INTERNATIONAL

RELEVANT TO ACCA QUALIFICATION PAPER P6 (UK)

THIS ARTICLE IS BASED ON TAX LEGISLATION AS IT APPLIES TO THE TAX YEAR 2008-09 (FINANCE ACT 2008), AND IS RELEVANT FOR CANDIDATES SITTING PAPER P6 (UK) IN JUNE OR DECEMBER 2009.

This article is based on tax legislation as it applies to the tax year 2008-09 (Finance Act 2008), and is relevant for candidates sitting Paper P6 (UK) in June or December 2009.

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 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 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.

1. 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.

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TRAVELLERS

FIGURE 1: UK IT ON FOREIGN INVESTMENT INCOME AND TRADING INCOME

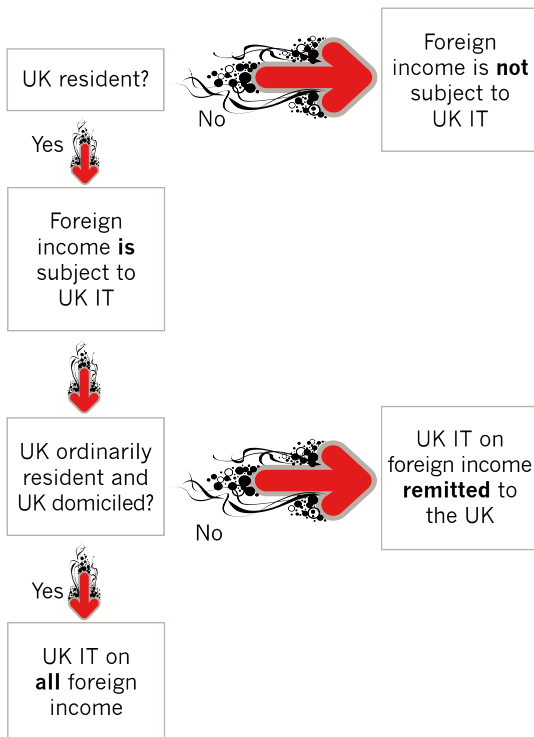


Figure 1 relates to the taxation of foreign investment income and trading income only. It has already been recognised that UK source income is always subject to UK IT regardless of the individual's tax status. Foreign employment income is considered below, following **Example 1**.

Note the following:

- Where an individual is non-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.

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.

- 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. Foreign income may be taxed on the remittance basis if the individual is non-ordinarily resident or non domiciled.
- From 2008/09, where an individual is non-ordinarily resident or non-domiciled, but has been resident in the UK for seven of the nine years prior to the year in question, the remittance basis is only available on payment of a fee of £30,000. Individuals can choose each year whether to pay the £30,000 charge and claim the remittance basis, or pay tax on their worldwide income (subject to a de minimis of £2,000 in respect of unremitted income and capital gains). Individuals who claim the remittance basis are not entitled to the income tax personal allowances.
- Under the remittance basis, income is subject to UK IT only if it is brought into the UK. 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.

Example 1 – Adele

Adele came to the UK in 2007/08, but did not become resident until 2008/09. 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. 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 2007/08 and 2008/09.
- In 2007/08, the foreign bank interest will not be subject to UK IT, as Adele is not resident in the UK.

- In 2008/09, Adele is UK resident and will be taxed on her foreign bank interest, as well as her UK source employment income. However, the foreign bank interest can be taxed on the remittance basis, as Adele is not domiciled in the UK. There will be no need for Adele to pay the £30,000 charge, as she has not been UK resident for seven of the nine years prior to 2008/09.

Figure 2 indicates the liability of foreign employment income, ie income in respect of foreign duties, to UK IT.

FIGURE 2: UK IT ON FOREIGN EMPLOYMENT INCOME

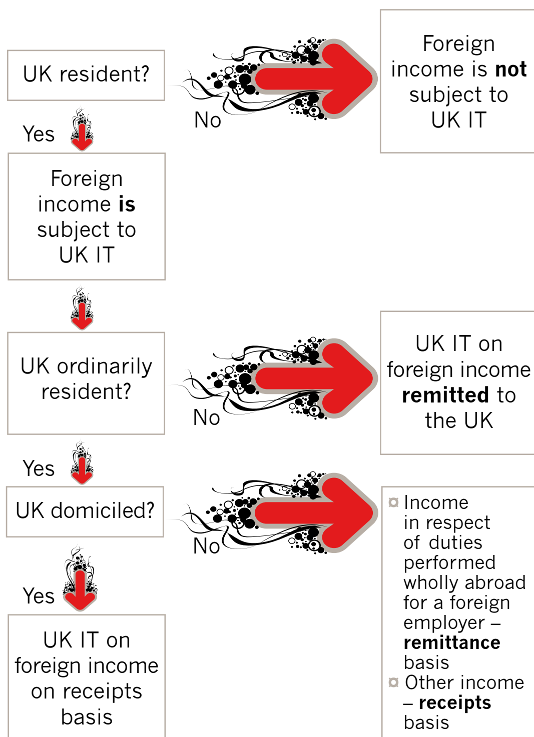


Figure 2 relates to the taxation of foreign employment income only and is slightly different from **Figure 1**. A UK resident and ordinarily resident but non-UK domiciled individual is not taxed on the remittance basis, unless the employer is foreign and the duties are performed wholly outside the UK

The rules set out above (in the notes below **Figure 1**) regarding the £30,000 fee and the remittance basis apply equally here.

2. 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 3** **opposite** indicates the liability of an individual to UK CGT on both UK and foreign assets.

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 the notes below **Figure 1**) regarding the £30,000 fee and 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. Individuals who claim the remittance basis are not entitled to the capital gains tax annual exemption.

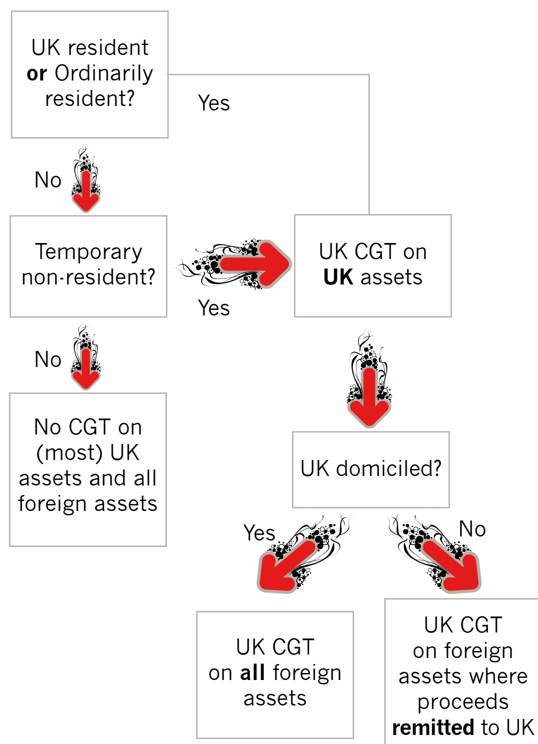
The rules for temporary non-residents were introduced in order to prevent individuals avoiding UK CGT by going abroad for a relatively short period of time, becoming non-resident and non-ordinarily resident, and then selling assets outside of UK CGT. The rules apply to individuals:

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

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.

Gains made on assets owned at the time of leaving the UK, but sold whilst 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.

FIGURE 3 – LIABILITY TO UK CGT



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.

Example 2 – Bosun

Bosun has always been UK resident, ordinarily resident and domiciled. On 1 June 2008, 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 2009/10, Bosun sold some shares (acquired in 2001) and a painting (acquired in 2009).

Bosun's liability to UK CGT 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.

3. 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.

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; AND 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. **Tables 1** and **2** **opposite** provide examples of the most common situations.

Rory Fish is examiner for Paper P6 (UK)

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TABLE 1: AN INDIVIDUAL COMING TO THE UK BECOMES:

UK resident	UK ordinarily resident	UK domiciled
If in the UK for 183 days or more in a tax year, deemed resident for that tax year	If resident from year to year	If all links with the former country of domicile have been cut; and Intending to remain in the UK permanently
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 from the outset	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 from the outset	
From date of arrival if intending to stay for two years or more	From date of arrival if intending to stay for three years or more	

TABLE 2: AN INDIVIDUAL LEAVING THE UK BECOMES:

Non-UK resident	Non-UK ordinarily resident	Non-UK domiciled
For the tax year if outside the UK for that year	If outside the UK for at least three years	If all links with the UK have been cut; and Intending to remain in the new country permanently
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	From a period of absence resulting from leaving the UK under a full-time contract of employment, where that period includes a complete tax year	
From date of departure if intending to leave UK for three years or more	From date of departure if intending to leave UK for three years or more	

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.