Moving abroad: the impact of double tax treaties on UK pension payments

Personal tax International Tax

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UK pensions can be paid gross under double tax treaties when taxpayers relocate abroad for work or retirement, though there are exceptions that must be considered.

Key Points

What is the issue?

Most UK pension payments are subject to taxation due to the fact that pension inputs were tax relieved when originally made. Expatriates' UK pensions can be free of tax under a double tax treaty.

What does it mean for me?

If dealing with expatriates or those going abroad, it is possible that UK pension payments can be paid without deduction of UK tax. Most foreign countries have pension double tax treaties within the OECD model.

What can I take away?

It is important to ensure that a non-resident individual who can benefit from a taxable UK pension receives and completes the necessary tax office forms. There are some important exclusions.

Long-term expatriate individuals resident abroad can apply to receive gross payment of UK pensions. At a time when non-domiciles are considering leaving the UK because of the new tax rules, it is likely that others will soon be joining them in this exodus from the UK.

Double tax treaties

Many individuals in the UK already have their pensions subjected to UK tax. The UK state pension and other additional pensions will be taxed at the taxpayer's marginal rate after the personal allowance is set off.

If, however, taxpayers relocate abroad for work or retirement and are classed as non-resident under the statutory residence test, their UK pensions can be free of tax under a double tax treaty. The opportunity arises for their UK pensions to be paid gross with a nil tax coding (NT code) applied by their pension administrator.

Many UK pensions – but not all – can be paid gross under double taxation treaty relief using the general Form DT-Individual (see tinyurl.com/mwdreh9w). However, a number of countries use country specific forms and require particular attention, including the US, Canada, Australia, New Zealand, South Africa, and a number of EU countries including France, Germany, Spain, the Netherlands and Ireland. Most of the specific country forms are detailed in 'Living and Working abroad and offshore forms' on the HMRC website (see tinyurl.com/bdeh88sh).

Government and non-government pensions

However, government pensions do not normally benefit from gross payment relief when Form DT-Individual is completed and will continue to be taxed by that government. (There are exceptions under individual double taxation agreements, however, so do check the instructions for the country in question.)

It is therefore important to check whether the taxpayer's pension is paid by the government or local authority or by non-government. HMRC's International Tax Manual (INTM343030 and INTM343040) contains further information and a list to clarify whether pensions are government or non-government.

For instance, the taxpayer may have been a teacher in the UK and now provide teaching services abroad. In a case such as this, you would have to distinguish which pension scheme is applicable, as there are a number of government and non?government teachers pensions (see ***Example 1: Ray and Helen***).

Example 1: Ray and Helen

Ray and Helen were teachers in the UK and have both retired. Ray receives a university teaching pension and Helen a general teaching pension from their previous jobs in the UK. Both apply for a teaching jobs abroad and expect to be UK non-resident for many years. As former teachers, they check with the INTM343040 list. This includes:

- teachers pensions – general;
- teachers pensions – paid for service to a private or independent school; and
- the Universities Superannuation Scheme.

Ray's income is within the University Superannuation Scheme and is non?government. Therefore, an NT tax code will be sent to his scheme administrators. However, Helen's pension falls within the general category, which is a government pension. Her pension does not benefit from gross payment by the scheme administrator.

Many other professions are similarly divided, including the police and fire security services (see ***Example 2: John***).

Example 2: John

John retires abroad from the UK police force after years of service. He receives a full police pension which is taxed at UK basic and higher rates. He also receives a full UK state pension, which amounts to £11,502 a year. This is offset against his personal allowance of £12,570, before the small balance being offset against his police pension.

John remits all his pension sources to his long-term foreign country of residence and asks the tax office there to confirm his permanent tax residence. After submitting the Form DT-Individual to HMRC, John is advised that the police pension is UK state funded and under the rules is taxable in the UK. (See INTM343040, which includes the Metropolitan Police Fund and Transport Police in police pensions).

Before his retirement, however, John was offered a position in the police force in Jamaica but declined. Had he accepted the job and received a Jamaican pension from that state, Article 13 of the UK-Jamaica Tax Treaty (1973) states:

'Remuneration, including pensions, paid by one of the contracting governments to any individual in respect of services rendered to that government in the discharge of governmental functions shall be exempt from tax in the territory of the other contracting government, if the individual is not ordinarily resident in that other territory or (where the remuneration is not a pension) is ordinarily resident in that other territory solely for the purpose of rendering those services.'

John's government pension would therefore have been taxable only in Jamaica unless he was ordinarily resident in the UK.

(See Double Taxation Relief Manual DT10552)

Processing Form DT-Individual

Clearly, the double tax treaty articles should be checked to ensure that the taxation of pensions is specified by limiting it to the ‘paying state’;
i.e. the UK.

Under the OECD double tax treaty convention applied by most countries, this is normally detailed under the heading ‘Pensions’. In the UK-Malaysian Treaty, for example, Articles 19 and 20 on ‘Pensions’ importantly distinguishes between government and non-government pensions. However, under a recent amendment (PU(A) ss 234 and 235), Malaysia has imposed tax on foreign source income, including pensions and annuities, within Income Tax Act 1967 s 4.

Having confirmed whether the pension being paid is government or non-government (i.e. UK taxable or not), the foreign country’s tax office can be approached to stamp the completed Form DT-Individual or provide a foreign residence ruling to accompany the form when it is sent to HMRC.

Normally there will not be any push back by the foreign tax office in undertaking this task. Commonly, the view is that it will result in more foreign income entering the country, which in the long run will be to their benefit. The Form DT-Individual does ask numerous detailed questions, including whether the expatriate will be remitting the income to the foreign state.

Tax-free benefits

Upon the individual arriving abroad on retirement or for a new job, certain foreign countries may not impose taxation on foreign source income, including UK pensions, received in that country. Many of these are in the Middle East. They may, of course, require the submission of a local tax return where there is local employment.

This special category of countries has differing requirements regarding the UK pension payments. In order to obtain tax-free benefits, the individual must not only be considered as non-resident in UK but must also meet the necessary criteria to be classed as resident in the foreign state.

Appendix 1 of Form DT-Individual applies to Bahrain, British Virgin Islands, Cayman Islands, Hong Kong, Kuwait, Qatar, Saudi Arabia and UAE. Box H: United Arab Emirates, for example, states:

- Under the law of UAE, are you recognised as resident in UAE by reference to your domicile, habitual abode or centre of vital interests there?
- Enclose a copy of your UAE certificate of residence.

See ***Example 3: United Arab Emirates***.

Example 3: United Arab Emirates

The United Arab Emirates, particularly Dubai, has seen a large increase in British expats relocating there for work and retirement.

A recent UAE Cabinet decision (85) in 2022 has provided new criteria of residence along these lines. This requires an expatriate to have a physical presence in UAE for 183 days in a year and to have their primary residence in the UAE, and consequently to be UK non-resident under the statutory residence test. If so, the expatriate can apply for a tax residence certificate in the UAE to forward with Form-DT Individual to HMRC. This then enables UK pension payments to be paid gross.

As the UAE does not tax foreign sourced income, the UK pension will be tax free in both countries.

In conclusion

In determining whether a UK source pension is excluded from taxation in the foreign state, the double tax treaty should first be reviewed with focus on the pensions articles and the government pension references. Even then, there may be different nuances to each different treaty. This is partially demonstrated in Example 3. Interestingly, Article 18(2)(b) of the UK/Spain treaty agreement is similar to the wording in the UAE treaty.

Even if only UK tax is exigible according to the treaty and the pension is not taxable in the foreign state, it may be taken into account in calculating the local marginal rate of tax on income applied in the foreign state. Pre-planning care should be taken when applying the foreign country's tax treatment of receiving a UK pension.