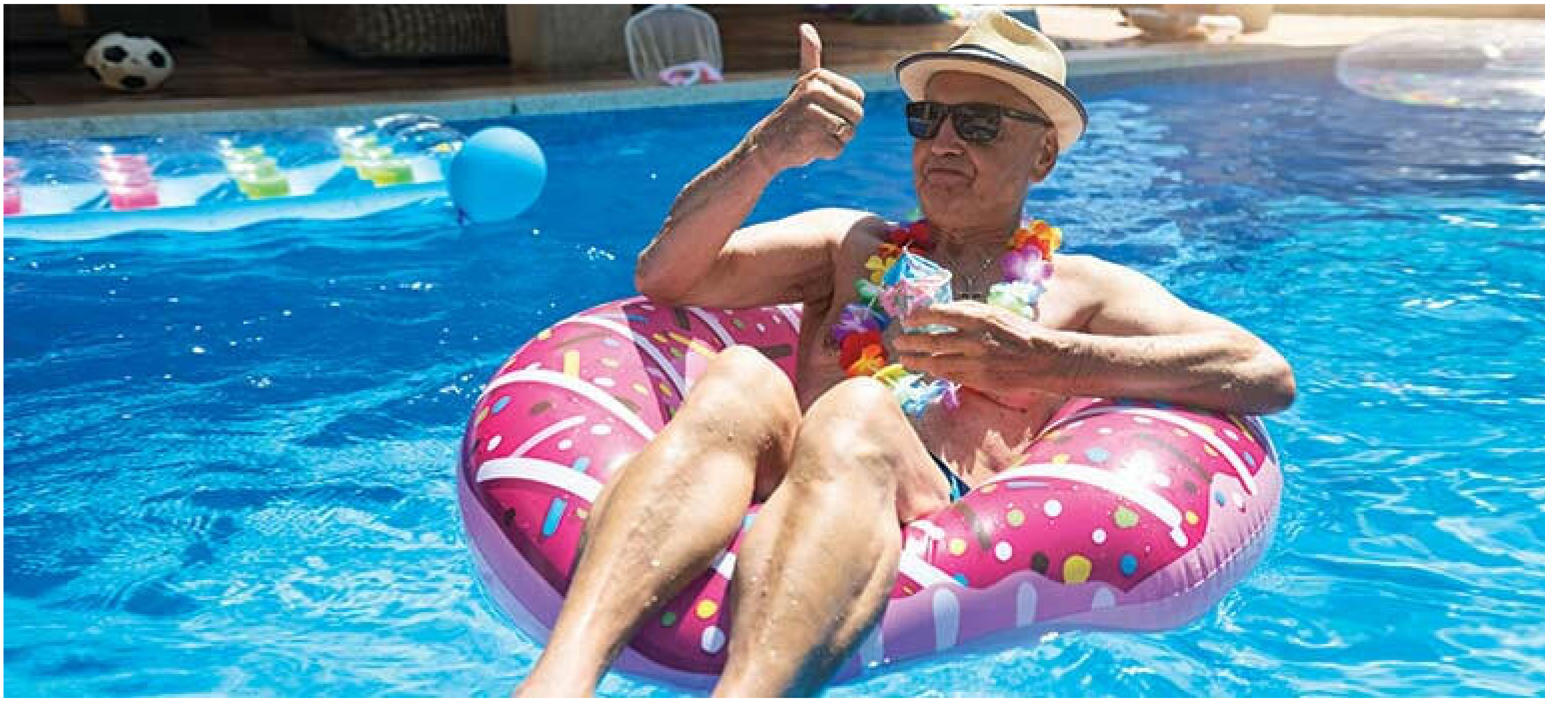
Accessing UK pension benefits: issues for a non-UK tax resident

International Tax Personal tax



23 September 2022

We consider the progressive pension and tax issues for those individuals planning to retire overseas, or those already retired abroad post-Covid.

Key Points

What is the issue?

Individuals with UK registered pension savings have significant flexibility over when and how they can take their retirement benefits. Choosing the right path can be complex, especially when they are resident overseas.

What does it mean for me?

Broadly, these rules could be relevant should they access UK registered pension scheme savings within five years of ceasing to be UK tax resident.

What can I take away?

Individuals should consider their options well before beginning to take benefits. They may be able to increase their UK pensions lifetime allowance from the 2022/23 UK tax year value of £1.0731 million by making specific

HMRC registrations. The drawing of retirement benefits can be complex where the pension scheme and the member are resident in different jurisdictions.

Following the reopening of borders and the relaxation of Covid-19 related restrictions, individuals planning to retire outside of the UK have picked up their plans to do so. Lockdowns have also seen people reflect on what they want to do with their lives and where they want to retire. Some of those living and working abroad may seek to return to the UK for retirement. With the UK's departure from the EU, Brexit has given rise to challenges for UK citizens seeking to retire in EU countries.

As a potentially dry subject, the options for their accumulated UK pension savings can get overlooked. However, there can often be an associated benefit of retiring abroad. We recap on some of the main considerations of retiring abroad when it comes to UK pension savings and the associated tax consequences of accessing retirement benefits. This article predominantly considers UK defined benefit and defined contribution registered pension scheme savings.

Tax residence position

Pension scheme members are often keenly focused on the income tax treatment of their UK pension savings in the country where they live or intend to live, which can be favourable when compared to the tax rates they had become accustomed to in the UK. However, their residence for tax purposes is the foundation of understanding the tax treatment of their UK pension savings.

Accordingly, members seeking to access their UK pension savings when non-UK tax resident should consider their tax residence position before drawing down on those pension savings. This is a complex area and pension scheme members need to ensure that they have considered any domestic tax legislation in all relevant territories, in addition to reviewing and correctly applying the double taxation agreement (see below) between the jurisdictions involved.

Care is often required and a number of issues must be addressed, including whether the individual might be dual resident or, perhaps as a result of Covid-19 restrictions, have inadvertently become tax resident elsewhere. Mismatches in the tax year between the UK and overseas countries can have consequences.

Individuals choosing to return to the UK after accessing any UK retirement benefits need to be mindful of the UK temporary non-residence rules. These are anti-avoidance rules which subject payments made from a UK registered pension scheme to an individual who is 'temporarily non-resident' to UK income tax, irrespective of the application of the double taxation agreement. Broadly, these rules could be relevant should they access UK registered pension scheme savings within five years of ceasing to be UK tax resident.

Double taxation agreements

Where individuals receive income from one country and are tax resident in another, they may be liable to pay tax in both jurisdictions under each respective country's domestic law. To relieve 'double taxation' in these circumstances, countries generally enter into a double taxation agreement with a view to assigning taxing rights.

Double taxation agreements and the 'Pensions' article contained therein are not all identical. Pensions articles in some agreements do not cover payments that most would assume were pension payments. For example, a wider assessment of the features of a double taxation agreement can include:

- distinguishing pensions derived from employment vs self-employment;

- whether an individual is drawing a pension income stream or lump sum benefit;
- the country of residence of the member at the time that the pension contributions were made;
- the relevance of any ‘Other income’ article of the agreement; and
- any ‘Limitation of benefit’ clause, which could further restrict the benefits of a double taxation agreement.

Individuals with top-up pension entitlements (i.e. outside the framework of UK registered pension schemes) should examine all of the relevant provisions of a double taxation agreement and the domestic tax legislation in all relevant territories if they are to understand their tax treatment. This applies to those with entitlements in:

- Funded Unapproved Retirement Benefit Schemes (FURBS);
- Employer-Financed Retirement Benefit Schemes (EFRBS);
- Unfunded Unapproved Retirement Benefit Schemes (UURBS); and
- International Pension Plans (IPPs).

Double taxation agreements are typically stable. However, it is possible that agreements can be terminated at relatively short notice. We have seen this in recent years with Finland, which terminated its double taxation agreement with Portugal in June 2018 as a result of the personal tax implications of their pensioners in Portugal.

UK defined benefit pension transfers

Individuals with UK defined benefit pension entitlements who are seeking to consider the appropriateness or otherwise of transferring their defined benefit pension rights into another pension structure are required by the UK’s Financial Conduct Authority to seek pension transfer advice (where the transfer value is more than £30,000). This is on account of it being an irrevocable decision with ‘no reverse gear’, which should not be taken lightly.

As the trustees of defined benefit pension schemes typically calculate transfer values with reference to long-dated gilts, the relative strength of transfer values being offered has been consistent with the level of gilt yields.

From the beginning of 2014 until the beginning of 2021, the general trend (and appreciating that gilt yields fluctuate) had been a decline in UK gilt yields, resulting in a general increase in transfer values. Since the beginning of 2021, the general trend for UK gilt yields has been in an upward direction, resulting in reduced transfer values.

Lifetime allowance

The March 2021 Budget confirmed that the lifetime allowance will remain at a level of £1.0731 million until 5 April 2026. Inflation means that more pension scheme members will be drawn into the tax effects of exceeding the lifetime allowance and its accompanying tax charge. Therefore, where possible, members should consider maximising their personal lifetime allowance position by registering for an enhancement with HMRC.

Subject to their associated conditions, there is no deadline for registering for Fixed Protection 2016 and Individual Protection 2016, both of which can give rise to a personal enhanced lifetime allowance of up to £1.25 million.

Those members who have accrued UK pension savings whilst non-UK resident may be eligible for an International Enhancement to their lifetime allowance. Pension scheme member awareness of this option for enhancing their lifetime allowance (and its accompanying complex HMRC conditions) can be low. Since there is a five to six year deadline for applying to HMRC, it can easily be missed.

Compliance and tax reporting

Disclosure to the relevant tax authorities remains a critical part of the overall process of accessing retirement benefits. Care should be given to any reporting requirements in the UK and overseas, depending on the individual's personal circumstances.

Inheritance, estate or wealth taxes

Accessing UK retirement benefits should be considered as part of the individual's wider wealth planning strategy, since any pension drawdown is likely to increase the value of their personal wealth for inheritance, estate or wealth tax purposes. There can also be a misconception that once an individual has left the UK, UK inheritance tax no longer applies to them.

Qualifying Recognised Overseas Pension Schemes (QROPS)

QROPS allow non-UK tax resident individuals with UK pension savings to transfer those pension savings to an overseas pension scheme (which satisfies requisite HMRC conditions).

Subject to detailed rules, transferring to a QROPS in the individual's country of residence can give rise to no UK pension transfer tax charge, whilst transferring to a QROPS in a third country can give rise to the 25% overseas transfer charge. It is then necessary to consider the tax treatment of the accessing of retirement benefits from the QROPS. There can be a preoccupation with the use of QROPS when there are alternatives, and pension scheme members should compare the respective advantages and disadvantages of using QROPS compared to UK pension savings vehicles.

Inbound to the UK

Individuals who are considering a return to the UK after spending some time abroad should consider their options before doing so. For example, in order to optimise their wealth planning, are there any actions that they should contemplate prior to arrival back in the UK? Where they have accrued UK pension savings whilst non-UK resident, they may be eligible for an International Enhancement to their lifetime allowance.

Conclusion

This article provides an overview of the common issues faced by internationally mobile individuals approaching or of retirement age and helps to demonstrate that pension drawdown by a non-UK resident remains a complicated matter. Individuals with material UK registered pension savings should take specific pensions, tax and investment advice tailored to their circumstances, well before proceeding.