RELEVANT TO ACCA QUALIFICATION PAPER P6 (UK)

International travellers

This is the Finance Act 2012 version of this article. It is relevant for candidates sitting the Paper P6 (UK) exam in 2013. Candidates sitting Paper P6 (UK) in 2014 should refer to the Finance Act 2013 version of this article (to be published on the ACCA website in 2014).

Liability to tax in the UK depends on an individual's residence, ordinary residence and domicile status, together with the location of their assets and the sources of their income. It is a tricky area and can be confusing. This article aims to clear up any confusion you may have.

It begins with some basic rules, an understanding of which enables us to identify the particular areas of tax affected by an individual coming to, or leaving, the UK. It then goes on to review those areas in some detail, and provides a clear set of questions to ask in order to determine an individual's liability to UK taxes. Finally, it deals briefly with the impact of double tax relief and treaties.

Some basic rules

Generally, the UK tax position of an individual who has always lived and worked in the UK (ie someone who is resident, ordinarily resident and domiciled in the UK) is as follows:

- Income tax (IT) on worldwide income.
- Capital gains tax (CGT) on worldwide assets.
- Inheritance tax (IHT) on worldwide assets.

Similarly, the UK tax position of an individual who has always lived and worked outside of the UK (ie someone who is not resident, ordinarily resident or domiciled in the UK) is as follows:

- IT on UK source income only.
- No CGT (unless the asset sold is used in a UK trade).
- IHT on UK assets only.

Read the above points carefully, think about them, and recognise that they result in the following:

- UK source income is always subject to UK IT, regardless of the status of the individual.
- There is no UK CGT, even on (most) UK assets, where the individual is based outside of the UK.
- UK assets are always subject to UK IHT, regardless of the status of the individual.

UK assets include land, buildings and chattels in the UK, cash in UK bank accounts, and UK registered securities.
UK source income consists of income in respect of UK assets, employment income in respect of duties performed in the UK, and trading income in respect of trades carried on in the UK.

Completing the picture

The rules, as set out above, raise three fundamental questions:

(1) Foreign income: At what point does foreign income become subject to UK IT?

(2) Liability to UK CGT: When are gains on UK and foreign assets subject to UK CGT?

(3) Liability to UK IHT on foreign assets: At what point do foreign assets become subject to UK IHT?

This article identifies the order in which the key factors of residence, ordinary residence, and domicile should be considered when answering these questions. A brief reminder of the rules used to determine an individual's residence, ordinary residence and domicile status is included in the appendix.

FOREIGN INCOME

The key factor when considering the taxation of foreign income is the individual's residence position. **Figure 1** indicates the liability of foreign investment income and trading income to UK IT.

Figure 1 – UK IT on foreign investment income and trading income

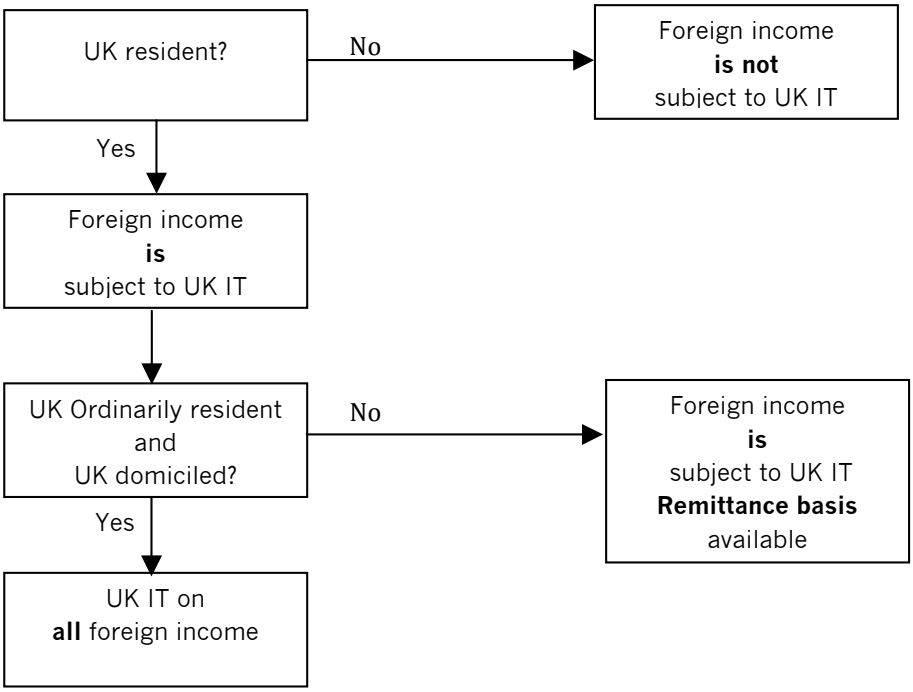


Figure 1 relates to the taxation of **foreign** investment income and trading income only. It has already been recognised that UK source income is always subject to UK IT regardless of the individual's tax status. Foreign employment income is considered below, following **Example 1**.

Note the following:

- Where an individual is not UK resident, foreign income is not subject to UK IT. There is no need to consider the person's ordinary residence or domicile status. This is true even if the individual brings the income into the UK.
- Where an individual is UK resident, foreign income is subject to UK IT. The manner in which it is taxed depends on the individual's ordinary residence and domicile status. The remittance basis (see below) is available if the individual is non-ordinarily resident or non-domiciled.

The remittance basis

A UK resident individual who is non-ordinarily resident or non-domiciled may be taxed on overseas income and capital gains on the remittance basis.

Under the remittance basis, amounts are subject to UK tax only if brought into the UK. For example, an individual with foreign bank interest will not pay UK IT on that interest if he can show that it has not been brought into the UK. This could be achieved by, for example, showing that it has not been removed from the foreign bank account.

A remittance is regarded as having been made where money or other property derived from offshore income/gains is brought into the UK. Individuals can choose each tax year whether or not to pay tax on the remittance basis.

Figure 2 (on following page) illustrates the three stages of the remittance basis. It is useful to think of the rules in stages as it avoids confusion and enables the issues to be addressed in the correct order.

- It is first necessary to consider the status of the individual in order to determine whether the remittance basis is available.
- The second issue is whether the remittance basis is available automatically or needs to be claimed.
- Finally, if a claim is required, the need to pay the remittance basis charge (RBC) must be considered.

Example 1 – Adele

Adele came to the UK in 2011/12 but did not become resident until 2012/13. She is domiciled outside the UK. Adele has employment income in respect of her job in the UK and interest arising on a foreign bank account of £4,000 per year. Adele's liability to UK IT is as follows:

- Her employment income is in respect of UK duties. Accordingly, it will be subject to UK IT in both 2011/12 and 2012/13.
- In 2011/12, the foreign bank interest will not be subject to UK IT as Adele is not resident in the UK.
- In 2012/13, Adele is UK resident and will be taxed on her foreign bank interest as well as her UK source employment income. However, she can claim to be taxed on the remittance basis as she is not domiciled in the UK. There will be no need for Adele to pay the RBC as she has not been UK resident for seven of the nine tax years prior to 2012/13.

Figure 2

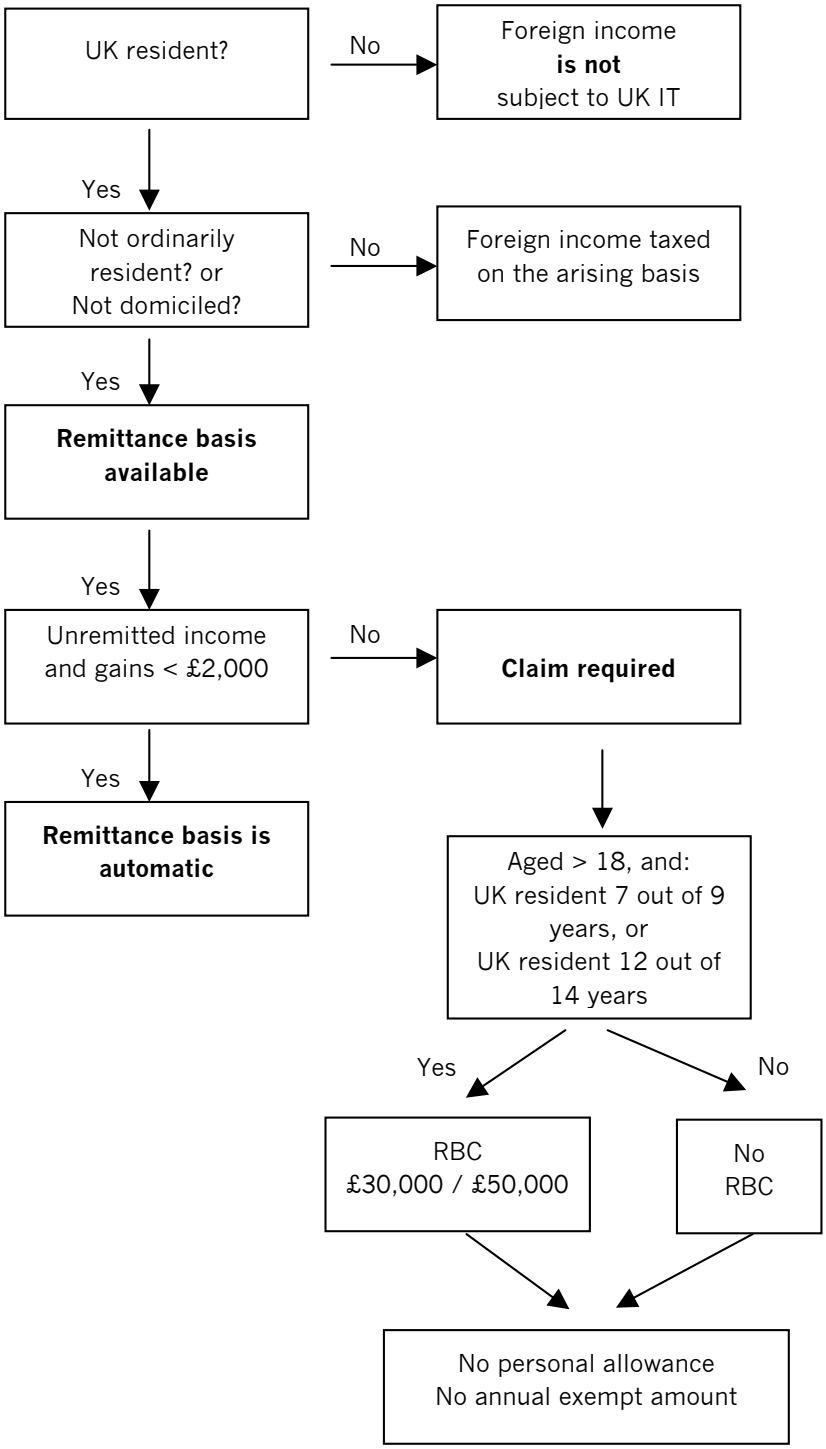


Figure 3 indicates the liability of foreign employment income, ie income in respect of foreign duties, to UK IT.

Figure 3 – UK IT on foreign employment income

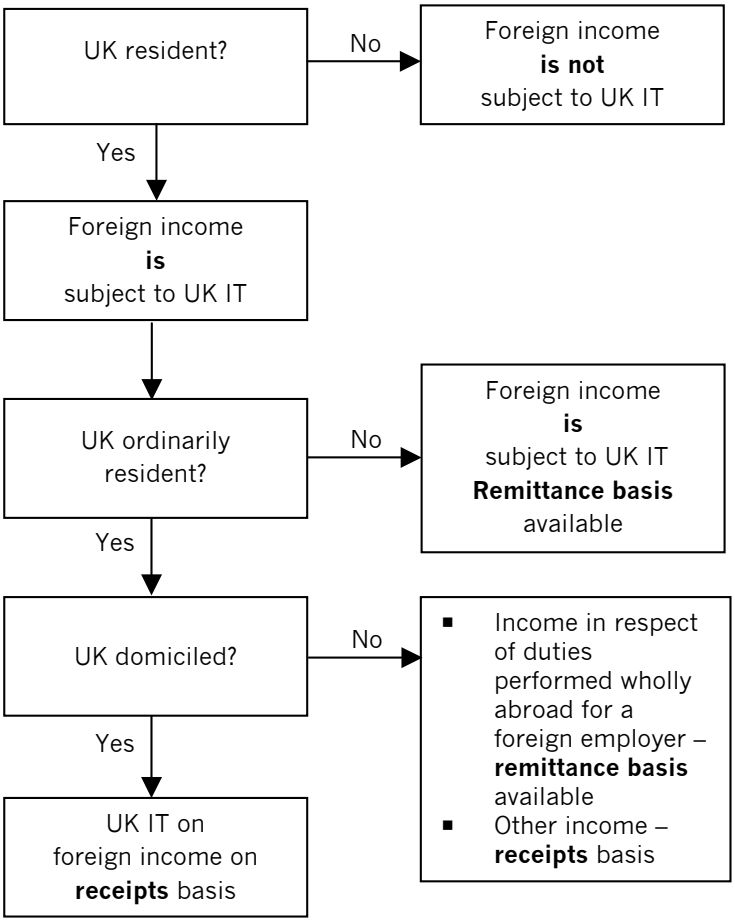


Figure 3 relates to the taxation of **foreign** employment income only and is slightly different from **Figure 1**. A UK resident and ordinarily resident but non-UK domiciled individual can not be taxed on the remittance basis unless the employer is foreign and the duties are performed wholly outside the UK.

The rules set out above in respect of the remittance basis apply equally here.

The costs of travelling to the overseas location may be deductible from earnings depending on the circumstances. It is important to identify whether the costs are being borne by the employer or the employee.

Where the costs are borne by the employer they should be included as part of the employee's earnings. A deduction will then be available for the employee's travel costs (including return trips to the UK during the period of employment) where the employee is absent from the UK wholly and exclusively for the purpose of performing duties that can only be performed outside the UK. A deduction is also available for the travel costs of the employee's spouse/civil partner and children provided certain conditions are satisfied.

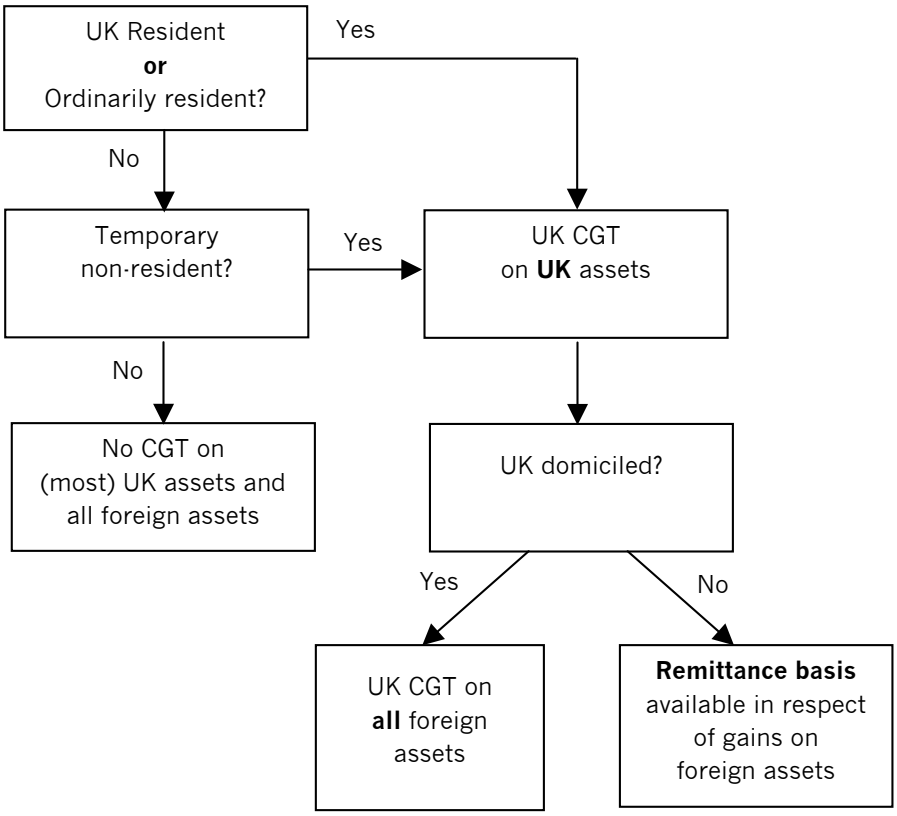
Travel costs borne by the employee are only deductible if they relate to the start and/or the end of the period of working overseas.

The costs of accommodation and subsistence while working overseas are only deductible from earnings if they are borne by the employer – ie they are first added to and then deducted from earnings.

LIABILITY TO UK CGT

The key factors in determining an individual's liability to UK CGT are residence and ordinary residence. Domicile is only relevant where gains have been realised on foreign assets. **Figure 4** indicates the liability of an individual to UK CGT on both UK and foreign assets.

Figure 4 – Liability to UK CGT



Note the following:

- To be outside of UK CGT, an individual must be both non-resident and non-ordinarily resident, and must not be a temporary non-resident.
- UK CGT applies to worldwide assets. Once an individual is subject to UK CGT it is then necessary to consider the person's domicile status to determine the treatment of gains on foreign assets.
- The rules set out above in respect of the remittance basis apply to capital gains as well as to income. Note that the de minimis limit of £2,000 applies to the total of unremitted income and gains.

The rules for temporary non-residents were introduced in order to prevent individuals avoiding UK CGT by going abroad for a relatively short period of time, becoming non-resident and non-ordinarily resident, and then selling assets outside of UK CGT. The rules apply to individuals:

- who have been UK resident for at least four of the seven tax years prior to the year of departure, and
- who leave the UK for a period of less than five years.

Gains made on assets owned at the time of leaving the UK, but sold while the individual is outside of the UK, remain subject to UK CGT. Gains on assets purchased after leaving the UK are not subject to UK CGT.

Example 2 – Bosun
Bosun has always been UK resident, ordinarily resident and domiciled. On 1 June 2011 he left the UK and became non-resident and non-ordinarily resident. His intention was to remain outside of the UK for four years. In 2013/14 Bosun sold some shares (acquired in 2005), and a painting (acquired in 2013).

Bosun's liability to UK CGT following his departure from the UK is as follows:

- Bosun is non-resident and non-ordinarily resident. Accordingly, he will not be subject to UK CGT unless he is caught by the rules for temporary non-residents.
- If Bosun returns to the UK as planned he will have been outside the UK for less than five years and will therefore be a temporary non-resident. The gain on the shares will be taxed in the year he returns.
- If he is non-resident for more than five years, the gain on the shares will not be subject to UK CGT.
- The gain on the painting will not be subject to UK CGT as the painting was acquired after Bosun left the UK.

LIABILITY TO UK IHT ON FOREIGN ASSETS

The key factor in determining an individual's liability to UK IHT on foreign assets is domicile. Foreign assets are subject to UK IHT where the individual is either domiciled or deemed domiciled in the UK.

The deemed domicile rules relate to IHT only and are not relevant for the purposes of IT or CGT. The rules can apply to individuals coming to, and leaving, the UK.

An individual who comes to the UK with the intention of returning, in due course, to their home country is likely to retain a non-UK domicile. This is true even where the individual remains in the UK for a considerable period of time. However, once the individual has been resident for 17 out of the last 20 tax years, he is deemed domiciled for the purpose of UK IHT. As a result, any foreign assets become subject to UK IHT even though he has not acquired true UK domicile.

An individual who leaves the UK and acquires a non-UK domicile is still deemed domiciled in the UK for a further three years. Accordingly, any foreign assets continue to be subject to UK IHT until he has been non-domiciled for more than three years.

Double tax relief and treaties
An individual who is liable to UK IT on worldwide income may find that income arising in respect of foreign assets is taxable in two countries – the UK, and the country in which the income arises. A similar situation may arise in respect of CGT or IHT. Relief may be available via either a double tax treaty or double tax relief.

A double tax treaty, between the UK and the country in which the income arises, will set out how double taxation is to be avoided or minimised. The treaty could state that the income will only be taxed in one of the countries concerned (for example, the country in which the income arises). Alternatively, it could impose a maximum rate of tax in one of the countries.

UK double tax relief is available where there is no treaty or where an element of double taxation occurs, despite the existence of a treaty. Foreign tax suffered, up to a maximum of the UK tax on the foreign income (or transaction, subject to CGT or IHT), is deducted from the UK tax liability.

Conclusion
International travellers add an extra dimension to exam questions because their liability to UK taxes changes as they move to, or from, the UK. When answering a question that includes an international traveller:

- Be specific and precise in your terminology.
- Be careful to address only those issues asked for in the requirement.
- Ensure that you are always clear as to which tax you are writing about.

APPENDIX: RESIDENCE, ORDINARY RESIDENCE AND DOMICILE

The rules governing residence, ordinary residence and domicile are complex, and depend on the time spent in the UK and the intention of the individual concerned. The tables on the following page provide examples of the more common situations.

Table 1 shows what an individual becomes on coming to the UK.

Table 2 shows what an individual becomes on leaving the UK.

Normally an individual is resident or not resident for the whole of a tax year. However, in the following circumstances, the tax year of arrival and departure can be split.

- Where the individual has come to the UK to take up permanent residence or to stay for at least two years.
- Where the individual has left the UK to become permanently resident abroad.
- Where the individual has left the UK for full-time service under a contract of employment for at least a complete UK tax year and any interim visits to the UK in the period do not amount to 183 days or more in any tax year or an average of 91 days or more in a tax year.

Table 1 – An individual coming to the UK becomes:

<table>
<tr><th>UK resident</th><th>UK ordinarily resident</th><th>UK domiciled</th></tr>
<tr><td>• Where the nature/degree of ties to the UK indicate that it is usual to live in the UK
• If in the UK for 183 days or more in a tax year, deemed resident for that tax year</td><td>• If resident from year to year</td><td rowspan="3">• If all links with the former country of domicile have been cut, and
• Intending to remain in the UK permanently</td></tr>
<tr><td colspan="2">• From year of arrival if in the UK for an average of 91 days or more for four tax years and this intention was clear at the outset</td></tr>
<tr><td>• From date of arrival if intending to stay for three years or more</td><td>• From date of arrival if intending to stay for three years or more</td></tr>
</table>

Table 2 – An individual leaving the UK becomes:

<table>
<tr><th>Non-UK resident</th><th>Non-UK ordinarily resident</th><th>Non-UK domiciled</th></tr>
<tr><td>• For the tax year if outside the UK for that year</td><td>• If outside the UK for at least three years</td><td rowspan="3">• If all links with the UK have been cut, and
• Intending to remain in the new country permanently</td></tr>
<tr><td colspan="2">• For a period of absence resulting from leaving the UK under a full time contract of employment, where that period includes a complete tax year</td></tr>
<tr><td colspan="2">• From date of departure if intending to leave UK for three years or more</td></tr>
</table>

Written by a member of the Paper P6 examining team

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