Key Points

- There are no statutory restrictions on membership of a UK pension scheme by persons who do not live or work in the United Kingdom.
- Restrictions on benefits accrued or provided under a registered pension scheme may be relaxed where a member does not benefit from UK tax relief because he or she is a "relevant overseas individual" or a transfer has been made into the scheme from a "recognised overseas pension scheme".
- A registered pension scheme may only make a transfer into an overseas pension scheme that is approved for the purpose by HMRC (a "qualifying recognised overseas pension scheme" - QROPS).
- Transfers to a QROPS (and onwards from a QROPS to another QROPS) are subject to the Overseas Transfer Charge (OTC) of 25% of the transferred value from 9 March 2017, unless certain exemptions apply.
- A member who comes to the UK as an existing member of a qualifying overseas pension scheme may benefit from migrant member relief on UK income tax.
- A scheme may only accept contributions from a "European Employer" if it is authorised to act as a cross-border pension scheme. Onerous funding requirements apply to cross-border defined benefit schemes.
- Despite the first bullet point above, it is worth noting that having a scheme member who is subject to the labour and social security laws of another EEA state (i.e. who works elsewhere in the EU in a scheme) makes that a cross-border scheme with onerous funding consequences.
- The European parliament and Council has agreed a revised IORP Directive (IORP II) which will make changes to cross-border pension arrangements (subject to how the Directive is applied in the UK as a result of the UK leaving the EU).
- Changes to the taxation of "Foreign Pensions" from 6 April 2017 are substantial.

Main sources

- Pensions Act 1995
- Pensions Act 2004
- Finance Act 2004
- Occupational Pension Schemes (Cross-border Activities) Regulations 2005 ("Cross-border regulations")
- Institutions for Occupational Retirement Provision (IORP) Directive
- Directive on the Activities and Supervision of Institutions for Occupational Retirement Provision (IORP II)

Overview

There are no statutory restrictions on membership of a UK pension scheme by persons who do not live or work in the United Kingdom. Indeed, the Pensions Act 1995 disapplies any provision of an occupational pension scheme which has a discriminatory effect against persons who are not wholly or partly employed in the UK.

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Where somebody who does not live in the UK accrues benefits under a UK pension scheme, the following consequences may follow:

- UK tax relief may not be available on the person's contributions;
- the person may be relieved from restrictions on the size of the benefits that he or she may accrue under the scheme (this is known as "international enhancement"); and
- where the scheme is an occupational scheme and the person is employed in another state which is within the European Economic Area, the trustees of the scheme may be obliged to obtain authorisation to operate as a cross-border pension scheme.

Where a person comes to live in the UK from abroad, he or she may continue to contribute to an existing overseas pension arrangement and receive tax relief if certain conditions are met.

Benefits may be transferred into a UK pension scheme from any overseas arrangement; but benefits may only be transferred abroad from a UK scheme if the overseas scheme is a QROPS.

Transfers to a QROPS on and from 9 March 2017 are subject to a new charge to taxation of 25%, the OTC, unless certain exemptions apply (see further below).

An occupational pension scheme is not permitted to accept contributions from an employer in respect of an employee who is permanently employed to work abroad in another EEA state unless it is authorised by the Pensions Regulator to act as a "cross-border" pension scheme. A modified regulatory regime applies to cross-border schemes, which is particularly onerous where defined benefits are provided.

Irrespective of the statutory position, a scheme's own rules may impose restrictions on overseas membership.

Restrictions on tax relief

The Finance Act 2004 allows relief from UK income tax on an individual's contributions to a UK registered pension scheme if he or she is a "relevant UK individual" during a tax year. An individual will be a relevant UK individual for a tax year if he or she:

- has relevant UK earnings chargeable to UK income tax for that year;
- is tax resident in the UK at some time during that year;
- was tax resident in the UK both at some time during the five tax years immediately before that year and when he or she became a member of the pension scheme; or
- has, or his or her spouse or civil partner has, for that year general earnings from overseas Crown employment subject to UK tax.

In any tax year, a relevant UK individual can get tax relief on pension contributions of up to 100% of his UK earnings or a £40,000 annual allowance, whichever is the lower, (although in some circumstances a lower annual allowance is applied).

The employer's contributions enjoy tax relief provided that the "wholly and exclusively" test is met.

Restrictions on benefits and "international enhancement"

The Finance Act 2004 restricts the amount of benefits that may be accrued or provided under a registered pension scheme and the form in which those benefits may be taken. Those restrictions are the "price" that the member pays for the tax relief that he or she has benefited from. For further information see the "Pensions tax allowances for individuals"

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fact card. These restrictions are generally eased or disapplied where the member has not benefited from UK tax relief either because he or she has been a member of the scheme whilst a "relevant overseas individual" or a transfer has been made to the scheme from a "recognised overseas pension scheme". In particular, the member may gain an enhancement to his or her "lifetime allowance".

If a person is not a relevant UK individual (see above), he or she will be a "relevant overseas individual". Where a person is a relevant UK individual, he or she may nonetheless also be a relevant overseas individual but only in limited circumstances and for limited purposes.

Legislation permits a scheme to have separate rules for members who have not benefited from UK tax relief, under which it need not comply with the rules relating to authorised pensions and lump sums. This is seldom encountered in practice.

Transfers

A registered pension scheme may only make an overseas transfer to a scheme approved for the purpose by HMRC (known as a QROPS.A list of recognised overseas pension schemes is published on the HMRC website at https://www.gov.uk/government/publications/list-of-qualifying-recognised-overseas-pension-schemes-qrops and regularly updated.

However, HMRC warns that the list is not exhaustive and that it will not be bound by it if it transpires that a scheme has been wrongly included (say, because of false information provided by the scheme manager). Generally, trustees are wise to exercise caution in making transfers to QROPS – clear communication with the member in particular is important, as is due diligence and especially given the recent introduction of a new tax charge on transfers to QROPS (explained below).

Unless certain exemptions apply, transfers to QROPS on and from 9 March 2017 are subject to a new charge to taxation of 25%, (the OTC), for which the scheme member and the scheme administrator are jointly and severally liable. QROPS cease being so on 14 April 2017 unless a revised undertaking is submitted to HMRC by 13 April 2017.

Transfers other than to QROPS are "unauthorised payments" and therefore subject to significant tax charges and penalties. A transfer into a registered pension scheme may be made from any type of overseas scheme, but it will only lead to an enhancement to the member's lifetime allowance if the scheme is what is called a "recognised overseas pension scheme" ("ROPS") (broadly, an overseas pension scheme that is established in one of a prescribed list of countries and which complies with other prescribed conditions).

Persons migrating to the UK: migrant member relief and relief under double taxation treaties

If a person comes to the UK as an existing member of a qualifying overseas pension scheme, he or she may make contributions to that scheme and receive relief from UK income tax provided that certain conditions are met. This is known as "migrant member relief". The annual allowance and lifetime allowance apply in respect of contributions that have received migrant member relief. Where the relief is available, employer contributions will be tax deductible.

Alternatively, tax relief may be available under a double taxation treaty, depending on the country in which the scheme is established.

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Occupational schemes: overseas employees and cross-border authorisation and approval

The Pensions Act 2004 prohibits trustees from accepting contributions from a "European employer" unless the scheme is authorised to act as a cross-border pension scheme and is also approved. Authorisation is "general" (in that it does not matter how many member states or employers are within the scheme). Approval is "specific" to each cross-border operation, so relates to specific employers in specific member states.

An employer will be a "European employer" if it employs and makes contributions in respect of a "qualifying person" (often termed a cross-border employee), namely:

> "a person who is employed under a contract of service and whose place of work under that contract is sufficiently located in an EEA state other than the United Kingdom so that his relationship with his employer is subject to the social and labour law relevant to the field of occupational pension schemes of that EEA state, but, for the purposes of this definition, a seconded worker is not to be regarded as being so sufficiently located in an EEA state other than the United Kingdom".

The essential question is whether the nature of any member's employment means that the scheme has to comply with any other EU state's social and labour laws in respect of that member.

An employee who is engaged to work permanently abroad will generally be a cross-border employee for this purpose. The place of registration of the employer (if it is a company) is not relevant.

An employee who is seconded to work abroad will not be a cross-border employee. The Pensions Regulator (in its Guidance on Cross-border Schemes) says that the characteristics of a secondment are:

- the employee being sent to work overseas from the UK;
- the employee providing services on behalf of the UK employer;
- the intention that this should be for a limited period; and
- the expectation that the employee will either return to the UK or retire at the end of that period.

It is up to the trustees to determine whether any members of the scheme who work in EU member states other than the UK are seconded employees.

Where an occupational scheme includes an active member who is a cross-border employee, the scheme will either need to be authorised as a cross-border scheme or the member will have to leave pensionable service

Scheme funding requirements

Authorisation as a cross-border scheme is not necessarily attractive, particularly where defined benefits are provided, as an onerous funding regime applies to cross-border defined benefit schemes.

Broadly, a defined benefit scheme applying for the first time to be authorised as a cross-border scheme must be "fully funded" at the date of that application (see regulations 4 and 7 of the Cross-border regulations). Indeed, the IORP stipulates in Article 16 that the scheme must be fully funded at all times.

Being "fully funded" means the scheme must meet statutory funding requirements, which in turn means the scheme has "sufficient and appropriate assets to cover the scheme's technical provisions" (broadly, the scheme has the necessary amount required to meet scheme liabilities, calculated actuarially). This could bring forward the date by which the scheme would otherwise have to be fully funded See the

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comment on IORP II below, as there is a view that the situation could be more nuanced than previously.

The position is slightly different for a newly established scheme, where a two year period to achieve full funding is possible (see regulations 6 and 7 of the Cross-border regulations).

The requirement for the scheme to be fully funded is over-arching. So all members must be considered and the scheme viewed as a whole, rather than just the liabilities for the cross-border employees.

According to the 2017 European Insurance and Occupational Pensions Authority (EIOPA) report on market developments in cross-border Institutions for Occupational Retirement Provision (IORPs), as at 1 March 2017 there were only 26 authorised cross-border schemes in the UK and only 90 in the EEA as a whole. Of the 90 EEA authorised schemes, just 79 were actively operating cross-border. The stringent requirements regarding scheme funding may be a factor in the low numbers. Termination of pensionable service

As mentioned above, if the scheme is not authorised as a cross-border scheme, any cross-border employee must leave pensionable service. It is a vexed question whether it is sufficient to simply terminate pensionable service or whether the member's deferred benefits also need to be transferred away from the scheme. The Regulator's Guidance states (unhelpfully) that:

> "Trustees and employers should be mindful of the position of all members, including deferred members and pensioners, when considering whether their scheme should be seeking authorisation and approval."

(A previous version of the Guidance indicated that benefits could be retained in respect of certain deferred members where pensionable service had ceased before a date in 2006.) The more cautious view is that deferred benefits should transfer away, so obviously contractual terms of employment will need to be considered.

Scheme rules

Subject to limited exceptions, a provision in the rules of an occupational pension scheme which has the effect of discriminating between members by reference to whether or not they are employed wholly or partly in the UK is not effective. This can make it challenging to terminate a cross-border member's pensionable service.

This provision does not apply to personal pension schemes and in fact personal pension scheme providers almost invariably only allow "relevant UK individuals" (see above) to join their arrangements.

IORP II

IORP II has now been finalised and agreed. This is a significant revision of the original IORP Directive. EU member states will have to implement the revised Directive in national legislation by 12 January 2019. IORP II introduces (amongst other things) a number of new requirements relating to scheme governance and member communications. The requirement for cross-border schemes to be fully funded at all times is retained in Article 15, although there is an implicit acknowledgement that cross-border schemes may not be fully funded at all times and in which case appropriate measures must be taken by the competent authority within the member state to ensure that members and beneficiaries are adequately protected.

How will Brexit affect this? The time period allowed for implementing IORP II and the two year period of agreeing withdrawal terms for Brexit will overlap, so the UK may be obliged to adopt the provisions of IORP II into domestic legislation (and indeed, this may be required as part of any agreement reached with the EU in the Brexit negotiations).

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The Pensions Regulator's guidance on cross-border schemes

The Regulator's guidance on cross-border schemes is helpful: http://www.thepensionsregulator.gov.uk/guidance/guidance-cross-border-schemes.aspx

For example, there are standard form letters for UK cross-border schemes to assist with reclaiming tax withheld in other member states. Note that automatic-enrolment may require some "UK" employees to be auto-enrolled into UK workplace pension saving, so thought as to whether the employee in question is truly cross-border or UK based is necessary from this regard too.

Foreign Pensions

The tax treatment of foreign pensions is to be more closely aligned with the UK's domestic tax regime, bringing foreign pensions and lump sums fully into tax for UK residents to the same extent as domestic ones from 6 April 2017. Specialist schemes for those employed abroad (section 615 schemes) are closed to new saving.

There is an extended right to tax recently emigrated non-UK residents' foreign lump sum payments from funds that have had UK tax relief, an alignment of the tax treatment of funds transferred between registered pension schemes and an updating of "eligibility criteria" for foreign schemes seeking to qualify as overseas pension schemes for tax purposes.

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