

Tech Talk

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The lifetime allowance and non-UK pension schemes

Contents

- Introduction
- Schedule 34
- Lifetime allowance test and relevant relieved amount
- Relevant relieved amount calculation
- Comment

Introduction

Individuals, as part of their retirement planning, may hold rights in a non-UK pension scheme and the question often asked is whether these rights are taken into account for lifetime allowance (LTA) purposes.

The first thing to ascertain is whether or not the non-UK scheme is a registered pension scheme. A registered pension scheme can be set up in any country; it doesn't have to be set up in the United Kingdom (UK). The same conditions for registering a pension scheme apply whether the scheme is set up in the UK or overseas. If the scheme is a registered pension scheme, then the LTA is a consideration (see HMRC's Pensions Tax Manual page PTM114000 for more detail).

If the scheme is not a registered pension scheme, then we have to look at Schedule 34 of the Finance Act 2004 for guidance. For the purposes of this Tech Talk, it is this type of scheme that will be considered. Therefore further references to a non-UK pension scheme will be to one that is not a registered pension scheme unless stated otherwise. What follows is a brief guide to the content of the schedule regarding the LTA provisions.

Schedule 34

Schedule 34 provides for certain tax charges that normally apply to, or in relation to, registered pension schemes to also apply in certain circumstances to members of non-UK pension schemes. The LTA charge is one such charge.

The LTA provisions apply to 'relieved members' of 'relieved non-UK pension schemes' as if they were members of a registered pension scheme. The rationale for this approach is that, just as rights under a registered pension scheme that have benefitted from UK tax relief are tested against the lifetime allowance, then it follows that so should rights under a non-UK pension scheme that have likewise benefitted. Therefore any individual who holds rights in a non-UK scheme and is not a relieved member does not have to consider the LTA.

A non-UK pension scheme is a relieved non-UK pension scheme if at least one of the following conditions is met:

- Migrant member relief has been given in respect of contributions paid to the scheme.
- Transitional corresponding relief has been given in respect of contributions paid to the scheme.
- Contributions made to the scheme after 5 April 2006 have received tax relief under a double taxation arrangement.
- Any member of the scheme has been exempt from liability to tax by virtue of section 307 Income Tax (Earnings and Pensions) Act 2003 (ITEPA) in respect of provision for retirement or death benefits made by the employer after 5 April 2006 when the scheme was an overseas pension scheme.

A relieved member of such a scheme is one who, at any time after 5 April 2006, has benefitted from any of the UK tax reliefs set out in these bullet points. The first 3 bullet points are reliefs in connection with contributions made by the member to the scheme and the last bullet point covers any income tax exemption received by the member in respect of employer provision made on their behalf through the scheme.

These reliefs will not be covered in this Tech Talk and if required a fuller description of them can be found in the relevant pages of HMRC's Pensions Tax Manual (see PTM111000).

A LTA test is carried out on the occurrence of a benefit crystallisation event (BCE) in the same way as it is for a registered pension scheme. However, there is an overall limit on the total amount of the benefits under a relieved non-UK pension scheme that may be tested against an individual's LTA. This limit, namely the relevant relieved amount, ensures that only amounts in the relieved non-UK pension scheme that have received UK tax relief after 5 April 2006 are tested against the LTA.

There are certain modifications to the BCE rules that apply specifically to relieved members of relieved non-UK pension schemes.

Firstly, such members may elect that a BCE is deemed to have taken place. A member who chooses to do so must send form APSS 254 to HMRC, specifying the date on which the BCE is to be treated as occurring, in respect of benefits under the relieved non-UK pension scheme. This allows individuals who leave the UK permanently to test their benefits under their relieved non-UK pension scheme at an earlier date. This gives them the opportunity to check to see if they have a lifetime allowance charge liability and, if one exists, discharge it before the benefits are actually crystallised, which could be many years down the line.

Secondly, a transfer to a qualifying recognised overseas pension scheme (QROPS) is a BCE 8 under certain circumstances. Therefore a transfer in respect of a relieved member of a relieved non-UK pension scheme to a QROPS could trigger a BCE 8. However, no BCE 8 applies where rights transferred from a relieved non-UK pension scheme form part of a block transfer. Following the block transfer the LTA provisions will continue to apply as appropriate to the receiving scheme and the member.

Lifetime allowance test and relevant relieved amount

At a BCE in respect of a relieved member under a relieved non-UK pension scheme, the first step in calculating the amount to be tested against the member's LTA is to assume that the BCE is occurring under a registered pension scheme and calculate the amount crystallised in the normal way for whichever of the 13 BCEs has occurred. The next step is to calculate the relevant relieved amount relating to the member under the scheme at the BCE.

The relevant relieved amount is made up of the following:

- The total pension input amounts, calculated in accordance with the guidance set out in schedule 34, that have arisen in relation to that scheme in each tax year after 5 April 2006 in respect of the member.
- The pension input amount that would have applied by virtue of schedule 34 if the period beginning on 6 April in the tax year in which the BCE occurs and ending immediately before the BCE was a full tax year.

Section 229 (3) of the Finance Act 2004 is ignored for the purpose of the calculation. This means that if, in a tax year, the member satisfies the severe ill health condition or has died, the pension input amount (PIA) for that tax year is not automatically zero.

The amount that is tested against the LTA is the amount calculated at the first step, reduced by any excess over what is termed 'the untested portion' of the relevant relieved amount. This portion is the relevant relieved amount, less all the amounts tested against the LTA at previous BCEs in respect of the individual under the relieved non-UK pension scheme.

To illustrate how this works in practice please consider the following examples:

EXAMPLE 1

Bernadette is a relieved member of a relieved non-UK pension scheme and she first took benefits from the scheme in the 2014/15 tax year. The value of the scheme benefits taken at that time, valued in accordance with normal BCE principles was £200,000. Her relevant relieved amount at that BCE was £250,000.

As there was no previous BCE in respect of the scheme to account for, the untested portion of the relevant relieved amount was also £250,000. The value of the benefits taken did not exceed the untested portion and it follows that the excess over the untested portion at that BCE was nil.

Therefore the amount tested against Bernadette's lifetime allowance was £200,000.

Bernadette is about to take another tranche of benefits from the scheme. The value of these benefits is £180,000 and her relevant relieved amount has increased to £300,000.

The untested portion of her relevant relieved amount is £100,000 (£300,000 - £200,000) and the excess over the untested portion is therefore £80,000 (£180,000 - £100,000).

Therefore the amount tested at this BCE is £100,000 (£180,000 - £80,000).

EXAMPLE 2

Details are as per Example 1 but with the following changes:

BCE 2014/15 – relevant relieved amount was £150,000

Current BCE – relevant relieved amount is unchanged at £150,000 i.e. Bernadette has not engaged in any pension funding under the relieved non-UK pension scheme since the 2014/15 BCE.

BCE 2014/15:

Untested portion of relevant relieved amount was £150,000 and the excess over this untested portion was £50,000 (£200,000 – £150,000).

The amount tested against Bernadette's lifetime allowance was therefore £150,000 (£200,000 – £50,000).

Current BCE:

Untested portion of relevant relieved amount is nil (£150,000 – £150,000) and the excess over this untested portion is £180,000 (£180,000 – nil).

Therefore the amount tested at this BCE is nil (£180,000 – £180,000).

A lifetime allowance charge results where at a BCE the amount used for testing exceeds the member's remaining LTA. Unlike registered pension schemes, a relieved member of a relieved non-UK pension scheme is solely liable to the lifetime

allowance charge. That member is liable to the lifetime allowance charge whether or not they or the scheme manager are resident or domiciled in the UK.

Relevant relieved amount calculation

As explained in the previous section calculating the relevant relieved amount is important if the LTA test is to be carried out properly in respect of a relieved member of a relieved non-UK pension scheme.

The calculation of the PIA for a relieved non-UK pension scheme follows the methodology used in calculating the PIA under a registered pension scheme with some modifications. Therefore, the type of arrangement(s) held in the scheme will have an influence on the calculation.

Let's consider a relieved non-UK pension scheme that contains an arrangement that is money purchase (not cash balance) in type. The calculation of the PIA for such an arrangement under a registered pension scheme is modified to ensure that:

- Only member contributions made in the tax year that have benefited from UK tax relief under one of the reliefs set out in the Schedule 34 section are included in the PIA.
- Any employer contributions made in the tax year in respect of the member that might relate to income that is not chargeable to UK tax is excluded from the PIA.

Identifying which member contributions are to be included in the PIA should be relatively straightforward.

However, employer contributions made to the scheme on behalf of the member in the tax year are multiplied by an 'appropriate fraction' before being included in the PIA. The appropriate fraction is the proportion that the member's UK taxable earnings from the employment in connection with which the benefit rights arise bears to the member's total income from that employment and is defined by the following formula:

(TE + TSI) / EI (for tax years on or after 2014/15)

TE/EI (for tax years prior to 2014/15)

EI is the total amount of a member's employment income from any relevant employment(s) for the tax year, excluding any employment income which is 'exempt income'.

A relevant employment is employment(s) with an employer(s) who is a sponsoring employer(s) of the relieved non-UK pension scheme. EI includes earnings from a relevant overseas employment even where they are not chargeable to UK tax in that year.

Exempt income is exempt within the meaning of section 8 Income Tax (Earnings and Pensions) Act 2003 (ITEPA 2003). For example, section 307 ITEPA 2003 provides that there is no liability to income tax under the benefits code for provision by an employee's employer for a retirement or death benefit.

TE is so much of EI as constitutes taxable earnings from any such employment coming within the meaning of section 10(2) ITEPA 2003. Section 10(2) provides for taxable earnings from an employment in a tax year to be determined in accordance with the rules in Chapters 4 and 5 of ITEPA 2003. It excludes income that is not remitted to the UK if it is not chargeable to UK tax.

TSI is so much of EI as constitutes specific income from any such employment coming within the meaning of section 10(3) to (5) ITEPA 2003.

EXAMPLE 3

Sven is a relieved member of a relieved non-UK pension scheme. In the 2017/18 tax year he received UK tax relief on his £12,000 contribution to the scheme. Sven's employer contributed £24,000 to that scheme in respect of him in that tax year, and Sven is exempted from liability to UK income tax on that contribution under section 307 Income Tax (Earnings and Pensions) Act 2003 (ITEPA 2003).

Sven had total income (EI) from his employment with the employer in that year of £120,000 (including non-remitted relevant foreign earnings not chargeable in that year but excluding the employer contribution). Only £80,000 of that income is UK taxable earnings (TE) under section 10(2) ITEPA 2003. Sven also had £10,000 taxable specific income which is UK taxable (TSI) under Part 7 ITEPA 2003 in relation to an employment related share option scheme.

The appropriate fraction for 2017/18 is

$$(TE + TSI) / EI$$

$$(\$80,000 + \$10,000) / 120,000 = 0.75$$

Sven's PIA in respect of the scheme for the 2017/18 tax year is Sven's individual contributions plus the appropriate fraction of the employer contribution.

$$\$12,000 + (\$24,000 \times 0.75) = \$30,000$$

Where the relieved non-UK pension scheme contains other arrangement types e.g. defined benefit, guidance on the PIA calculation for these types of arrangement can be found in the relevant section of HMRC's pension tax manual (see PTM113300).

Comment

Where the lifetime allowance provisions apply, in respect of a member of an overseas pension scheme, it is not just the mechanics of the lifetime allowance test that have to be borne in mind. For example, where an individual has enhanced protection they will lose it if they become a relieved member of a relieved non-UK pension scheme after 5 April 2006 unless it is as a consequence of a permitted transfer being made to the scheme, or they make a relevant contribution to a money purchase arrangement (not cash balance) under a relieved non-UK scheme.

This Tech Talk provides insight into whether rights held in an overseas pension scheme are required to be taken into account for lifetime allowance purposes. The content does not cover every eventuality that advisers may encounter when dealing with clients who have such rights, but hopefully it offers a useful introduction into the subject matter.



John Dunn
Pension Specialist
Technical Support Unit

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