STEPHENSON HARWOOD

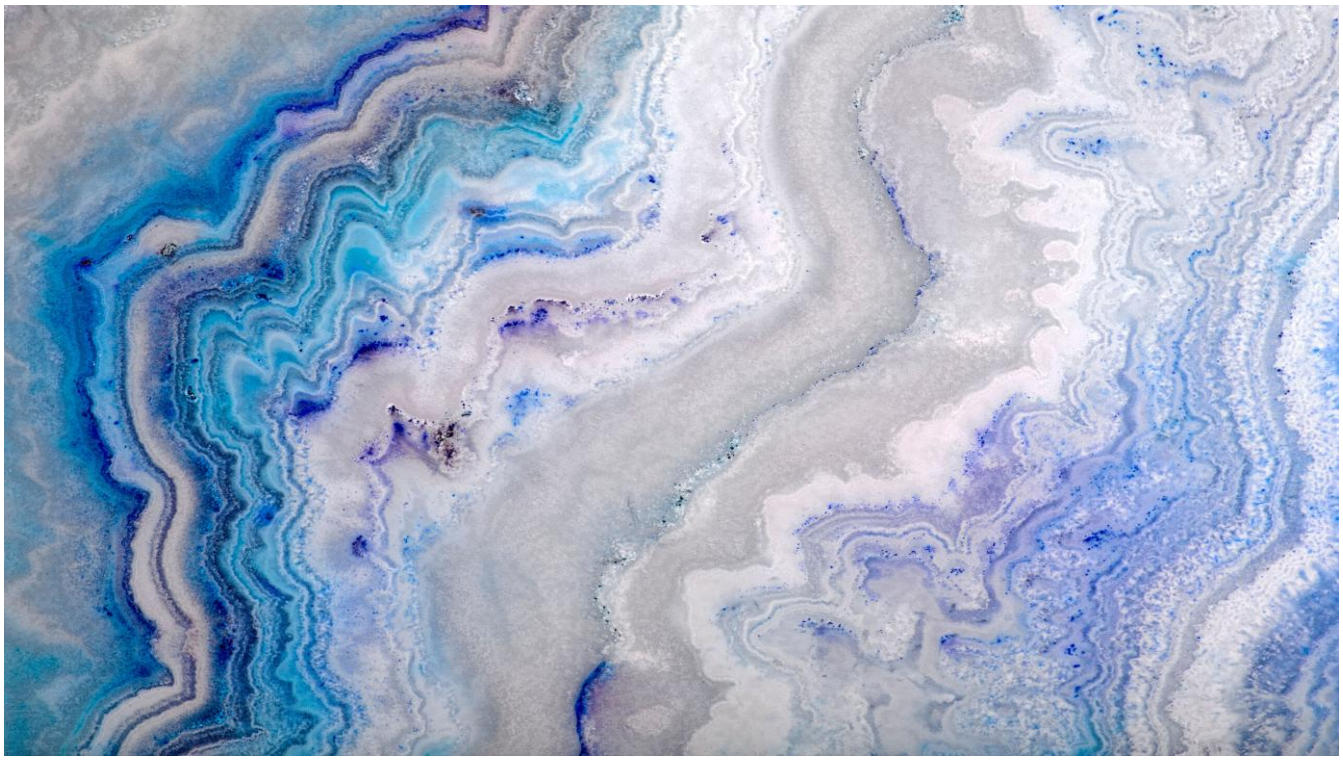
# INTERNATIONAL PENSIONS QUARTERLY

October 2025

# INTRODUCING INTERNATIONAL PENSIONS QUARTERLY

Welcome to the first edition of the Stephenson Harwood "International Pensions Quarterly". We are delighted to launch the inaugural edition of this newsletter, designed to share insights from our market-leading practice in non-UK pension arrangements. A newsletter prepared for our clients, colleagues and contacts globally who have an interest in non-UK pension arrangements.

Each quarter, we will bring you updates on key legal developments; highlight emerging trends and sharing our "on the ground" experience to help you stay informed and ahead in an evolving pensions landscape.



# DOUBLE TAX TREATIES - RECENT CASE LAW

The UK's First-tier Tribunal (FTT) has given some helpful guidance on when individuals can claim relief from UK income tax under the terms of the UK's double tax treaties. In the case *of Masters v Revenue and Customs Commissioners*, the FTT (rejecting HMRC's arguments) found that payments from a UK self-invested personal pension (SIPP) to a member resident in Portugal were "in consideration of past employment" and taxable only in Portugal under the terms of the UK-Portugal Double Tax Treaty (DTT). As the member benefitted from a special residence regime in Portugal (which is now closed to new applicants), he did not pay tax on his foreign pension income in Portugal either.

The FTT considered terms that appear throughout the UK's tax treaties, including what it means for a pension to be paid "in consideration of past employment" and to be "subject to tax". It also gives an insight into how HMRC applies these terms. The judgment therefore has wider significance beyond Mr Masters and the taxation of individuals in Portugal.

The facts of this case were as follows. Mr Masters took a cash equivalent transfer value of his Tesco defined benefit (DB) pension to a SIPP. He then moved from the UK to Portugal, where he benefitted from the non-habitual resident (NHR) scheme, which exempted foreign pension income from Portuguese tax at that time.

Within a few years, Mr Masters withdrew £3.5 million from his SIPP, on which he paid £1.5 million of UK income tax. HMRC had rejected Mr Masters request for a No Tax (NT) code prior to his withdrawals on the basis they did not consider the payments to be eligible for relief under the DTT, which broadly granted Portugal as the country of residence taxing rights on income paid from the UK. HMRC did not consider that the payments received by Mr Masters were "paid in consideration of past employment" as was required for Article 17 (Pensions) of the DTT to apply. Nor did HMRC consider that the payments came within Article 20 (Other Income) of the DTT as they deemed that these payments were not "subject to tax" in Portugal as was required for that Article to apply.

## "PAID IN CONSIDERATION OF PAST EMPLOYMENT"

The key legal question was whether the withdrawals were "paid in consideration of past employment". If that were the case, only Portugal (being the country of residence) could tax the withdrawals.

The phrase is not defined in the DTT, nor has it any specific meaning for the purpose of UK tax law. However, both parties agreed that the SIPP withdrawals could only be "paid in consideration of past employment" if there was sufficient causal connection between the past employment and the withdrawals.

HMRC argued that the SIPP was essentially an investment product and the transfer of funds from the Tesco DB scheme to the SIPP broke the causal link.

The FTT rejected HMRC's arguments ruling that because the funds did not become Mr Masters' property until the withdrawals were made a transfer did not automatically break the link to past employment. The fact that (a) there were no further contributions to the SIPP and (b) the withdrawals were taken from the SIPP not long after the transfer (4 years later), which was a relatively short period compared to more than 32 years of pensionable service accrued in the Tesco DB scheme, were also relevant to the FTT's determination that a causal connection was maintained between Mr Masters' past employment with Tesco and the SIPP withdrawals.

As a result, Mr Masters was entitled to relief from UK tax on his SIPP withdrawals under Article 17 of the DTT.

# DOUBLE TAX TREATIES - RECENT CASE LAW

## "SUBJECT TO TAX"

The FTT also considered when a payment could be considered "subject to tax" for the purposes of Article 20. The point was considered because had Article 17 not applied, the parties would have looked to Article 20, the "other income" provision. Under Article 20 the UK could tax the income if that income was not "subject to tax" in Portugal.

The FTT held that for income to be "subject to tax", there must be actual and effective taxation of the specific income in the state of residence. The fact that the income was taken into account in determining the tax rate applicable to an individual was insufficient. The FTT read those words as a safeguard to avoid non-taxation and endorsed the distinction between "liable to tax" (i.e. within a state's charge) and "subject to tax" (i.e. actually taxed) as set out in Weiser v HMRC.

In the FTT's view, a payment which was exempt from tax under the NHR scheme was not "subject to tax" and the FTT noted (but did not need to decide) that if Article 17 had not applied, the UK could have taxed the SIPP withdrawals because they were not actually taxed in Portugal.

## OUR EXPERIENCE

We have noticed increased engagement from HMRC with Treaty relief claims in the past 12 months. HMRC can be very slow to process such claims, and you cannot assume that the person involved at HMRC fully understands the Treaties or pensions taxation. We had a case for one client earlier this year where HMRC rejected the claim for Treaty relief (as between the UK and Switzerland, which has a complex pensions Article) based on HMRC's misunderstanding of how the Treaty applies. The client has now received a refund of the UK tax withheld on the pension at source, but it took multiple telephone calls and letters from us to achieve the right outcome.

We expect this experience will continue following the *Masters* case, particularly if HMRC starts to interrogate more closely the connection between employment and the benefit paid.

## KEY TAKEAWAYS

Keeping pension withdrawals within the pensions article of the DTT (e.g. by preserving the causal link to past employment) may be crucial to claiming relief from UK tax. The origin of the funds and the timing of withdrawals may be important to the analysis.

Where a double tax treaty includes a "subject to tax" condition, consideration must be given to the context of that requirement and the impact of any tax regime or scheme that limits the tax paid by individuals on foreign source income.

Individuals should maintain a robust chain of evidence for all treaty-related claims and expect requests for information from HMRC before it is prepared to issue an NT code or grant a tax refund.

# OVERSEAS TRANSFER CHARGE: CAN THE OLD EEA EXCLUSION EVER APPLY TO AN ONWARD TRANSFER?

The 2024 Budget removed a popular exclusion to the Overseas Transfer Charge (OTC) from the statute books. Before that date, a UK (or EEA resident) member could transfer their UK tax-relieved funds held under a registered pension scheme to a qualifying recognised overseas pension scheme (QROPS) located in another EEA state or Gibraltar without an OTC arising (the EEA Exclusion). The OTC remains relevant for five years post-transfer, during which time if the EEA Exclusion is no longer satisfied (for example because the individual make a further transfer to a scheme outside of the EEA) an OTC tax charge will arise.

The legislation repealing the EEA Exclusion is clear that the exclusion is not available for transfers made after 30 October 2024, but there is debate about how the transitional provisions under the new legislation should operate. For example, how does the OTC regime work where an original transfer was made before 30 October 2024 and relied on the EEA Exclusion and on an onward transfer is made within 5 years? Our experts explain the issues below.

The legislation implementing the repeal of the EEA Exclusion is clear: the EEA Exclusion is not available for transfers made after 30 October 2024. The Government did however announce that it would apply important savings in the legislation: it stated that the repeal "does not impact transfers that have already been made. **This includes where there is an onward transfer of such funds** [emphasis added]". Unfortunately, the way these transitional provisions have been drafted into the final legislation is far from straightforward.

## THE PROBLEM SCENARIO...

In a real world scenario, could a UK resident who transferred his UK registered pension savings to a Gibraltar QROPS in 2023, but who now wishes to move his funds to another Gibraltar QROPS, be liable for the OTC because the EEA Exclusion is not available to him in respect of that onward transfer?

One view is that the onward transfer is a new transfer and the EEA Exclusion cannot be relied upon. Or is it the case that because the onward transfer is made within five years of an original transfer that was made before 30 October 2024 and that benefitted from the EEA Exclusion, the onward transfer also benefits from the EEA Exclusion? The policy intention seems to support the latter view, which is also, we think, the fairer outcome for taxpayers.

The legislation is not clear, however, and we have seen conflicting views from HMRC, so we caution against transfers in this situation. The consequences of making a transfer that is unintentionally subject to tax are high: a 25% OTC and potentially penalties too.

## SO, WHERE DO WE GO FROM HERE?

The safest option is to wait until the relevant five year period has expired, so that the onward transfer can be made outside the OTC regime entirely. But what should trustees be considering if a member is pressing for an onward transfer within the relevant period? The risks and potential liabilities for affected schemes and members of not paying an OTC that is in fact payable are significant and could even affect the status of the QROPS. It is important therefore that schemes and members weigh these issues carefully and take specialist legal advice before taking any steps. HMRC has promised further clarity on this area, including an update to their online guidance but have not said when this will appear. We are however continuing to engage with HRMC on this issue so watch this space!

# IHT ON PENSION BENEFITS FROM 6 APRIL 2027 - WHAT YOU NEED TO KNOW - PART 1

A momentous policy shift was announced in the 2024 budget when the Chancellor declared that inheritance tax (IHT) would apply to unused funds held in registered pension schemes and most currently exempted non-UK schemes from 6 April 2027. The effect of the policy means that death benefits payable in respect of a member who dies after age 75, could be subject to an effective tax rate of 67% taking account of the income tax payable as well as the new IHT liability.

The change affects decades of financial planning for retirees and those near retirement, will likely result in significant drawdowns from pension schemes and lifetime gifting by that cohort, and risks disincentivising pension saving for younger individuals. There are, though, some helpful points to note: dependant's pensions and some death in service benefits are excluded from the new rules. Further, death benefits payable to a spouse, civil partner or charity will also continue to be exempt from IHT.

Taken together with the recent changes to the regime for non-UK domiciled individuals, the clear winners are longer-term UK expats, for whom the new rules may be advantageous compared to the previous position.

For any individual with a UK pension scheme on death, IHT will be payable on the basis that the scheme's assets are UK situs assets. Income tax will also be payable where the member dies after age 75, although relief may be available if the beneficiaries are resident overseas.

The Government has consulted on a process by which UK scheme trustees must interact with a deceased's Personal Representatives (PRs) to ensure the value of the member's estate includes the value of unused pension savings and ensures that the correct amount of IHT is paid, by whom and when. Draft regulations are expected in the coming months.

## WHAT ABOUT FOR NON-UK SCHEMES?

When and how IHT will apply to non-UK schemes has also undergone a significant change due to the abolition of the non-domicile regime from 6 April 2025. Pension savings under most non-UK schemes (including QNUPS) will no longer benefit from historic exemptions from IHT.

Only individuals who are long-term resident (which is a technical term with its own legal definition) in the UK will be subject to UK IHT on their worldwide assets (i.e. on their non-UK pension arrangements). If the member was long-term UK resident at death, death benefits will likely be within scope of UK IHT, unless one of the limited exclusions apply. UK income tax may also be payable on death after age 75.

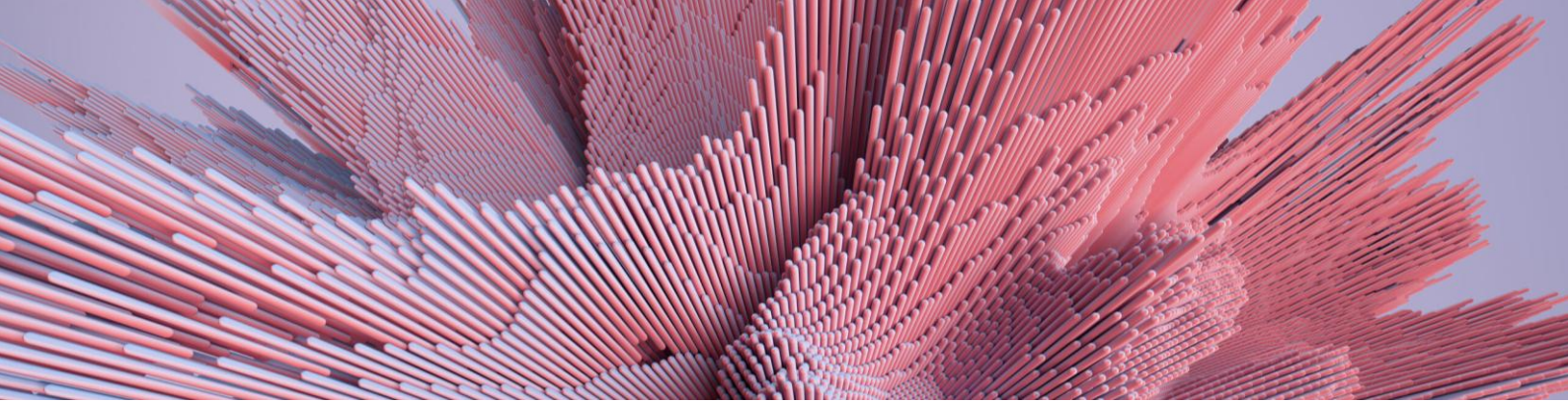
For schemes which, prior to 6 April 2025, were outside the IHT regime by virtue of having a non-UK domiciled settlor, the landscape may have changed dramatically. Trust based schemes will now need to consider whether the long-term resident status of the settlor will bring the funds held within the pension scheme within scope of UK IHT. The issues here are complex and need to be considered carefully on a case-by-case basis taking account of the history of the scheme, the source of funds and the member's residence status.

For individuals who are not long-term UK resident at death, the benefits payable from a non-UK scheme are likely to be outside the scope of UK IHT and UK income tax (unless the beneficiaries are UK resident, subject to any relief under a double tax treaty).

The practical challenges of assessing and collecting the IHT due on pension savings in non-UK pension schemes is still being worked out and regulations are due next year.

Notably, the Government is currently holding its line that any IHT due must be calculated and paid within 6 months of death in the usual way. Trustees and scheme administrators will therefore need to be prepared to devise and deploy very efficient processes to ensure they can coordinate with the deceased's PRs accurately and promptly to meet this timeframe, and to avoid unnecessary interest and penalties for the scheme and/or beneficiaries.

We will be running a series of updates in this International Pensions Quarterly to keep you updated on developments in this area.



# CASE STUDIES

We have considerable multi-jurisdictional expertise in the legal and taxation issues that arise on international pension transfers, and on pension distributions, whether in respect of UK pension schemes, schemes beneficially owned by UK residents, or schemes that have at some point benefitted from UK tax relief.

Here are some examples of the matters that we've been involved with since the Chancellor announced the IHT changes.

## TRANSFERS OUT OF THE UK

Some of our non-UK resident clients with UK pensions are withdrawing their pensions from the UK ahead of 6 April 2027, whether by way of direct distribution to the individual, or by transfer to a non-UK pension scheme. Even where a transfer cannot be achieved tax-free, some clients prefer a tax charge now (see our article on the Overseas Transfer Charge above) to ongoing UK IHT and income tax exposure.

## THE FIG REGIME FOR NEW UK RESIDENTS

We've helped a number of clients with non-UK pensions who have recently become UK resident understand whether the benefits payable from their pension arrangements satisfy the requirements of the new "foreign income and gains" (FIG) regime to be received free of UK income tax.

## WITHDRAWALS FROM NON-UK SCHEMES

We've advised UK long-term resident clients (who are now subject to IHT on their worldwide estate) on withdrawals from non-UK pensions schemes globally, and on IHT-efficient planning with the proceeds, such as offshore trust settlement and lifetime direct gifting.

The rules are complex: some death benefits are exempt from IHT; some non-UK scheme benefits will be subject to income tax even if the beneficiaries are not UK resident; some non-UK schemes will be excluded from the IHT regime under the standard offshore trust rules. Individuals should review their pension position now so that there's sufficient time for planning and implementing changes should that be necessary.

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