<u>Portable Retirement Plans</u>

Russell Hammond, Principal Client Adviser from AES International - Netherlands, considers some of the issues and wider choices affecting expats in planning for their retirement.

Over the last few years, more and more people have come to realise that they must examine *very* closely their plan for retirement in order to ensure that they are able to retire at a time, and income level, that is in keeping with their objectives. Gone are the days where your employer, or the state, would look after you in your 'golden' years.
If we skim through the press we will find a mass of, recent, news articles reporting how that a significant proportion of the population are coming into retirement to find that they are drastically under invested and, thus, unable to retire comfortably. They find themselves either needing to keep working (if indeed that is possible) or dependent upon family or charity in order to be able to make ends meet.
Whilst it is to true that expats will tend to earn more, than their local counterparts, the fact that they move from place to place goes against them as it will often prevent the forming of coherent financial plans, including retirement planning.

So, what is the solution?

In days gone by it was the case, for most, that your employer pension scheme would make up the majority of what you would end up living off when you came to retire. The state provision would come in second place, with your own private provision topping up your retirement nest egg. Fast forward to the 21st Century and this has, effectively, been turned on its head. Companies simply cannot afford, any longer, the once highly generous defined benefit schemes. So, Expat or not, you need to be taking responsibility for saving for <u>your</u> retirement. I often say, to clients, that you should consider future benefits payable from company schemes and the state as the icing and cherry on the cake. However, you must buy the ingredients and make the main part of the cake yourself – no one else will do it for you.

Now that you have decided that you do not wish to be dependent upon the state or companies that you may work for, over the years, to provide for your retirement so what are the options? In simple terms, you can either make use of a ‘state sponsored’ pension/retirement plan or an international private retirement plan. We will examine both, below.

When we describe a ‘state sponsored’ pension what we mean by this is a pension plan where the local government provides a tax ‘break’ for encouraging you to save for your retirement. Just how attractive this break is, or indeed if such a plan is even available, depends upon where you are in the world. When we make investment into these state sponsored retirement plans we do so from our gross income. Depending on contribution limits, this amount is then deducted from our taxable income. So, in the case of the US you are able to make use of a 401K. 401K’s or ‘Individual Retirement Accounts’ plans are subject to IRS limits on how much can be contributed, known as the section 415 limit. In Spain you would make use of a ‘Third Pillar Scheme’ and in the UK you could make use of a ‘SIPP’ (Self Invested Pension Plan).
Now, this tax 'break' is not really tax relief more tax deferral. When you access your money at retirement age you will pay tax on the income that your pension pot will produce.

The problem for expats is that they may not be able to predict that they will retire in any particular place. Ask a 35 year old international where he or she is likely to retire in 25 years time and very few would be able to give a concrete answer. Deciding where and when we will retire is very much dependent upon our situation at the time. As there are so many unknown factors that can influence where we will retire the lack of flexibility within local, domestic, retirement plans can make them seem an unattractive proposition.

Currently, if you make use of an ‘indigenous’ domestic pension scheme, you may not gain access to the funds or move the money before reaching retirement age. You may see this as a problem when you have only made contributions for a short period of time and, as such, are concerned that the value of the investment will be consumed by ongoing administrative charges and will not be effectively managed when you move.
So, you want to take you money back and move it elsewhere? Well, even if you were physically able to, you will normally have to pay back the tax relief that you have been given by the particular government that authorised your plan. What’s more, the tax that you would pay back could be greater than the tax relief that you got in the first place and, or, a penalty could be applied. The whole reason that any particular government has granted you an element of tax relief is because they think you will retire there. If you think about it, it makes sense that individual governments are only going to let you invest into retirement schemes that they sponsor, if you do actually end up retiring there. If you leave that country then, quite frankly, you are no longer their problem and will not, thus, drain on their domestic infrastructure.

So we have to ask ourselves, then, what is the solution to the Expat retirement need? Having worked as a financial adviser, to expats, for many years I have often been asked about a “Pan-European or even “Pan-Worldwide” retirement plan solution. Is such a solution a possibility? Yes, but it is not about making use of individual state sponsored retirement plans but international or ‘offshore’ private investment plans that exist outside of the standard, domestic, state sponsored solutions.

With offshore retirement plans you pay in to them from your net income, therefore, there is no tax deferral, however, you are not accumulating any future tax liability on the contributions. You are free to have access to your fund at a time of your choosing (not at a predefined retirement age) and you are not committed to buying a life assurance income plan (annuity) when you get to retirement. Offshore retirement plans are geographically portable so they are unaffected as you move to different places in the world. The plan stays in the same place, whilst you move around, all the time growing tax free, in a tax efficient investment area. The perfect solution to any expatriates long term retirement investment need.

As with any important financial plan you need to decide, with your financial adviser, how much it is that you need to save each month to hit your target retirement fund. How much you will need to save is dependent upon the level of income that you will require in the future. An important factor to always consider is the effect of inflation on future spending power. If you wish to retire on an equivalent income of €30,000 in 30 years time, you will actually need to be generating an income of around €60,000 to be able to maintain the same lifestyle. After making calculations of what you need to save, it may not be financially possible, now, to save at this target level. The important point is getting something in place and making a *start*. You can always increase what you pay in, each month, when your salary goes up in the future. Making a *start* is the golden key to retirement planning. If the editor of this article would allow, I would have 'start' flashing and spinning on the page as this is the real key to hitting your retirement goals – not leaving it too late!

In terms of how the retirement plan would work, it would function in a similar fashion to if it had been based locally. You contribute into your retirement plan, each month. You select whether you wish the fund to grow in Euros, USD, GBP or any other major currency, and the money that goes into your plan is then further divided, between different underlying funds. It is these underlying funds that will get your money working for you and building your future retirement nest egg. Sometimes the choice of funds and different investment options are wider when you invest offshore.

We have mentioned, above, that when you make use of an offshore plan, you are not normally accumulating any future tax liability on the contributions that you have made. However, it may also be possible to minimise the future taxation on any gain that you make within your plan. With offshore investing, because the plan will exist in a tax 'neutral' investment area, you are able to control when and where you will pay tax on the gain as it is normally dependent upon where you are fiscally resident at the point of cashing in your plan.

To make this easier to understand let's take a look at a specific example. Having been working as a contractor, in Oil and Gas, for many years, you have been paying into an offshore retirement plan for 23 years. You are now working in the Netherlands and have 5 years left to run on the plan. Over the last 23 years you have been resident in various areas of the world, including the UAE, UK and US. Soon, you will be returning to the UK and it is within the UK that you will start needing the money that has accumulated within your retirement fund. You have €1.5 Million within your retirement plan and are, obviously, keen to minimise the tax that you will pay on your investment. Because you are about to move to an area of the world (UK) where a capital gains tax is applied, it may make sense to encash your plan a little early whilst resident in the Netherlands where a capital gains tax in not applied. Such a decision to cash in your plan is made on a case-by-case basis, however, it is just to highlight that the tax *you* pay is normally based on where *you* reside not where the plan resides. There is no tax taken at source. You decide where and when you pay tax.

In summary, offshore retirement plans offer a great solution to the transient expatriate who, just like his local counterpart, wishes to invest and make financial plans, for his or her future. The inconvenience and disruption of needing to re-establish a new retirement plan every time you 'country hop' is negated by this geographically portable solution.

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