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## New UK Pension Auto-enrolment Law Raises Questions for US Employers with UK Employees

Many countries are in the process of reforming their pension systems. In the UK, the UK Pensions Act 2008 introduced a number of reforms intended to encourage more workers to adequately save for their own retirement.<sup>1</sup> As a major part of that reform, beginning in October 2012, employers will be required to automatically enrol all their eligible jobholders into a qualifying pension scheme and make minimum contributions towards it. (As a side note, "enrol" is spelled with one "l" in the UK.) Each UK employer will have a date from when the changes must be in place which will be from October 2012 to September 2016, based on their number of employees and other information. This is known as the employer's "staging date".

Generally, by the staging date, the employer must:

- Have chosen the qualifying pension scheme(s) to adopt to satisfy their new duties; and either
  - Have employees make a minimum contribution, phased in beginning at 1% and going up to 4% over a transition period, while also making a minimum employer contribution, phased in beginning at 1% and increasing to 3% during the transitions period, towards a defined contribution scheme (based on qualifying pensionable earnings) or NEST (the National Employment Savings Trust – something like a national IRA); or
  - Offer membership in a defined benefit scheme or a certain hybrid scheme which either has a "contracting out" statement or meets the "test scheme" standard.

Generally, upon full phase-in, the required contribution for worker automatically enrolled in a defined contribution (DC) scheme or NEST, is a minimum of 8% of qualifying earnings, of which the employer must pay a minimum of 3% and with a further 1% paid as tax relief by the government. (Qualifying earnings is earnings between £5,715 (2010/11 - the UK personal income tax year runs from April 6 to April 5)) and £38,185). For a defined benefit plan, the test scheme standard is a minimum of 1/120th of average qualifying earnings in the last 3 tax years preceding the end of pensionable service multiplied by the number of years of pensionable service, up to a maximum of 40.

<sup>1</sup> While we cannot advise clients with respect to UK law, this note reflects our general understanding of the major implications of the new UK auto-enrolment laws, and information from Department for Works and Pensions and The Pensions Advisory Service. For UK tax and legal advice on their own situations, readers should consult with UK counsel.

As in the US, workers will have a period during which they may be able to opt out of their employer's scheme if they choose not to participate and receive a refund of any contributions taken following automatic enrolment. However, they will also be periodically automatically subject to re-enrolment with another opportunity to opt out.

An eligible worker for purposes of this auto-enrolment requirement is an employee aged between 22 and state pension age (60 to 68, depending upon date of birth) and earning above the income tax personal allowance (£7,475 in 2011/12). Contributions become payable on earnings over the National Insurance primary threshold (£5,715 in 2010/11).

US employers with both US and UK employees should begin planning for the implementation of this new law. Some questions have already arisen in the context of businesses with employees in both the US and the UK and mobile employees. Recently, representatives of the Department for Work and Pensions have provided some informal guidance on these questions.

#### **Is the staging date based on just UK employees, or employees worldwide?**

The Department for Work and Pensions has indicated that employers will be staged into automatic enrolment according to the number of employees subject to payroll withholding for UK income taxes, known as the "Pay As You Earn" or PAYE scheme. This number will determine the size of an employer - i.e. whether they are large, medium or small/micro and, therefore, the employer's staging date.

Example: An employer has 5000 employees worldwide, but only 60 in the UK to whom PAYE applies. This employer has a staging date of July 1, 2014 (the staging date for employers with 50 to 89 employees), rather than May 1, 2013 (the staging date for employers with 4100 to 5999 employees).

#### **Can a US tax-qualified plan constitute a qualifying pension scheme for auto-enrolment?**

Some employees may already have taxpayers in the UK participating in US tax-qualified plans. For example, a person may have been hired in the US, begun participation in a US plan, then continue participation in the US plan after secondment to the UK. The question has arisen as to whether the US based pension scheme could be used to fulfill the employer's auto-enrolment and contribution duties, provided that it meets the "test scheme" minimum benefit or contribution standard described above.

In these cases, the Department of Work and Pensions has indicated that a jobholder who is already a member of a qualifying scheme does not need to be automatically enrolled into another scheme, while a jobholder who isn't a member of a qualifying scheme will need to be automatically enrolled. Consequently, a US plan could be a qualifying scheme for jobholders already in the scheme. However, it cannot be used to automatically enrol jobholders not already in a pension scheme.

Under applicable regulations, for such a non-UK plan to meet the requirements to be a qualifying scheme:

- the scheme must be appropriately regulated in the home country;
- for money purchase and personal pension schemes, some of the jobholder's benefits must provide an income for life;

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- the scheme must be a qualifying overseas pension scheme for tax purposes (which may require registration with HMRC – a number of US plans have already done this); and
- an individual must be given tax relief under a double taxation agreement (which generally only applies to members of non-UK pension schemes who are resident in the UK).

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Additional guidance in this area is likely as 2012 approaches, and there may be further changes to the auto-enrolment laws, but US employers with UK employees may wish to begin considering how mobile employees will be treated under its US and UK plans in light of the upcoming UK auto-enrolment regime.

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