Charlton House
WEALTH MANAGEMENT

A guide to UK pensions for UK resident international citizens

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In the UK, there are four distinct types of pension scheme. These schemes might be set up by yourself, be offered by your employer, or automatically build up benefit through your National Insurance contributions.

Here's your complete guide to the various types of scheme that are available, and what joining them means for you.

1. Defined Contribution scheme

A Defined Contribution (DC) scheme is also known as a 'money purchase' scheme. There are various specific DC schemes available and some of the more common products are:

- Personal Pension
- Group Personal Pension
- Self-Invested Personal Pension (SIPP)
- Occupational Money Purchase Pension
- Stakeholder Pension
- Small Self-Administered Scheme (SSAS)
- Section 32 Pension
- Retirement Annuity Contract
- Free-standing Additional Voluntary Contributions (FSAVC)

OR

Types of Defined Contribution pension schemes

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What is it?

This is by far the most common type of pension scheme. It is effectively a product in which you, or a third party such as your employer, can contribute to. The money in the 'pot' can then be invested and the value will go up or down according to the underlying investments. You do not need to be employed to open a Defined Contribution scheme, unlike a Defined Benefit scheme which are also employer pension schemes.

What can I invest in?

This will depend on the type of scheme you have. Stakeholder pensions only have a very limited range of collective funds available which will typically allow you to invest in collective funds holding shares, bonds, cash and, sometimes, UK commercial property.

At the other end of the spectrum, a SIPP or a SSAS will typically allow you to invest in a much wider range of assets including, but not limited to:

- Collective Funds (often referred to as OEICs and Unit Trusts)
- UK and overseas shares
- Corporate Bonds
- Gilts/government bonds
- Commercial property, including the trading premises of a company you own i.e. your company pays rent to your own pension instead of a landlord
- Exchange-Traded Funds (ETFs)
- Land such as agricultural land and land plots, e.g. car parks
- Cash and deposit accounts, including foreign currency
- National Savings and Investments products

OR

What can I invest in within a Defined Contribution pension scheme?

- Collective Funds (often referred to as OEICs and Unit Trusts etc)
- Shares (UK and overseas)
- Corporate Bonds
- Gilts / Government Bonds
- Commercial property (including the trading premises of a company you own i.e. your company pays rent into your own pension instead of a landlord)
- Exchange-Traded Funds (ETFs)
- Land (such as agricultural land and land plots e.g. car parks)
- Cash and deposit accounts (including foreign currency)
- National Savings and Investments products

However, it should be noted that not all SIPP and SSAS providers will grant access to all the above investments. So, it is important you ensure the specific plan you wish to set up and contribute to,, or transfer your other pensions to, has the ability to hold the assets you wish to invest in.

What are the benefits of investing my money in a Defined Contribution pension?

The main benefits are as follows:

- Generous tax relief is given to pension contributions
- Investments held, and any returns generated within your Defined Contribution pension, will not be subject to Income Tax, Dividend Tax, or Capital Gains Tax and, in most cases, Inheritance Tax (IHT). This makes a pension a very IHT efficient saving structure
- It is a very good long-term investment plan as you cannot access the money until the minimum pension age which is currently 55. This helps to ensure that funds that are intended for retirement are not allocated towards shorter-term expenditure. An exception to this is if you are terminally ill, in which case you are allowed to access the money if medical opinion states that you have less than 12 months left to live. For some, this is also the main downside of investing in a pension as you cannot access the money in an emergency prior to age 55
- You will have access to broadly the same types of investments as investing outside of a pension.

How can I access my pension money?

You cannot access this money until you reach a minimum age which is currently age 55. However, this is due to rise to age 57 in 2028. There is no maximum age you must access the pension by, although you cease being able to receive Income Tax relief on contributions from age 75.

When you access the money, you will usually be able to take up to 25% tax-free (although this can vary in specific circumstances) with the remaining 75% being liable to Income Tax.

You do not need to take the tax-free element of the pension all in one lump sum and this can be taken in smaller lump sums over time.

You can take your pension in a variety of ways with the following options available to you:

- **Flexi-Access Drawdown (FAD)**

This is the most 'flexible' way to access your Defined Contribution pension scheme. FAD allows you to take some or all of your tax-free cash to commence accessing your pension – you can then take the remaining 75% taxable monies however you wish e.g. as regular (i.e. monthly, quarterly, annual) income or in one-off lump sums.

Once you have accessed the taxable element of your pension via FAD you will be limited to making or receiving tax relievable pension contributions of up to £4,000 per tax year. This is called the Money Purchase Annual Allowance (MPAA).

The money can be held in drawdown for as long as you wish and can be withdrawn whenever you wish after reaching the minimum pension age. You can use the money held in drawdown to purchase an annuity (see below) at any point in the future.

Drawdown may or may not be available depending on your specific pension plan and provider, although you will be allowed to transfer your pension to a new pension which offers drawdown. Before doing so you should always seek financial advice.

Note – an option called Capped Drawdown was available before 6th April 2015 and is only still applicable to pensions which were already in capped drawdown before 6th April 2015.

- **Uncrystallised Funds Pension Lump Sum (UFPLS)**

UFPLS is a simple way to take your pension money and most schemes now allow this. You effectively take a one-off lump sum of anywhere between £1 and 100% of your pension value. This is made up of 75% taxable cash and 25% tax-free cash. For example, a £20,000 UFPLS withdrawal will give you £15,000 of taxable income as a lump sum and £5,000 of tax-free income.

Again, by taking an UFPLS you will trigger the MPAA (see above).

- **One-off full withdrawal**

Usually done as a one-off UFPLS, but if it's worth less than £10,000 it may be done using the 'small pots' rules which wouldn't trigger the MPAA.

- **Purchase an annuity, with various annuity types and options available**

The traditional way to access your pension, although now far less common. After taking your available tax-free cash, you use the remaining 'taxable' element of your pension to purchase an annuity which is effectively a guaranteed income, usually for life.

- **Taking a 'guarantee'**

Although the above are the main options available, in some circumstances you may have preferential terms which allow you to receive a higher income from the pension scheme. These are typically from guaranteed annuity rates, guaranteed minimum pension and/or protected tax-free cash. You should speak to a financial adviser to check whether any of these typically valuable guarantees apply to your plan.

2. Defined Benefit schemes

In the UK, a Defined Benefit (DB) scheme is usually referred to as a Final Salary scheme.

However, there are two main types of DB schemes: Final Salary schemes and a Career Average Revalued Earnings (CARE) scheme.

All Defined Benefit schemes are employer-based pension schemes. Unlike a Defined Contribution scheme, you cannot open one up yourself. Simply put, a Defined Benefit scheme allows you to build up a defined benefit which usually consists of the following:

- A guaranteed[1] income for life, which will usually increase with inflation, starting from your predefined 'normal retirement date'. You can bring your retirement date forward or move it back, however, this will change the amount of income you will receive from the commencement date.
- A spouse's/dependant's pension if the member predeceases their spouse/dependant.
- A tax-free lump sum will also be built up annually in some schemes (mainly in public sector schemes). Irrespective of the type of scheme i.e. public or private - you will also be allowed to partially reduce your annual income benefit in order to take a tax-free lump sum upon commencement of the benefits.

Open to new member' Defined Benefit schemes are now very rare in the private sector. It is far more likely you will be put into a Defined Contribution scheme if you enter a new employer pension scheme with a private sector company.

However, these types of schemes are still the most common type of pension scheme provided to employees working in the public sector, such as doctors, nurses, and teachers.

You will pay pension contributions from your salary to build up benefits in the Defined Benefit scheme. Your employer will also contribute.

It should be understood that whereas with a Defined Contribution scheme the individual takes the risk as to what they get in retirement via investment performance/risk, the risk of meeting the defined liabilities in a Defined Benefit scheme falls on the employer and the trustees of the scheme.

1Unless the pension scheme can no longer meet its liabilities, at which point the benefits will be provided by the Pension Protection Fund (PPF) in which case you will receive lower benefits than would have been provided by the original scheme.

How does a Final Salary pension scheme work?

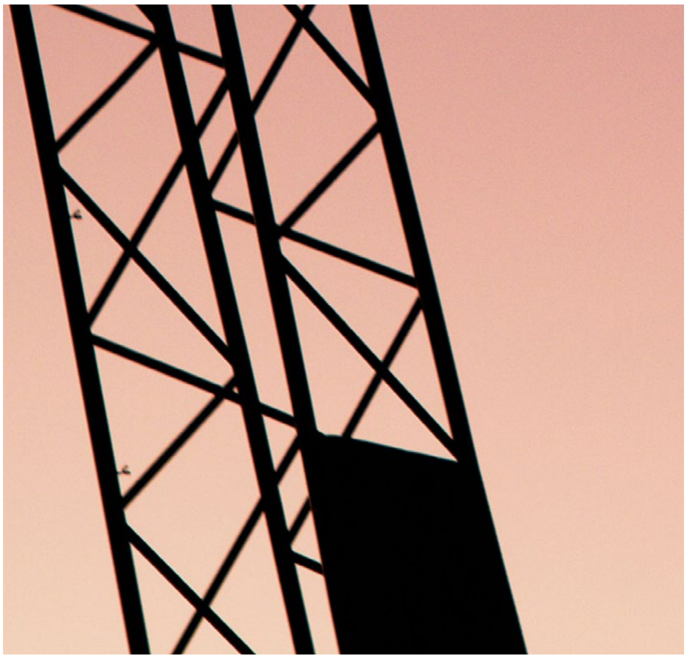
For every year in which you are a member of the scheme, you will be given a predefined fraction/percentage of your final pensionable salary. This is determined at the point you leave the scheme either because the scheme closes, you leave the company, you retire or you decide to leave the scheme of your own accord. This fraction is typically 1/80th or 1/60th.

For example, in a 1/60th scheme, if you are a member of the scheme for 20 years before you leave the scheme, you will have built up a benefit of 20/60ths (or 33%) of your pensionable salary when you leave the scheme.

If your pensionable salary was £100,000, you would therefore be entitled to a pension worth 20/60ths (or 33%) of £100,000 - £33,333 per annum - payable from your normal retirement date.

If you leave the scheme before the normal retirement date, then usually the pension amount will increase in line with inflation until your normal retirement date (typically age 60 or 65).

Depending on the scheme, you may also annually build up a tax-free lump sum entitlement, typically at a rate of 3/80ths of your final pensionable salary each year. At the point you wish to take the benefits, the scheme will also allow you to reduce some of your annual pension income in order to be provided with a tax-free lump sum.



How does a 'Career Average Revalued Earnings' (CARE) scheme work?

A CARE scheme works in a similar way to the Final Salary scheme example above. However, there is one key difference.

Instead of building up, for example, 1/60th / 1/80th of your final pensionable salary, you will build up an entitlement to an annual pension (and in some instances, also a tax-free lump sum) each year based on your pensionable salary in the year you build up the benefit.

For example, if your pensionable salary is £100,000 this year (and the scheme is a 1/60th CARE scheme), you will add to your overall annual pension entitlement - 1/60th of £100,000 i.e. £1,666.66 per annum.

If next year, your pensionable salary is £120,000, you would add £1,999.92 per annum (1/60th of £120,000) to your overall annual pension entitlement.

Once you leave the scheme your annual pension at the normal retirement date will be the accumulation of all the annual pension entitlements you have built up. This is usually revalued to the normal retirement date to take account of inflation.

Again, at the point you wish to take the benefits, the scheme will allow you to reduce some of your annual pension income in order to be provided with a tax-free lump sum.

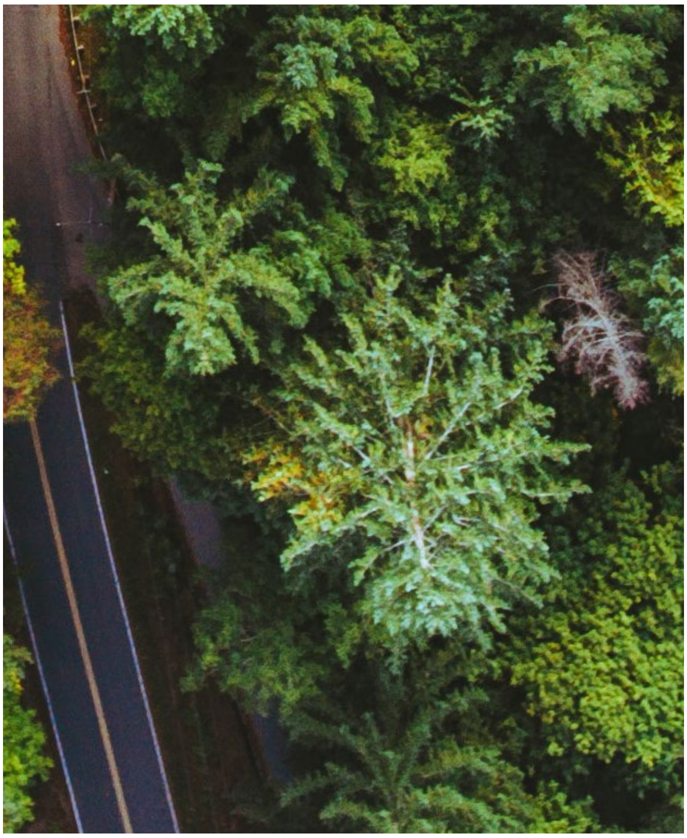
Do I build up a pot of money with my Defined Benefit scheme?

Typically, no, but possibly yes! Some schemes (mostly private sector schemes) will provide you with a Cash Equivalent Transfer Value (CETV) once you are no longer an active member building up new benefits and before you take the retirement benefits. This means you typically need to be a deferred member of the scheme to be offered a transfer value.

It is compulsory that you seek financial advice on the suitability of accepting a CETV. However, once advice is received, you may transfer your Defined Benefit pension to a pot of money held in a Defined Contribution plan.

This is a complex area, as the suitability for transferring depends on several variables. It is important to note that a transfer is irrevocable and you will lose all the benefits you previously held in the Defined Benefit pension, for example, a guaranteed income for life.

Note that some Defined Benefit schemes also allow the member to set up an Additional Voluntary Contribution (AVC) pension scheme. This is a type of Defined Contribution pension which is linked to a Defined Benefit scheme and usually builds up a tax-free pot of cash to take alongside the Defined Benefit pension.



3. Hybrid scheme

The third type of UK pension scheme is a hybrid scheme. This is effectively a mix between the other two pension types. It is typically a Defined Contribution scheme with a Defined Benefit underpin or, less commonly, a Defined Benefit scheme with a cash balance underpin.

We will not go into detail regarding these schemes in this guide, as these types of pension schemes are very rare and it is unlikely you will come across a hybrid scheme during your stay in the UK.

However, if you do, you should contact a UK-based financial adviser to help you understand how the scheme works and what your options are regarding these types of scheme.

4. State Pension

Most UK based workers build up an entitlement to the UK's State Pension throughout their working lives. The State Pension is similar to a Defined Benefit pension, but the state is the organisation responsible for the pension.

It provides individuals with a guaranteed inflation linked income for life from their State Pension age (SPA). SPA varies depending on your date of birth; however anyone born on or after 6th April 1978 will have a State Pension age of 68.

To build up an entitlement to the UK State Pension, you typically have to make a certain amount of National Insurance contributions (NICs). These are automatically taken from an employee's pay, although anyone not paying employee NICs in a tax year can make voluntary NICs to build up their entitlement to the State Pension.

Once the contribution threshold for the tax year has been met, you complete a qualifying year. You then receive one years' worth of State Pension entitlement. You require 35 qualifying years of NICs to be entitled to the full State Pension.

If you do not build up the full 35 qualifying years, you will receive a partial State Pension based on the number of qualifying years you built up. For example, if you have 14 qualifying years you will receive 14/35 (40%) of the full State Pension.

However, something very important to note for international individuals who work or who have previously worked in the UK is that you normally have to have paid at least ten years' worth of full NICs to be able to receive any State Pension at your SPA.

Therefore, if you have worked in the UK for eight years and only have eight years' worth of qualifying years, you will not be entitled to any State Pension.

The State Pension is quite complex. Whatever your individual circumstances, you should always speak to the UK's Department for Work & Pensions (DWP) about your individual entitlement to a UK State Pension.

Can I transfer my pension overseas?

You can transfer your Defined Contribution pension to an overseas pension. However, you must ensure that the overseas pension is a Qualifying Recognised Overseas Pension Scheme (QROPS) and the transfer is a recognised transfer to avoid any excessive tax charges.

However, even if the transfer is a recognised transfer a 25% tax charge may be levied on the transfer if none of the following conditions are met:

- The member is resident in the same country in which the QROPS is established
- The member is resident in a country within the European Economic Area (EEA) and the QROPS is established in a country within the EEA
- The QROPS is set up by an international organisation for the purpose of providing benefits for or in respect of past service as an employee of the organisation and the member is an employee of that international organisation
- The QROPS is an overseas public service pension scheme and the member is an employee of an employer that participates in the scheme
- The QROPS is an occupational pension scheme and the member is an employee of a sponsoring employee under the scheme
- The transfer charge can only apply to transfers where the transfer request was made on or after 9th March 2017.

You may also pay tax on any of the transfer above your individual Lifetime Allowance (see Lifetime Allowance below).

Can I transfer my Defined Benefit pension overseas?

Maybe. This depends on whether your scheme is a funded scheme - typically private sector schemes - or an unfunded scheme - typically public sector schemes.

If the scheme is a funded scheme and the scheme trustees allows you to transfer than it would be possible to transfer this pension to a Qualifying Recognised Overseas Pension Scheme (QROPS), as discussed above.

You will not be allowed to transfer an unfunded scheme, whether within the UK or overseas.

What is the Lifetime Allowance?

The Lifetime Allowance is the amount of pension savings, including a deemed value for Defined Benefit schemes, you are allowed to build up before you have to pay an additional Lifetime Allowance tax charge. This charge is either 25% on income or 55% on lump sums.

The standard Lifetime Allowance is £1,073,100 in the 2020/21 tax year. It is possible to have a higher protected Lifetime Allowance and, for more information on this, please contact a financial adviser.

Do I receive tax relief on my contributions to my pension scheme?

Yes – usually. You will typically receive Income Tax relief, at your marginal tax rate, on your pension contributions. You may even receive National Insurance contribution relief if your pension contributions are made via salary sacrifice.

However, you may not always get full tax relief on your pension contributions. This could be because your total pension contributions in any tax year – including those made by yourself or on your behalf from a third party, such as your employer - are above your available tax relievable Annual Allowance (see below).

This could also be because you earn below the tax-free Personal Allowance and the pension contribution is taken via the net pay arrangement.

UK pension contributions are complex and therefore we advise that you contact a financial adviser if you wish to make pension contributions or would like further information regarding pension contributions.

What is the Annual Allowance for pension contributions?

Typically, you will have an Annual Allowance for tax-relievable pension contributions of £40,000 per tax year. In addition, you can potentially carry forward any of your unused allowances from the previous three tax years.

However, this allowance could be reduced to just £4,000 based on numerous triggers such as:

- Earning a large salary as a consequence of the Tapered Annual Allowance
- Having previously accessed a Defined Contribution pension via Flexi-Access Drawdown or UFPLS in which case the 'Money Purchase Annual Allowance') may apply.

Therefore, you should always consult with a financial adviser before making pension contributions. An adviser can confirm how much tax relievable pension contribution you can make in any tax year.

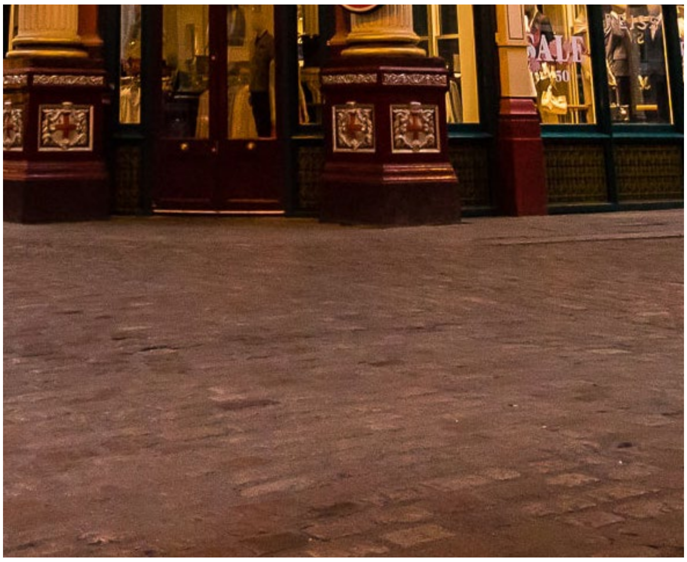
If you exceed your Annual Allowance, you will suffer a tax charge to ensure you receive no tax relief on the excess contributions.

Is my annual pension income taxed?

If you are resident in the UK, then your UK pension income will likely be taxed.

Your annual pension income (whether received as part of a Defined Benefit scheme or Defined Contribution scheme) will be added to your other income in the tax year you receive it and therefore it will be liable to Income Tax if this is due.

Remember that, as a UK tax resident, you may have a tax-free Personal Allowance which can be used to offset any tax due on the pension income.



Is my UK pension income taxed if I live overseas (i.e. I'm a non-UK tax resident)?

This is complicated and will usually depend on the double taxation agreement (DTA) signed between the UK and the country in which you are resident.

Based on the majority of DTAs, most UK pension income will not be liable to UK Income Tax if you are a non-UK tax resident. However, in these circumstances tax may still be deducted at source (i.e. by the pension provider) before it is paid to you. In this instance, you would need to claim back the tax paid.

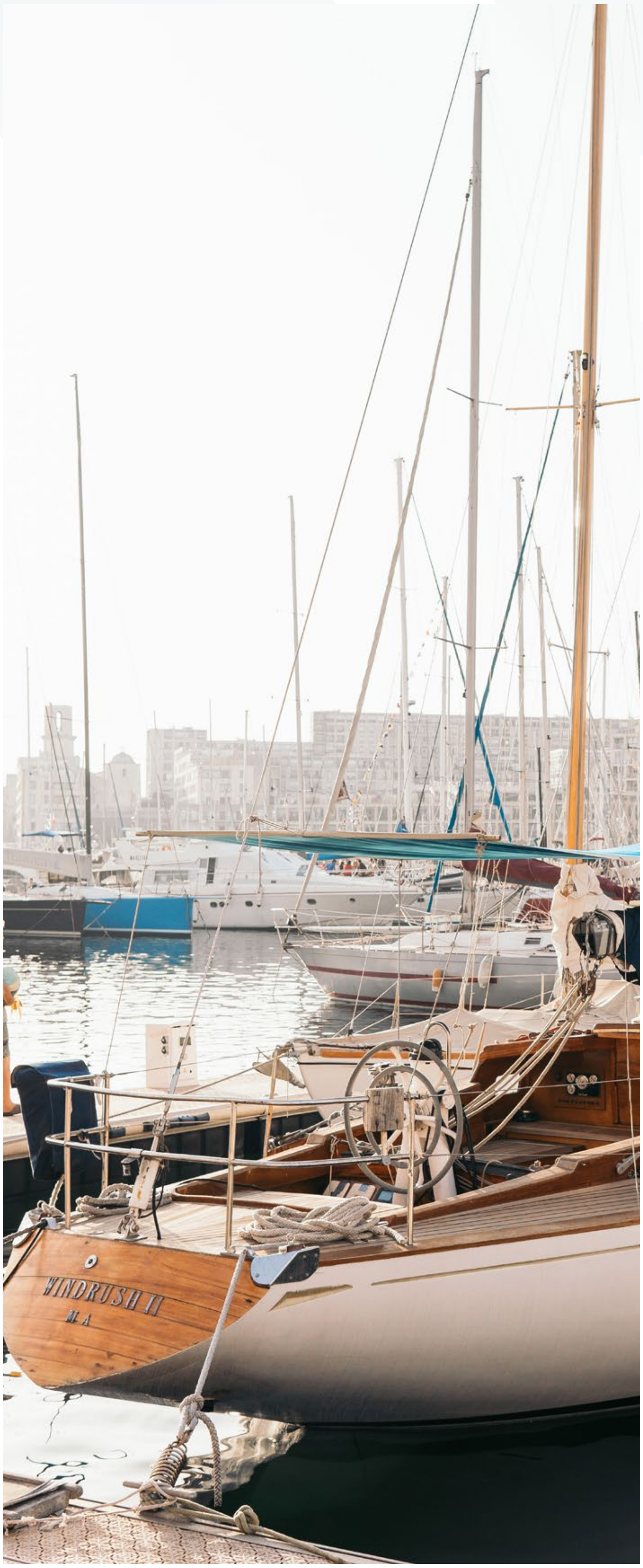
If the relevant DTA states that the jurisdiction of residence has taxing rights, you should try to ensure your UK pension income is paid to you before being taxed at source; i.e. paid to you gross.

In the circumstance that you do not have to pay UK tax, you may have to pay tax on your UK pension income in the country in which you are resident.

However, some DTAs (such as the most current 2010 UK-Hong Kong DTA) state that pension income is taxable in the country in which the pension benefits arise (so the UK for UK pension income) and not the country of residence. Therefore, you should always seek advice and check the relevant DTA to understand your individual taxation position.

It should be noted that certain types of UK pension, such as Civil Service pensions, will always be taxed by the UK. The DTA between the UK and your country of residence (if one exists) will usually ensure that these types of pensions are only taxed once.

If no DTA exists, then you may be taxed both in the UK and in your country of residence on your UK pension income. You should speak to a qualified tax adviser to determine your exact taxation position to ensure you do not pay more tax than you need to.



If I am working in the UK, but for a non-UK based company or have been seconded to work in the UK but your contract is with a non-UK based company – will I be automatically enrolled into a UK pension scheme?

This is a very complex question to answer and the answer depends on your exact circumstances.

However, if you are deemed to be ordinarily working in the UK and are not a member of your employer's pension scheme in your home country (the scheme would need to be a qualifying overseas pension scheme) then it is likely that you will have to be automatically enrolled in a UK pension scheme, although you can opt out of this.

A few examples of things to look out for to help ascertain whether you are deemed as ordinarily working in the UK would be:

- Are you paid in GBP?
- Do you start and end your working day in the UK?
- Where are your employer's headquarters?
- Is your private residence in the UK?
- Do you pay UK National Insurance contributions?

Will I be automatically entered into a pension scheme by my UK employer?

Yes, this is very likely. Most employees of UK based companies are automatically enrolled into a UK pension scheme. You can opt out if you wish.

However, this is not usually a bad thing as you will be entitled to receive free pension contributions from your employer as part of this auto-enrolment scheme.

If you have total worldwide income from all sources above £200,000 per tax year, it is advisable that you speak with a financial adviser about any potentially negative tax consequences of being automatically enrolled into a UK pension scheme.

Disclaimer

The information provided in this guide is for information purposes only and to understand your individual situation and the implications of this you should always speak to a professional financial adviser.

For more information regarding UK Inheritance Tax and any related matters, please contact us by **email** or, if you would prefer to speak to us, you can reach us

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