

The taxation of non-resident individuals (Lecture P1307 – 14.04 minutes)

Non-residents are not free of UK tax on their income and (from 2015) their gains. However, the tax situation is not straightforward either. It should be noted that it is always important to check the double tax treaty for the jurisdiction in which the individual is resident (if the UK has such a treaty with that place).

The liability of non-residents to income tax is effectively zero on 'disregarded income' over any amounts already deducted at source. However, the tax on the remaining income is calculated ignoring reliefs such as the personal allowance.

This provisions effectively limits income tax payable to this amount which means that if the 'normal' tax treatment is more beneficial, then this can apply. Tax return software will normally work this out for you.

Not all non-residents will be entitled to the personal allowance (see below) and that may impact which of these options is more favourable.

An additional complication of the calculation is that dividends paid to non-residents are received with the basic rate of dividend tax deemed to have been paid. This should not affect the overall calculation but it does make the calculations produced by tax return software look slightly odd.

Disregarded income is generally investment type income and specifically covers:

- Dividends and stock dividends from UK companies;
- Interest;
- Purchased life annuities;
- Profits from deeply discounted securities;
- Distributions from unauthorised unit trusts;
- Profits from transactions in deposits;
- State retirement pension and widow's pension.

Example 1

Mr Jones, who is resident in France, has income from land and property in the UK of £10,000 and dividends from UK companies of £20,000. Total income is £30,000 which would leave £17,430 of income after personal allowances.

The tax on this would be $(2,000 \times 0\%)$ plus $(15,430 \times 7.5\%) = £1,157.25$.

If we compare this with the disregarded income calculation, the tax on the property would be $(10,000 \times 20\%) = £2,000$ plus tax treated as deducted from the dividends which would be $(20,000 \times 7.5\%) = £1,500$ so a total of £3,500.

The 'normal' calculation gives a better result, particularly since the actual tax liability is nil, as you would get credit for the basic rate tax on the dividends, although the excess tax would not be repayable. So the actual tax due is nil.

If Mr Jones had been resident in a country where he did not get the personal allowance, then the calculation would alter but the outcome would still be the same.

Tax would be £1,157.25 (as calculated above) plus $(10,000 \times 20\%) = £3,157.25$. Still less than under the alternative calculation and actual tax to pay would be £2,000.

Personal allowances

An individual who is not resident will be able to claim personal allowances if they are any one of the following:

- A citizen of a state within the EEA, including British citizens;
- A current or former employee of the British Crown;
- A UK missionary society employee;
- A civil servant in a territory under the protection of the British Crown;
- A resident of the Isle of Man or the Channel Islands;
- A former resident of the UK who lives abroad for the sake of their own health or the health of a member of the family who lives with them;
- A widow, widower or surviving civil partner of an employee of the British Crown;
- A National and/or resident of a country with which the UK has a Double Tax Agreement which allows such a claim.

The notes to the non-resident self-assessment pages (SA109) include a convenient list of all countries which fall within the final category. Commonwealth citizens were only entitled to personal allowances up to 5 April 2010.

Employment income

A person who is not UK resident is taxable on employment income only to the extent that it relates to duties performed in the UK. The applicable earnings are obviously calculated by apportioning the person's salary between that attributable to UK and non-UK work.

Notwithstanding this basic principle, many of the UK's double tax agreements prevent the UK from taxing the UK earnings of a resident of the other country if that person is present in the UK for 183 days or less in any 12-month period commencing or ending in the year of assessment concerned, the employer is not UK resident and the remuneration is not borne by a UK permanent establishment. This exclusion does not normally apply to entertainers and sportsmen.

Trading income

A non-resident who carries on a trade in the UK through a branch or agency is taxable on the profits of that branch or agency. It is unclear whether it is possible for a non-resident to carry on a trade here as a sole trader other than through a branch or agency. This is because a trade is normally carried on at the place from which it is controlled and managed, and it would be fairly unusual for that not to take place where the proprietor is resident.

It used to be thought that a trade could not be carried on in the UK if all of its sales contracts were made outside the UK. However, the courts now tend to look at the overall substance of the trade.

The same applies to partnerships where a non-UK resident individual is a partner in a UK partnership. It is likely to be easier to show that there is taxable income arising in the UK as they can be part of the trade which is being exercised by the wider partnership in the UK. However, there might be argument that the non-resident individual is actually operating through a branch or agency in their home country which would complicate matters.

Property income

The basic rule is that the rental agent (or the last agent in the chain if there is more than one) must deduct tax at 20% from the rent and account for it quarterly to HMRC. He can calculate this deduction on the rents that he receives less any expenses he pays on the landlord's behalf during the quarter that he reasonably believes are deductible in calculating the taxable income of the UK property business. He cannot deduct expenses paid direct by the landlord. In most cases the largest expense is likely to be loan interest and this is normally either paid by the landlord or the rents are paid into a bank account with the lender. It is rare for it to be paid by the agent. Accordingly, where there are borrowings the tax deduction is likely to exceed the tax actually due on the profits of the UK property business. Where there is no agent, the tenant is obliged to deduct tax at 20% from the rent and to account for it to HMRC.

Alternatively, the non-resident can elect to be taxed directly under the Non-Resident Landlord's Scheme. This requires the approval of HMRC. When approved, HMRC will authorise the agent or tenant not to deduct tax from the rents. Until he receives such authorisation the agent must deduct tax. Most non-resident landlords opt to use this scheme. It ensures that only the right amount of tax is paid. The non-resident has to file an annual tax return and must pay tax in accordance with the normal self-assessment rules, which of course require interim tax payments to be made based on the previous year's income.

A non-resident individual should normally consider holding UK property through a non-UK company. There are two reasons for this. The individual will pay tax on rental income at rates of up to 45% if the income is high enough, whereas an overseas company pays corporation tax at the rate of 19%.

However, it should be noted that this rate is to go up to 25% from April 2023 as all foreign companies will pay tax at the main rate of corporation tax even if they have low profits. The second is that as the property is situated in the UK it is within the scope of UK inheritance tax if it is held by the individual but will be outside the scope of IHT if held through an overseas company.

Capital gains tax

An individual is chargeable to CGT only if he is resident in the UK at some time during the tax year in which the gain is realised. Split year treatment is available for CGT.

There are important exceptions to this basic rule. The first is that if a non-UK resident is carrying on a trade, profession or vocation in the UK through a branch or agency he is liable to tax on gains on the disposal of UK assets which are used in (or held for the purpose of) the branch or agency at the time the gain accrues, or were used (or held for) such a purpose at an earlier time or have been acquired for use for such a purpose. For the charge to apply the trade must be carried on at the date of the disposal.

The second is that a taxpayer who is a temporary non-resident is chargeable to CGT in the period of return on some gains realised during his period of non-residence. Where the legislation applies, the individual is treated as realising in the year of return capital gains equal to the aggregate of the gains that arose to him during his period of temporary non-residence other than if he bought and sold the asset whilst non-resident.

The final exception came in from 6 April 2015 as a new CGT charge was introduced on non-residents relating to disposals of residential property which was then extended in April 2019 to commercial property and indirect holdings of UK property.

Residential property

Residential property is defined as property suitable for use as a dwelling. It does not extend to non-residential property or particular categories of accommodation such as care or nursing homes, purpose built or converted student accommodation (where there are at least 15 bedrooms occupied more than 50% of the time by students) or residential accommodation for school pupils.

The rate of tax for individuals is the same rate as UK individuals i.e. 18% or 28% depending on total UK income and gains. Individuals will benefit from the annual capital gains tax exemption.

The chargeable gain is on the growth from 6 April 2015. The property is rebased to its market value at 6 April 2015 with the growth from that point falling within the charge. Alternatively the taxpayer can elect to apportion the gain.

There are different ways in which the gain can be calculated. The standard approach for calculating the gain is to use the market value at 5 April 2015.

Establish the value of your property as of 5 April 2015 (known as 'rebasings').

Work out the difference between the value on 5 April 2015 and the value when you disposed of the property.

Deduct any costs of improving the property incurred after 5 April 2015 and the legal cost of selling the property.

Example 2

	£
Disposal proceeds	1,250,000
Incidental disposal costs	<u>30,000</u>
Net disposal proceeds	1,220,000
Market value at 5 April 2015	<u>1,000,000</u>
Gain	<u>220,000</u>

Alternatively, you can work out a simple straight-line time apportionment of the whole gain made over the period you owned the property.

Example 3

Total ownership 128 months, period from 6 April 2015 to disposal was 77 months, 60.15% ($77/128 \times 100$) of ownership relates to period from 6 April 2015 to disposal.

	£
Disposal proceeds	1,250,000
Incidental disposal costs	<u>30,000</u>
Net disposal proceeds	1,220,000
Less:	
Acquisition cost	750,000
Incidental costs of acquisition	<u>40,000</u>
Gain over period of ownership	<u>430,000</u>
Time apportioned post 5 April 2015 gain 60.15%	£258,645

The final option is to decide not to make an apportionment, particularly if you want to establish an amount of loss on a property. You can also use further apportionments to reflect any non-residential use of the property.

From April 2015 a person's residence will not be eligible for PPR for a tax year unless:

- The person making the disposal was tax resident in the same country as the property for that tax year; or
- The person spent at least 90 midnights in that property – the "90 day rule".

The new 90 day rule also applies where there is an existing nomination.

Nominations remain unchanged on properties in a country in which you are resident so a UK resident owning two UK residences will not be affected by these changes – they can still nominate their second UK residence. A UK resident owning a UK residence and an overseas residence will however be affected by these changes.

For non-residents PPR nominations are to be made at the time of disposal.

Extension of the provisions in 2019

There was an extension to the type of assets which are subject to capital gains tax or corporation tax on capital gains where the person is not resident in the UK with non-residential property being brought within the remit of the charge as well as indirect holdings of UK property of all types.

The charge is extended to non-residential property and indirect holdings being assets which derive at least 75% of their value from UK land where the person has a substantial indirect interest in the land. There are effectively two questions to be asked:

- Does the asset disposed of derive at least 75% of its value from UK land?
- Does the person making the disposal have a substantial indirect interest in the UK land at the time of the disposal?

An asset derives at least 75% of its value from UK land if the asset consists of a right or an interest in a company and at least 75% of the total market value of the company's qualifying assets derive directly or indirectly from interests in UK land. Market value can be traced through any number of companies, partnerships, trusts or other entities.

A person has a substantial indirect interest in UK land if at any time in the period of 2 years ending with the time of the disposal, the person has a 25% investment in the company.

Other points to note are:

- Any gain will be calculated according to capital gains tax principles;
- A loss is not an allowable loss if it accrues at a time when a gain would not have been a chargeable gain;
- Only losses arising to assets described above are allowable losses to be set off against gains of non-resident persons;
- Allowable losses count for these purposes even if they accrue when the person was tax resident;
- Tax is charged at the normal rate on gains arising under these provisions; and
- If assets of a company are vested in a liquidator, these provisions apply as if the assets were vested in the company and the acts of the liquidator were the acts of the company.

Rebasing, which has been a facet of the non-resident capital gains provisions as they relate to residential property, will also feature in this regime. It should be noted that time apportionment is not an option for non-residential or indirect holdings of land. There are transitional provisions for land which has changed status between 2015 and 2019.

A direct disposal of UK land will not be fully residential before 6 April 2019 if in the period beginning with the day on which the person acquired the interest in land being disposed of or, if later, 6 April 2015, and ending with 5 April 2019, there was no day on which the land to which the disposal relates consisted of or included a dwelling. If the disposal is of an interest in land subsisting under a contract for the acquisition of land that, at any time before 6 April 2019, consisted of or included a building to be constructed or adapted for use as a dwelling, the disposal is taken to be fully residential before that date.

A disposal is made by a person who was not chargeable before 6 April 2019 if, immediately before that date, the person was

- a company which was not a closely-held company (as defined by Schedule C1 TCGA 1992 which means either it is under the control of 5 or fewer participators or 5 or fewer participators together possess or are entitled to acquire such rights as would give the greater part of the assets on a winding up excluding rights as a loan creditor. Care also needs to be taken if any of the participators are diversely-held companies or qualifying institutional investors as this might mean the definition of closely-held is not met);
- a widely-marketed scheme (again defined in Schedule C1 and mainly relating to unit trusts and OEICs);
- a company carrying on life assurance business where the interest in UK land was, immediately before that date, held for the purpose of providing benefits to policyholders in the course of that business.

In calculating the gain or loss accruing on the disposal it is assumed that the asset was on 5 April 2019 sold by the person, and immediately reacquired by the person, at its market value on that date. It is possible to make an election to calculate the gain as if this has not occurred but if this is an indirect disposal of UK land and a loss accrues then the loss is not an allowable loss.

Where the property is partly residential and partly non-residential then an apportionment will need to be done and different rebasing applying to each portion separately. If the land is mixed use, then the gain is pro-rated for that mixed use or if there has been change in use, pro-rating is also undertaken. If both occur, then both need to be taken into account with the overall computation being done on a just and reasonable basis.

Contributed by Ros Martin