

## **The benefits of non-resident status**

In the wake of the inconclusive outcome to the General Election and resultant coalition Government, it is becoming clear that higher taxes are on the way. These will be required to finance not only a reduction in the the national debt, but also the substantial increase in the personal allowance which was a manifesto commitment of the Liberal Democrats. A significant increase in the rate of capital gains tax has also been unofficially announced. Becoming non resident outside the United Kingdom as a tax exile may therefore appear attractive to some.

It is sometimes supposed that non residents are not liable to UK higher rates of income tax, but this is in fact a misconception. Any earned income in respect of duties performed in the UK is fully taxable here in the hands of a non resident, as also is any rental income from UK let properties. If the income is sufficient to extend into higher rates of tax, then there will be liability in excess of the basic rate band.

Personal allowances are not generally available to those not resident in the United Kingdom. Instead, all nationals of states within the European Economic Area are entitled to personal allowances in limited circumstances. These are set out in section 56, Income Tax Act 2007 and include (somewhat archaically) those who have left the United Kingdom for residence abroad for health reasons, and those who have been in the service of the Crown. In the past, Commonwealth citizens were also entitled to personal allowances, but this was abolished in the Finance Act 2009, except in so far as a double tax treaty preserves the relief for such citizens. There are 14 such double tax treaties.

Non residents also benefit from an upper limit on UK tax liability which is framed in rather complex terms. In order to operate the limit, income has to be segregated between 'disregarded income' and other types of income. Disregarded income includes bank interest, dividends from UK companies and authorised unit trusts, the UK state pension, occupational pensions and annuities paid under an approved retirement annuity contract. Note that this list does not include pensions from personal pension schemes and SIPPs.

Once UK sources of income have been segregated between (1) disregarded income and (2) other types of income, liability to tax is calculated as follows. The total income tax liability on sources within (2) is calculated leaving out of account both sources within (1) - the disregarded income, and also any personal allowances which may be due.. Commonly, this part of the calculation therefore includes any employment income for UK duties and any sources of UK rents, as explained above. The tax liability in respect of (2), the disregarded income, is then limited to the amount of tax actually deducted at source from it, or in the case of dividend income the amount of the tax credits. Since the UK State pension never has tax deducted from it, this effectively means that it is tax free to non residents. Equally, non-residents can arrange for UK sources of bank interest to be paid gross, upon making a declaration of non-resident status. It is therefore quite common for sources of disregarded

income to have no tax paid at source so that in effect they are tax- free for non residents.

Those who are not resident or ordinarily resident in the United Kingdom are exempt from UK capital gains tax in respect of the disposal of any assets, including those which are UK assets. This is subject to a five year rule for temporary non-residents.

HMRC has a published concession which applies in the year of commencement or cessation of residence in the United Kingdom. Under the concession, the fiscal year can be split into resident and non-resident parts, so that where someone goes abroad on a permanent basis during a fiscal year, after the time of departure, he or she will be treated as non resident in the United Kingdom. Equally, where someone comes to the United Kingdom during the fiscal year to take up permanent residence, the period of time prior to arrival is treated as a non-resident period. It is important to note, however, that the concession is of quite limited scope. First and foremost, it does not operate in relation to capital gains tax for those who have previously had a history of residence in the United Kingdom. So if someone goes abroad in order to realise a substantial profit on a property or on the sale of private company shares, for example, it is crucial that the contract for the sale must be made during a fiscal year when the individual is non resident for the whole of the year.

The concession also states that splitting the fiscal year does not permit 'disregarded income' (see above) after the time of departure to be left out of account when calculating UK tax liability. This means that all UK investment income and pension income for the entire fiscal year must be fully included in the calculation of UK tax liability. This point is of particular importance to those who take up residence abroad in order to extract funds from a UK family company in the form of a dividend which they hope will be tax free by virtue of their non-resident status. This expectation will not be realised if the dividend is taken at any time in the fiscal year in which the person leaves the United Kingdom. It will be necessary to wait until after 5 April following the date of departure before taking the dividend.

It should also be noted that all profits from unapproved share options granted to an employee whilst UK resident remain liable to UK tax, even if the options are exercised when non resident. This rule applies on a world-wide basis, and is not restricted to options in respect of the shares in a UK company.

Becoming non resident does not in itself have any impact on inheritance tax liability, which applies on a world-wide basis to all those who are domiciled in the United Kingdom, even though resident abroad

The foregoing is a summary only of complex rules upon which advice should be taken in the particular circumstances of the case. The summary applies to those who remain domiciled in the United Kingdom, as non domiciliaries have a range of provisions applying specifically to them.

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