Stakeholder pensions and residency

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Abstract This paper covers the residency requirements for personal pensions and stakeholders and considers whether eligibility continues once an individual moves abroad. By way of comparison, the paper also covers the position of members of occupational pension schemes who are seconded abroad.

Keywords: *stakeholder pensions; earnings threshold; residence and ordinary residence; Crown servants; secondment abroad*

Eligibility for a personal pension (or stakeholder)

Prior to 6th April, 2001, any individual under 75 who was in receipt of net relevant earnings (ie, earned income assessable to UK tax) in the current tax year could become a member of and contribute to a personal pension scheme. It should be noted that it is possible to be assessable to UK income tax even though no tax is actually payable.

From 5th April, 2001, an individual may still contribute to a personal pension (or stakeholder) scheme based on their net relevant earnings, whether they are resident in the UK or not. However, it is now possible, in certain circumstances,¹ for contributions to be made to a personal pension (or stakeholder) even if the individual does not have net relevant earnings.

Contributions may be paid up to the 'earnings threshold' into a personal pension (or stakeholder) scheme, without evidence of net relevant earnings, if the

individual is under age 75 and they are or have been any of the following:²

- Resident and ordinarily resident in the UK in that tax year (the individual's domicile is not relevant)
- Resident and ordinarily resident in the UK at some time in the previous five tax years and was resident and ordinarily resident in the UK when the personal pension was started³
- A Crown Servant at some time in that tax year
- The spouse of someone who was a Crown Servant at some time in that tax year.

For the tax year 2001/2002, the 'earnings threshold' is £3,600 a year gross,⁴ or £2,808 a year net of 22 per cent basic rate income tax. While it is called an 'earnings threshold', it is more accurately a 'contribution threshold'. The earnings threshold may be amended (note that the legislation

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does not say increased) by Treasury order.

Individuals moving abroad

Individuals becoming non-resident but continuing to have net relevant earnings

Where a member with a personal pension moves abroad, but continues to have net relevant earnings and pay UK income tax, contributions can continue up to the earnings threshold or, if the member has declared a basis year, up to the maximum permitted.⁵ These contributions may continue as long as net relevant earnings continue and, for higher level contributions, there is a basis year set within the last five years.

Once the member has stopped being resident and ordinarily resident in the UK for more than five tax years, contributions must stop once they cease to have net relevant earnings.

Individuals becoming non-resident and ceasing to have net relevant earnings

Where a member with a personal pension moves abroad, and ceases to have net relevant earnings, contributions can continue as follows:

- If a basis year has been declared, contributions can continue at the higher level until the basis year expires (as for all other members).
- If no basis year has been declared, contributions can continue up to the earnings threshold for up to five years.

If the individual has had no net relevant earnings for a full tax year (known as a 'break year') they can continue to pay higher level contributions based on the net relevant earnings for any basis year in the six tax years prior to the break year.

Higher level contributions may continue during the break year and the following four tax years. If the individual starts to have net relevant earnings again (for example, on returning to the UK and becoming subject to UK income tax) they will need to provide evidence of earnings if their basis year was more than five tax years ago. If the basis year is still within the last five tax years, that year can continue to be used as a basis year and no new evidence of earnings needs to be supplied.

Higher level contributions can be based on any basis year in the six tax years before the break year, and can continue during the break year and for up to a further four tax years. This means that they could conceivably continue at the higher level for up to 11 years without new evidence of earnings. But of course the basis year could be as close as the tax year prior to the break year.

Where an employer with overseas subsidiaries runs a group personal pension plan (or stakeholder), and employees are seconded to the overseas subsidiary for a period, they will normally cease to have net relevant earnings. Contributions for the employee can be paid at the higher rate for up to five years (as long as a basis year has been declared). It should be possible for contributions to continue to be remitted via the UK employer's payroll, with the cost being reimbursed by the overseas employer (note that, if the overseas employer contributes direct, it will not receive tax relief).

Individuals ceasing contributions and then becoming non-resident

Members who have ceased to contribute to their personal pension, and have since moved abroad, may recommence contributions up to the earnings threshold as long as they ceased to be

UK resident within the last five years. If they have provided evidence of earnings within the last five years (and therefore have a basis year), contributions can be paid at the higher rate until the basis year expires.

In all cases, the Inland Revenue requires members to tell the scheme administrator as soon as they cease to be UK resident,⁶ and if they become UK resident again.

Residence and ordinary residence

The rules regarding residence and ordinary residence are complex and are not defined in the legislation. To determine an individual's exact status it may be necessary to seek clarification from their local Inspector of Taxes or from a tax practitioner. The following is a summary of guidance issued by the Inland Revenue⁷ which in turn is largely based on rulings of the Courts.

Residence

In general terms, an individual is resident in the UK for the whole tax year (6th April–5th April) if they spend 183 or more days of that year in this country. They are non-resident for the whole tax year if they spend less than 183 days of that tax year here. However, where an individual leaves the UK during a tax year to take up full-time employment abroad, or returns after such employment, the tax year may, with the agreement of their Inspector of Taxes, be split into resident and non-resident portions.

Individuals can also be treated as resident if they make 'habitual and substantial' visits to the UK. The Inland Revenue define this term as follows:

— *Habitual*: if the visits continue for four consecutive years; and

— *Substantial*: if the duration of the visits average three months (91 days) a year or more, the average being taken over a maximum of four years.

Visitors to the UK are normally only regarded as becoming resident in the fifth year, unless it is clear from the outset that they intend to make habitual and substantial visits. If the latter applies, they are treated as resident from the date of arrival.

Individuals who have been granted residence and ordinary residence (see later) status, retain such status if they go abroad with the intention of returning to the UK for substantial visits.

Ordinary residence

Ordinary residence in the UK is defined as being resident here on a regular year-by-year basis. The Inland Revenue's view on the date ordinary residence is to start (or end) varies with the length and purpose of the visit.

As mentioned earlier, under the habitual and substantial test, visitors to the UK will normally only be regarded as becoming ordinarily resident in the fifth year. However, if it is clear from the outset that they intend to make habitual and substantial visits, they can be treated as ordinarily resident from the date of arrival.

Individuals making an extended visit to the UK are regarded as ordinarily resident from the outset provided they intend to remain in the UK for three years or more. Individuals going abroad for full-time occupation for at least a complete tax year are regarded as not ordinarily resident from the day following the date of departure. Individuals going abroad for any other purpose are provisionally regarded as not ordinarily resident from the date of departure, if it is clear that they have left the UK permanently.

The dual requirement that individuals must be both resident and ordinarily resident to remain eligible should mean that borderline cases are minimal.

Crown servants

Crown servants (eg, diplomats and members of the Armed Forces) are regarded as performing the duties of their occupation in the UK, irrespective of where they are actually residing at the time. As their occupation is subject to UK income tax, Crown servants have always been eligible to contribute to a personal pension (unless in an occupational pension scheme and earning more than £30,000). What has changed since 6th April, 2001 is that spouses of Crown servants with no net relevant earnings are also now eligible for a personal pension (or stakeholder) for contributions up to the earnings threshold. Since 6th April, 2001, spouses of Crown servants have also been eligible for Individual Savings Accounts (ISAs).

Occupational pension schemes and secondments abroad

Individuals working abroad for an overseas employer

Members of occupational pension schemes may join or continue to accrue benefits under the scheme, even while working abroad, as long as all the following requirements⁸ are satisfied:

- The period of service abroad does not exceed ten years. Where there are previous periods of service abroad, scheme membership may only continue for ten years in total (although periods separated by at least one year's employment in the UK may be ignored). The Inland Revenue will only agree to an

extension beyond ten years in exceptional circumstances.

- Either there is a definite expectation (evidenced in writing) that the employee will return to the UK to retire (or to work for an employer participating in the scheme), or the employee's earnings remain chargeable to UK tax because the period overseas totals less than 365 days in any year.
- The UK employer continues to pay to the UK scheme any employer contributions due, and the overseas employer reimburses the UK employer for the costs. The Inland Revenue is only prepared to dispense with this requirement if reimbursement is not possible because of exchange control difficulties or because the law of the overseas country does not allow transfers of assets to the UK. Reimbursements must be made annually or more frequently, but no payments are required while the scheme is on a contribution holiday.
- The prospective pension in respect of the overseas service is calculated and funded by reference to the equivalent UK rate of remuneration for the job.

As long as the above are satisfied, the member may remain in the UK scheme even if they join an overseas scheme while abroad. However, it will not be possible to transfer the benefits of that other scheme into the UK scheme (or any other UK-approved scheme).

Also, as long as the above requirements are satisfied, an individual overseas can join a UK occupational pension scheme (ie, they do not have to be a member or an employee of the UK employer when they leave the UK).

The employee may contribute to the UK scheme during the absence overseas, but this will have tax implications

especially if the UK scheme is not approved in the overseas country. Some countries even tax employees on contributions paid to a UK scheme.

Unpaid absence overseas

An employee who is temporarily absent abroad, and who is not in paid employment (or self-employment) while abroad, may remain in full membership of the UK scheme if:

- The period of absence does not exceed ten years
- There is a definite expectation (evidenced in writing) of return to service with the UK employer
- The employee has provided the employer with a written undertaking not to do paid work while abroad.

If the employee starts paid work abroad full membership must stop immediately, unless the work is with the employer, another employer participating in the scheme or with an overseas employer on secondment. If the latter, the same conditions apply as for normal secondments except that the maximum period of absence abroad of ten years must include the unpaid absence abroad as well as the period of secondment abroad.

Summary

The new rules since 6th April, 2001 provide more scope for individuals to continue contributions to a personal pension (or stakeholder) while abroad. In brief, if they no longer have net relevant earnings, they may continue paying for up to five years after leaving the UK.

This will be up to the earnings threshold where no basis year has been declared and up to the higher rate where a basis year has been declared. This does not help those who are already abroad when a personal pension scheme is started, or⁹ those who are abroad for more than five years. Regardless of residency, contributions may always be paid where an individual has net relevant earnings.

Despite this increased flexibility, members of occupational pension schemes are in a better position if ceasing to be UK resident, as they may continue to accrue benefits in the UK scheme for up to ten years while abroad. In addition, if they qualify under the concurrency rules they can also pay up to the earnings threshold into a personal pension (or stakeholder) for up to five years. It should also be noted that an individual may continue paying into a free standing AVC while seconded abroad, but only if they remain a full member of the UK occupational pension scheme and there is actual taxable remuneration to which the 15 per cent limit can be applied.

References

- 1 Section 632A Income and Corporation Taxes Act 1988, as inserted by paragraph 8 Schedule 13 Finance Act 2000.
- 2 3.7 of the Inland Revenue Personal Pension Schemes Guidance Notes IR76 (2000).
- 3 3.27 of the Inland Revenue Personal Pension Schemes Guidance Notes IR76 (2000).
- 4 Section 603 (1) Income and Corporation Taxes Act 1988, as amended by paragraph 5 Schedule 13 Finance Act 2000.
- 5 3.28 of the Inland Revenue Personal Pension Schemes Guidance Notes IR76 (2000).
- 6 3.29 of the Inland Revenue Personal Pension Schemes Guidance Notes IR76 (2000).
- 7 IR20 residents and non-residents.
- 8 Part 15 of the Inland Revenue Occupational Pension Schemes Practice Notes IR 12 (1997).