, worth £43,000, into the “Holme Limited Pension Plan”. His benefits were used to purchase an annuity, due to commence at age 75, from the “Homes Insurance Company”. However, he was also granted an immediate loan of £33,000 secured against the annuity. The relevant companies were registered in Polynesia. The Special Commissioners of HMRC found that the “Holme Limited Pension Plan” was a sham, and that the member had no genuine employment relationship with its nominal sponsoring employer.

Mr Holme found himself with a £14,000 tax bill. HMRC did not pursue the trustees of his original scheme, on the grounds that they had made the transfer in good faith.

A later case, *Dalriada Trustees Limited v Faulds* [2011], dealt with two artificially created pension schemes which “invested” their assets by lending money to each other’s members.

This structure circumvented the more blatant abuse of a single pension scheme lending money to its own members, which would uncontroversially be an “*unauthorised payment*” under the tax laws. However, the relevant legislation also deems that an unauthorised payment has been made to a person if “*an asset held for the purposes of [a] pension scheme is used to provide a benefit... to... the person*” (Finance Act 2004, s.173(1)(a)). The term “*benefit*” is not defined, and the judge held that the arrangement at issue offended against this provision on the grounds that facilitating the cross-loans to scheme members amounted to conferring a “*benefit*”. He also went on to hold that the schemes had not been entitled to make the loans because they had not truly constituted investments of the scheme assets.

### Clyde & Co Comment

No-one really profits from a pension liberation scheme other than the individuals running it. Pension scheme members would be well advised to give such arrangements a wide berth.

In the same way, pension trustees, providers and administrators would be well advised to think twice before approving a transfer of a member's benefits to a receiving scheme which seems in any way suspicious. The tax legislation only allows trustees to make "recognised transfers", and a transfer into a sham arrangement set up to facilitate pension liberation may fall foul of this restriction and generate a tax charge. Although members of occupational pension schemes have statutory rights under the Pension Schemes Act 1993 to make transfers-out, schemes would be entitled to refuse to carry out a transfer where they suspect it is for liberation purposes and therefore not a *bona fide* transfer. It is unwise to assume that HMRC will be as understanding as it was in the *Dunne* case in relation to any resulting tax liability.

As the cases referred to above make clear, the regulatory authorities take cases of unlawful pension liberation seriously. The Pensions Regulator can take action against them in the High Court (under the Pensions Act 2004, ss.18-20) or by means of its own regulatory powers (as in the case of the **Holywell Enterprises Pension Scheme** in 2011). The Regulator's ongoing investigations into pension liberation scams are shrouded in a degree of secrecy, but it was **confirmed** in August 2012 that the Regulator was investigating 16 current cases. The recent establishment of a pension liberation team by HMRC indicates that the authorities are unlikely to let the issue drop any time soon.

### Further information

If you would like further information on any issue raised in this update please contact:

#### Mark Howard

E: mark.howard@clydeco.com

#### Laura Cooke

E: laura.cooke@clydeco.com

#### Jack Wheeler

E: jack.wheeler@clydeco.com

Clyde & Co LLP  
The St Botolph Building  
138 Houndsditch  
London EC3A 7AR

T: +44 (0)20 7876 5000

F: +44 (0)20 7876 5111

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