International Tax Issues

Hot Topics - March 2014

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Contents

This document offers commentary on the main changes, as well as highlighting some areas where advice might be needed, on International tax issues.

The past 12 months have been busy in respect of changes affecting individuals with an international tax angle. We have seen a range of new legislation, including the Statutory Residence Test (SRT), a UK/Swiss Bilateral Agreement, non-domiciled spouse elections for inheritance tax and Annual Tax on Enveloped Dwellings (ATED). We have also experienced an escalation of HMRC activity in an attempt to limit the loss of tax from taxpayers using offshore structures, so the following is essential reading.

RESIDENCE– THE NEW STATUTORY RESIDENCE TEST (SRT)

We are now becoming familiar with the concept of a new SRT, introduced with effect from 6 April 2013 and the need for individuals to review their residence status taking into account the new rules (see our website article posted on 25 February 2013). However, it is easy to make assumptions and the following are some 'traps' that may be experienced by the unwary.

Full-time work overseas

The third leg of the automatic overseas test allows an individual working 'sufficient hours' overseas to be non-UK resident if certain conditions are met. The test roughly mimics the previous practice for individuals leaving the UK to work full-time overseas. However, there can be some surprising results when applying the steps set out in legislation. For example, which of the following would you consider qualifies under the third leg of the automatic overseas test?

a. Alex works for an overseas employer and all work is undertaken outside of the UK. He works Monday to Friday 35 hours per week. He takes 5 weeks holidays per year, one week at a time and 9 bank holidays. He has no sick days or parental leave days. His employment continues throughout the tax year and he spends 40 days in the UK. He has been UK resident in at least one of the previous three tax years.

b. Karl works overseas for an oil firm. He works shifts of 4 weeks on and 4 weeks off. He works 10 hours per day Monday to Saturday during his 'on shift'. He spends most of his 'off' days at his holiday home in France and he visits the UK for 50 days in the tax year. He does not take any annual or sick leave in addition to his 'off shift' days.

It is easy to assume that both Alex and Karl would be considered as being in 'full-time employment overseas', but in fact neither of them meet the conditions of the third leg of the automatic overseas test. This is because they do not work sufficient hours when the five-step test is applied. They could of course still be non-resident as long as they are not resident under the automatic UK test and fulfil the non-residence conditions of the sufficient ties test but that then makes their position a lot more complicated! And, in addition, they and their spouses will not qualify for split-year treatment under Cases 1 and 2 (for leavers) and Cases 6 and 7 (for arrivers).

Split-year treatment

Prior to 6 April 2013, split-year treatment was generally applied to just about anyone coming to or leaving the UK on a day other than 5 April. There were a few restrictions but they did not affect many people at all. However, we are no longer within the flexibilities offered by ESCs A11 and A78 and must now look to legislation to determine if split-year treatment is relevant.

There are three Cases relevant for leavers and five Cases relevant for arrivers. However, for each there are strict conditions that must be met. If split-year treatment does not apply, the worldwide income and capital gains of the full tax-year will be taxable in the UK unless the individual can show that he was treaty resident in another country under the terms of a relevant double tax treaty[1].

Case 6 in particular received a last minute revision as the 2013 Finance Bill went through Parliament. This Case refers to individuals returning to the UK after working in full-time employment overseas. However, the revision means it only now applies to individuals who have been UK resident in at least one of the five previous tax years (but not the one immediately preceding the year of return). This revision can have serious repercussions for long-term overseas workers and their spouses (Case 7) returning to the UK to retire if they find they do not fall within any of the other Cases 4, 5 or 8.

In addition, the dates on which split-year treatment apply are often no longer the physical date of arrival or departure into or out of the UK. The date will be determined by the Cases and if more than one Case is relevant for the individual, it is then necessary to apply the 'priority' rule. This is simple for leavers as the priority is given to Case 1, then Case 2 and then Case 3 (in that order depending on how many Cases are relevant for the leaver). However, the priority rule for arrivers who qualify under more than one of the Cases 4 to 8 is far more complicated and not necessarily logical!

In all cases, it is advisable to plan ahead and fully review the intended arrival, departure and years of non-residence to make sure there are no nasty surprises.

Dual contracts – non-domiciliaries

A non-domiciled, UK resident employee can claim the remittance basis of assessment in respect of foreign employments performed wholly outside the UK. Where any duties of that employment are performed in the UK, the remittance basis is lost and the whole of the remuneration is liable to UK income tax on an arising basis.

Dual contract arrangements are set up to distinguish the foreign employment from an employment exercised in the UK. If operated correctly, this can provide the remittance basis of assessment for remuneration received from the foreign employment, limiting the charge to UK income tax to the UK contract. HMRC does not like such arrangements believing that the contracts are largely implemented for tax reasons by artificially separating UK and foreign employments.

The Autumn Statement included an announcement that new legislation would be introduced in the Finance Bill 2014 and in January 2014 draft legislation was made available for consultation. This will treat 'related' employments, one of which is in the UK, as being assessed on the arising basis if certain tests are met. All dual contract arrangements should be reviewed in anticipation of the new legislation which is due to be effective from 6 April 2014.

Overseas workdays relief

As part of the SRT changes, all non-domiciled employees coming to the UK on or after 6 April 2013 may benefit from the overseas workdays relief if they perform some of their employment duties offshore.

In previous years, the employee had to have the intention of leaving the UK within three years of arrival and HMRC opened a number of enquiries, particularly into employees who had remained in the UK beyond their third anniversary. Such enquiries were often long-winded, complicated and expensive and this put many employees off claiming the relief. Now, however, it is only necessary for the employee to be non-UK resident for the three tax years immediately preceding the tax year of arrival. The relief may be claimed for the first three tax years of UK residence (counting split-years).

This is now a relatively easy relief to claim so it should not be overlooked when advising non-domiciliaries coming to the UK for work reasons. However, it is important to ensure that the remuneration is paid offshore and for the offshore bank account to be structured correctly to ensure maximum tax efficiency.

Repayment of the 2012/13 Remittance Basis Charge (RBC)

There will be a number of individuals who paid the RBC of £30,000 in 2011/12 and made payments on account towards their tax liability for 2012/13 on the basis that they may claim the remittance basis. For those individuals who have subsequently decided not pay the RBC for 2012/13, it is necessary to consider how the RBC was initially paid and the tax consequences.

Tax legislation states that offshore income and gains can be used to settle the RBC without causing a taxable remittance if payment is made direct to HMRC. Where the 2012/13 payments on account made in January and July 2013 included the RBC but the taxpayer then decided not to claim the remittance basis in the 2012/13 tax return, the RBC is no longer payable and will be refunded or used to settle the UK tax liability assessed on a worldwide basis. This can cause a taxable remittance if the original payments were funded using offshore income and capital gains.

Finance Act 2013 inserted s.809UA ITA 2007 to allow offshore income and gains previously used to pay the RBC not to be treated as a taxable remittance. However, in order to achieve this, it is necessary for an amount equal to that previously brought onshore to pay the RBC to be taken offshore by 15 March 2014. The amount taken offshore will be treated as having the same composition of income, gains and capital as used to make the payments on account. If the funds are not taken offshore within this timeframe, a taxable remittance will be applicable.

Where the individual does not have funds readily available onshore but is expecting a tax repayment consisting of the RBC originally paid, a claim may be made by 5 April 2014 to HMRC to extend the deadline.

Remittance initiative

HMRC issued a number of letters last year to non-domiciliaries that paid the RBC and claimed the remittance basis. HMRC advised that these letters were to educate taxpayers regarding the wide interpretation of what is considered a 'remittance' to help them with tax compliance.

The legislation covering remittances is exceptionally complex and it is easy to make mistakes or not appreciate that a remittance has been made. Expert advice is essential, especially when large amounts are involved. This was evidenced in the case of Mehjoo v Harben Barker (2013) which found an accountant negligent of advising his non-domiciled client properly and suffering costs of £1 million. The ruling was found against the accountant because he should have advised his client to take advice from a non-dom specialist rather than trying to find the best solution himself.

HMRC's desire to highlight the far-reaching scope of remittances may be a fore-runner to opening enquiries into such matters. There is also a risk that higher penalties will be sought where additional tax is found to be payable and the taxpayer has not come forward following receipt of HMRC's letter.

Forward tax planning can help to mitigate the tax should offshore funds be needed in the UK.

DISCLOSURE OF OFFSHORE INCOME

During 2013, we saw a number of overseas British territories sign up to sharing agreements with the UK. The Swiss Agreement also came into force on 1 January 2013. Individuals who did not authorise their Swiss bank to disclose details of their accounts to HMRC suffered a one-off deduction from their accounts in May 2013 (unless non-domiciled and able to confirm the remittance basis was relevant). The same individuals have suffered withholding tax at source on income and gains credited to the account directly by the banks.

UK residents holding overseas assets including property and bank accounts may start to receive letters from HMRC asking if they have been wholly tax compliant.

There are a variety of disclosure facilities in force at the moment to allow individuals to report any past irregularity and taxpayers are encouraged to check if they are at all concerned. It is far better to make a voluntary disclosure now rather than have to react to a letter from HMRC at a later date.

ANNUAL TAX ON ENVELOPED DWELLINGS ("ATED")

The ATED legislation was introduced on 1 April 2013 for non-natural owners of UK residential property worth more than £2 million as at 1 April 2012 (or the date of acquisition if later). The first ATED return had to be submitted by 1 October 2013 and the next return is due for submission by 1 April 2014 in respect of the year to 31 March 2015. All companies owning a UK residential property worth more than £2 million must complete the ATED return. Relief from the ATED charge can apply in certain circumstances, but the return must be completed and the relief claimed to avoid the charge (a minimum of £15,000 per annum).

Properties that have been liable to the ATED charge and which are sold after 5 April 2013 realising a gain, will also need to consider the new ATED capital gains tax charge. This is also applicable for both UK and non-UK resident companies and can mean that a UK company is liable to corporation tax and capital gains tax on different parts of the gain.

CAPITAL GAINS TAX – NON-RESIDENT PROPERTY OWNERS

The 2013 Autumn Statement included an announcement that non-resident owners of UK residential property would become liable to capital gains tax for disposals after 5 April 2015. Draft legislation is currently not available and a consultation is due early 2014. In particular, the Autumn Statement referred to 'future gains' which implies only the gain attributable to the period from 5 April 2015 will become taxable. But we don't yet know if this will mean having properties revalued as at that date or if the gain will be an apportionment on a straight-line basis across the period of ownership for properties acquired before that date. It also remains to be seen how the tax will be collected and whether there will be a withholding requirement by a vendor selling to a non-resident.

It has previously been possible to sell a property within 36 months of ceasing to use it as the main residence without triggering a capital gains tax liability but the reduction of this exemption to 18 months for disposals after 5 April 2014 will no doubt also affect some expat's exposure to capital gains tax if they sell their former main residences after 5 April 2015.

As mentioned above, the ATED legislation introduced a capital gains tax charge for corporate owners of certain UK residential property worth more than £2 million. It will be interesting to see if the separate capital gains ATED charge continues for non-resident companies or whether it is incorporated into the new non-residents capital gains tax legislation.

INHERITANCE TAX – NON-DOMICILED SPOUSE ELECTION

Transfers between spouses are normally exempt for inheritance tax purposes. However, the exemption applicable for transfers from a UK domiciled person to their non-domiciled spouse is restricted. Until 5 April 2013, the exemption was only £55,000 but from 6 April 2013 it is equal to the inheritance tax nil rate band (ie £325,000 for 2013/14 and 2014/15). A UK domiciled person in this respect includes someone who is deemed domiciled in the UK due to being resident for at least 17 out of 20 tax years. So, it can apply to two non-domiciled individuals if one has been in the UK for at least 17 years.

Where the nil rate band still produces an inheritance tax charge on the UK domiciled spouse's death, the surviving non-domiciled spouse may make an election to be treated as UK domiciled for inheritance tax purposes thereby benefitting from the unlimited spousal exemption. The election may be back-dated for transfers made up to seven years before death, but not before 6 April 2013. An election can also be made while the UK domiciled spouse is alive. Once an election is made it will remain in force until such time that the non-UK domiciled spouse has been non-UK resident for four complete tax years.

Any married couple that consists of one UK domiciled spouse and a non-UK domiciled spouse should consider planning solutions with regard to their inheritance tax position. In particular, excluded property trusts should be considered before electing to bring the non-domiciled spouse's worldwide assets into the scope of inheritance tax.

TAX YEAR END PLANNING

As we approach the end of the current tax year, it is necessary to consider making claims and elections that have a deadline of 5 April 2014. The following are a number that affect non-domiciliaries:

- A claim for foreign capital losses – this must be made by 5 April 2014 if the first time the non-domiciliary claimed the remittance basis after 5 April 2008 was for 2009/10.
- A claim for the remittance basis – this must also be made by 5 April 2014 if relevant for the 2009/10 tax year and a claim has not already been made.
- A non-domiciled individual who has been UK resident for 1998/99 onwards will become deemed domiciled for inheritance tax purposes on 6 April 2014 if they remain resident for some/all of 2014/15. On becoming deemed domiciled, worldwide assets will come within the scope of inheritance tax. Urgent consideration should be given to whether an excluded property trust is a suitable solution.