

Budget 2009 Pension Changes

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International consequences of proposed pension taxation changes

UK Budget 2009

On 22 April 2009, the UK Chancellor announced that those who have taxable income in excess of £150,000 p.a. will:

- be subject to an income tax charge of 50% from April 2010 on earnings and other elements of income above £150,000 p.a.; and
- have tax relief on pension accrual or contributions restricted from April 2009. (Anti-avoidance provisions were also introduced.)

This paper focuses primarily on the consequences of the changes to pensions taxation for internationally-mobile employees, UK-based non-domiciled employees and other employees outside the UK.

Pension tax changes (where known)

From April 2011

The UK Government will consult with interested parties on the taxation of pensions from April 2011. Consequently, few details are known yet. Tax relief on pension contributions/accrual could be limited to the basic rate (currently 20%) for all with taxable incomes exceeding £150,000 p.a.

It may be worth noting that a General Election is expected before April 2011. If the UK Government changes, pensions policy may shift again.

From April 2009 to March 2011

Some details are known for the period prior to April 2011. Special transitional provisions being put in place, for tax years 2009/10 and 2010/11, that will impose additional tax charges on individuals:

- with incomes in excess of £150,000 p.a.; and
- whose pension contributions/benefit accrual exceed £20,000 p.a.

and who, on or after 22 April 2009, change either:

- their normal pattern of regular pension contributions; or
- the normal way in which pension benefits accrue.

What should I do? (Putting it simply)

In the short term, employers with UK tax-relieved pension plans and employees liable to UK income tax should exercise care before varying:

- accrual rates or pension contributions (both regular and one-off);
- the terms of such a pension plan; or
- setting the terms of any change in employment (e.g. promotion, pay increase, end of a secondment outside the UK, etc.).

Some common situations are considered further below.

UK pension plans

UK tax residents

From April 2009 until March 2011, individuals with UK taxable earnings exceeding £150,000 may be subject to additional tax liabilities if they benefit from:

- employee and employer contributions to defined contribution pension plans; and/or
- accrual in defined benefit plans

that both vary from the previous level and exceed £20,000 p.a.

One key consequence is that annual "bonus sacrifice" arrangements, which have become commonplace, will be significantly less tax-effective for high-earners, at least until March 2011 and possibly thereafter.

Comment: Hewitt has produced detailed guidance on this situation. If you would like to receive this material, please contact us (details below).

Non-UK tax residents

Pension contributions to a UK plan with respect to members who are not UK tax resident will typically be subject to the tax charges and pension contribution limits of the country in which they are tax resident.

We would not expect any UK tax charges to be applied to contributions provided they do not exceed the existing annual allowance (currently £245,000) but this remains to be clarified.

If the individual returns in future and becomes resident for tax purposes in the UK, it may also be possible to apply for an enhancement to the member's maximum tax-advantaged pension in view of time spent outside the UK, during which no UK tax relief was received.

Comment: continued benefit accrual in a UK pension plan may remain:

- *an attractive element of the package provided to employees who agree to work outside the UK for a period (and, so, cease to be UK tax resident); and*
- *worthwhile, in some cases, for those who:*
 - *are able to determine the country in which they work; and*
 - *expect to reach the maximum UK tax-favoured pension benefit (currently £1.65m unless a larger amount has been "protected").*

Reinstatement and "making whole" in a UK Pension Plan on return

It has been common practice for some employers to suspend the UK pension scheme benefit accrual/contributions for employees being asked to work outside the UK, in return for a commitment from the employer that the employee would be "made whole" (i.e. put back in the UK pension plan with their service outside the UK reinstated), on return to work for the employer in the UK. Reinstatements would normally be achieved by augmenting pensions.

We would expect any UK plan augmentation after 22 April 2009 to be subject to the proposed UK tax charges. This may lead to a substantial, additional income tax liability for the employee.

Comment: possible alternative approaches include:

- *Even if the period outside the UK is mostly completed, consider (enhanced) membership of a local pension plan, instead of the UK pension plan, to take advantage of local tax rules - it may be possible to transfer this pension into a UK pension arrangement later with no tax penalty and, also, apply for an enhancement to the member's maximum tax-favoured UK pension benefit.*
- *Pay a cash lump sum in lieu of the pension benefits (before the employee returns to the UK, if local tax rates are favourable).*

An employer may wish to consider whether the terms of the employee's non-UK service will require reimbursement of any additional tax liability in consequence of the "making whole" augmentation.

Tax liabilities are expected to be higher for UK pension augmentations between April 2010 and March 2011 than before April 2010. Therefore, it may be worth considering changing the date on which service outside the UK ends and/or the date on which any augmentation is provided.

Non-UK pension plans

UK tax residents

According to the UK Revenue's summary, the Budget legislation permits the extension of the new pension taxation rules to members of "currently-relieved non-UK schemes". These are pension schemes that are not UK-registered and where:

- relief from UK tax is given in respect of individual or employer contributions paid, including relief due to double tax arrangements and migrant member relief; or
- contributions after 5 April 2006 have received transitional corresponding relief.

Comment: While the details are unavailable, as yet, it appears likely that that the Government will seek to apply the new revenue-raising rules as widely as possible. Hewitt will monitor the situation under this heading

Two cases are considered in a little more detail below.

1. IORPs Many funded pension arrangements established in the European Economic Area (EEA), including the UK, are IORPs (as defined by the relevant EU directive). The UK taxation position of members of a non-UK IORP (including any "International Pension Plan" established within the EEA) is expected to be the same as the position of members of UK pension plans (as outlined above).

As we expect the tax charge applied to pension contributions to increase in stages, it is likely that pension contributions will remain a more tax-efficient option than cash – at least initially.

Comment: employers may wish to consider suspending membership of the plan outside the UK, whilst a high-earning member is UK tax resident, with a view to reinstating the individual with backdated service or contributions on return to their home country.

Note that:

- *reinstatement may not be possible in all countries and all plans (and where it is currently possible there is no guarantee that local legislation will not change before the member returns to their home country);*
- *in the current financial situation, employees may be uncomfortable with this unfunded approach; and*
- *there may be other, unexpected consequences of such a suspension (e.g. the need to provide replacement life cover) and it may be worth reiterating here that the 2009 UK Budget contains new anti-tax-avoidance powers.*

2. Non-IORPs There are some EEA pension arrangements that are not IORPs. Examples include:

- many insured pension schemes; and
- direct pension promises in Germany.

Comment: As each case will differ, please contact us (details below) to discuss your situation. In addition, it may be appropriate to obtain tax advice (e.g. on the completion of annual tax returns in these cases).

Non-UK residents

Pension contributions to a non-UK plan, including an International Pension Plan (IPP), with respect to members who are not UK tax resident will typically be subject only to the tax charges and pension contribution limits of the country in which they are tax resident.

If the individual becomes resident in the UK subsequently, it may be possible for the member to transfer their non-UK pension benefit into a UK plan on a tax free basis (depending on transferring country and pension arrangement), as well as applying for an enhancement to the member's Lifetime Allowance with respect to service abroad, during which no UK tax relief was received. However, it is unlikely to be possible for the member to transfer IPP benefits into a UK plan, due to a clause within the UK's transfer guidelines.

Comment: the Budget appears likely to have little impact on non-UK resident members of most pension plans outside the UK.

Tax and legal advice

This paper summarises Hewitt's understanding. However, it is important to note that Hewitt does not provide formal tax or legal advice. We recommend that you confirm any planned actions with your tax advisers, before taking the actions.

Contact details

To discuss any aspect of this paper, please contact a member of Hewitt's International team. The following team members are familiar particularly with the issues raised above:

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