

## TAXGUIDE 3/09

### UK TAX DEDUCTIONS FOR CONTRIBUTIONS TO OVERSEAS PENSIONS SCHEMES

Guidance note issued on 31 March 2009 by the ICAEW Tax Faculty following meetings between various representative bodies and HM Revenue & Customs.

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## UK TAX DEDUCTIONS FOR CONTRIBUTIONS TO OVERSEAS PENSIONS SCHEMES

### Introduction

- 1 This guidance has been prepared by the ICAEW Tax Faculty in response to concerns that have been raised by a number of interested parties about the continued deductibility for UK tax purposes of pension contributions made to overseas pension schemes following the FA 2006 changes (the A day changes) in respect of non-UK employees, namely foreign nationals who have never been, and are never likely to be, resident in the UK. The schemes themselves are based on normal employment practice in the countries concerned but inevitably they will not always be wholly compatible with UK arrangements.
- 2 The guidance note has been prepared following a series of meetings between a number of representative and trade bodies and pensions specialists at HM Revenue & Customs (HMRC).
- 3 This note has been agreed by HMRC.

### The issue

- 4 The point of concern is whether, following the changes made to the pensions rules post A-day, contributions made by a UK business (whether incorporated or unincorporated) to an overseas pension scheme in respect of its foreign employees continue to be deductible for UK tax purposes.
- 5 In relation to foreign employees, this means overseas employees who do not, nor are ever likely to, come and work in the UK. This situation is not unusual and may arise in a number of businesses, often as a result of regulatory or other operational reasons. Typical examples of businesses that could be affected include:
  - employees who work for an overseas branch of a UK bank;
  - employees in an overseas office of a professional services firm such as legal partnership; and
  - employees working overseas for UK construction firms.
- 6 This guidance note is concerned **solely** with contributions made for the benefit of overseas employees who do not have a UK connection. It does not apply in relation to migrant workers, both those who may leave the UK to work overseas nor those who may come to the UK.

### The position prior to A day

- 7 Prior to A-day (6 April 2006), payments to overseas pension schemes would have been regarded as payments to non-approved pension schemes. The deductibility of contributions to such schemes was dealt with by s 76(6C), FA 1989 (inserted by paragraph 2 of Schedule 39 to the FA 1996) and provided that the conditions set out in that section were satisfied HMRC allowed a tax deduction on a paid basis. Broadly, relief was allowed provided that the foreign scheme 'corresponded' to a UK pension scheme (the so-called 'corresponding relief' rule).

### **The position post A day**

- 8 The position changed with the new rules that took effect post A Day. The FA 1989 provisions were repealed and the taxation of pension schemes is now set out in Part 4 of the FA 2004. The new rules do not contain a provision analogous to s 76(6C)(b), FA 1989 . Broadly the new rules provide for tax relief on a paid basis only for employers' contributions to UK-registered schemes (s 196, FA 2004).
- 9 The new regime does not accord any tax advantages to overseas pension schemes that are not UK registered pension schemes in relation to members resident outside the UK. Such schemes are treated like any other arrangement to provide benefits to employees and subject to the rules on employer deductibility set out in Schedule 24, FA 2003 (for further details see below). Under those rules, tax relief for contributions to what are referred to as employer-financed retirement benefit schemes will only be allowed when benefits are paid to employees, thus potentially deferring relief for many years and, in practice, relief may never be available. It is important that businesses can continue to claim UK tax relief for such contributions.
- 10 Schemes which were in place Pre A day are subject to transitional arrangements set out in paragraph 15 of the *Taxation of Pension Schemes (Transitional Provisions) Order 2006* (SI 2006/572). The transitional rules enable relief to continue post 'A Day' for those who were members of a Pre A Day scheme. However, no relief is available for members who joined the scheme post 'A Day'. The result is that over time as Pre A day employees leave and post A day employees join, the benefit of the transitional relief will reduce.
- 11 Therefore, post A day in order to obtain full tax relief for overseas pension contributions the payments must be made to a **UK registered pension scheme**. The question then arises as to whether such overseas schemes can be UK registered schemes for these purposes, especially given that they will usually be constituted under local tax law rules which may be broadly similar to, but not within, the UK rules and will probably have a local administrator.
- Registering overseas schemes in the UK**
- 12 Overseas pension schemes can apply for registration in the UK. Whilst UK registration of such overseas schemes may appear at first sight to be impractical, in reality the position for overseas schemes with no UK employees is more straightforward than it may appear.
- 13 Registration requires a nominated scheme manager in the EEA to be responsible for the UK tax position. Note that the manager:
- could be a company;
  - does not need to be the employer making the contribution.
  - does not need to be responsible for any duties other than those imposed by the UK pensions tax legislation. All other duties, including the day to day running, may be carried out by a local person resident outside the EEA.

14 Registration can be made online. HMRC has advised that where overseas schemes register online, they should inform the Nottingham pensions office that the application is being made.

#### **Duties of the scheme manager**

15 The nominated scheme manager needs to make a declaration that they will report to HMRC any:

- breach of the lifetime allowance; and
- unauthorised payments.

16 Whilst these may appear onerous requirements, the principle of territoriality applies to limit the scope of these reporting requirements. Overseas employees not resident in the UK and with no UK earnings are not subject to the UK pension scheme rules and therefore neither of the above reporting requirements will be in point. There is guidance on this in HMRC's Registered Pension Schemes Manual at RPSM13103040-50 and at RPSM12301020.

#### **Registration in practice**

17 Therefore, in practice, for an overseas pension scheme with such overseas employees as its sole members, no further reporting will be required in the UK. The fact that the precise terms of the scheme may not correspond to the UK rules does not alter the ability of that overseas scheme to be a registered pension scheme for these purposes.

18 The position is more complicated where employees became UK resident. As noted in paragraph 6 above this note does not address the issue of migrant workers. Arrangements would need to be in place to ensure that any such personnel were identified and reported. However, where secondees were involved it may be possible to avoid this issue arising in practice by giving the employee a pension contribution holiday so that they cease to be active members of the scheme during the period they are resident in the UK.

19 There is also a rule that a person remains attached to a UK scheme for five years after they cease to become resident in the UK. However, this only applies if they were already UK resident or had UK earnings at the time that they joined the registered pension scheme, a situation which would be unlikely in practice.

20 In summary, an employer should be able to:

- register an overseas scheme as a UK registered scheme even though it relates solely to overseas employees; and
- make the relevant declaration in respect of the UK tax position.

21 So long as all of the active members remain overseas and do not become UK resident or start to receive UK earnings, no further reporting requirements would be needed.

22 We understand that in relation to the EU, the Commission has confirmed to the UK that the above registration requirements in relation to pension schemes established

in other EU countries, in order to obtain tax advantages available to registered pension schemes, are compliant with the EU treaty. The rationale is that the registration requirement applies to everyone and that because there are no UK reporting requirements in respect of active members, who remain overseas, the requirement is a proportionate one.

#### **Other types of overseas scheme**

- 23 The requirements of the post A day rules are designed to be 'light touch' and for employer financed overseas schemes, UK registration should be relatively straightforward.
- 24 Overseas pension schemes may take a variety of forms. The position may be less clear where the scheme is not employer financed. If a particular scheme is established by a sponsoring employer there are no additional restrictions on the ability to register the scheme in the UK.
- 25 In practice, even though schemes may appear to be member directed, the scheme may have been established by the employer. Perhaps the most common form of overseas pension arrangements that fall into this category are US s 401(k) plans. Our understanding of the position is that, while the investments in s 401(k) plans in respect of individuals are member-directed, the scheme or arrangement itself has to be established and sponsored by the employer. Under UK tax legislation this is akin to an occupational pension scheme (unlike, for example, a group personal plan in the UK which is established by an insurance company etc and not by the employers whose employees are members) and the registration requirements set out above will apply.
- 26 For schemes not established by an employer it may be more difficult for a scheme to register in the UK because of the requirements of s 154, FA 2004 about who may establish a registered non-occupational scheme.
- 27 In some countries, payments may be made in respect of a government scheme. In this instance, mandatory employer contributions are likely to be equivalent to a social security scheme. In this case, the mandatory contributions are unlikely to be contributions to an overseas pension scheme within the pension tax relief rules and if this is the case on the facts any deduction would be subject to the normal business deduction rules (s 74, ICTA 1988).
- #### **Tax relief for contributions to a non-registered scheme**
- 28 Contributions to an overseas pension schemes that is not a UK registered scheme will be treated in the same way as contributions to any other non-registered employer-financed retirement benefit scheme and the deduction will be subject to the rules on deductibility set out in Sch 24 of the FA 2003.
- 29 These rules do not permit a tax deduction for any payment to an employer-financed retirement benefit scheme until such time as the benefits are paid out to the employees. In the case of a pension scheme, this would be likely to defer tax relief for a long time.

### **Summary**

30 In summary, the key changes between the pre and post A day rules for overseas pension schemes operating in relation to local employees in the relevant country are that such schemes (subject to the transitional relief rules set out above):

- now need to register in the UK in order to continue to claim UK tax relief on contributions, but the registration process should be relatively straightforward; and
- there is no longer a requirement to satisfy HMRC that the overseas scheme corresponds to a UK scheme.

31 Where payments are made to overseas pension schemes that are not UK registered schemes, contributions will only be eligible for tax relief under the rules for employer-financed retirement benefit schemes set out in Schedule 24, FA 2003. These rules would deny tax relief until such time as the benefits were paid out (normally as a pension or lump sum to the ex-employee), but relief could be deferred for many years and in practice may well be lost (due to inability to track when benefits crystallise). It is therefore essential that employers review their overseas pension arrangements and take any necessary action so as to ensure that UK tax relief is available (subject of course to the availability of any transitional relief).

FJH

31 March 2009