A Bluffer's Guide to the UK Tax System

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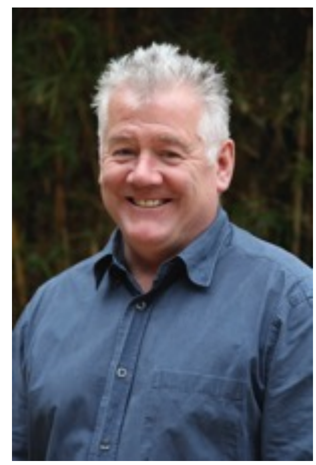
Introduction

Neil Stokes



The UK tax system works on the principle of "the man or the money" – if the "man" is UK tax resident then he is liable to tax, and if the "money" (i.e. an income-producing asset) is in the UK then that source is taxable.

The result is that once an individual leaves the UK for tax purposes (see the section on the Statutory Residence Test) they are no longer liable to UK income tax, an attractive state of affairs that contrasts sharply with the American system, where individuals have to report locally and back to the US at Federal level.

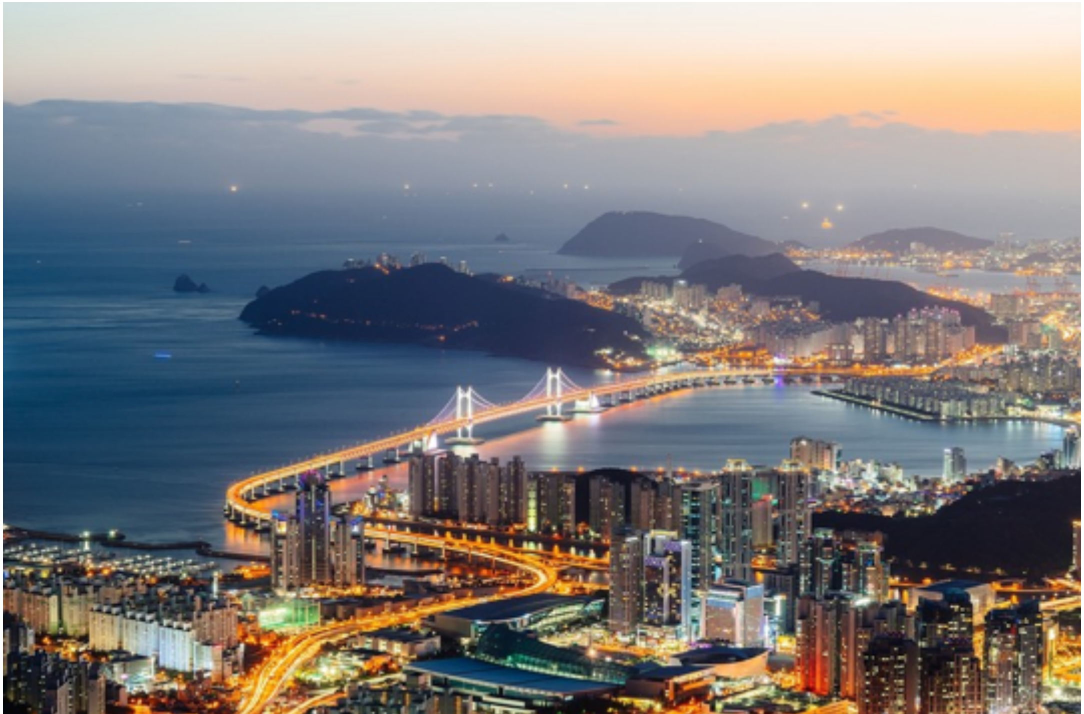
The above leaves former UK taxpayers into a false sense of security, for there are other taxes in play.

Inheritance Tax is chargeable on all UK assets for non-domiciled as well as domiciled persons and, since 6 April 2015 Capital Gains Tax is now levied on gains from that date for both resident and non-resident persons. These latter taxes can be forgotten about by ex UK taxpayers but also have the effect of drawing taxpayers who have never been UK resident into the UK net.

The clear danger for people with UK assets, whether income-producing assets or not, is that they either believe that there is no reporting requirement or simply overlook the need to file a return. This can be an expensive mistake……

Chapter One

Residence



If you have recently become an ex-pat and/or make regular trips back to the UK you should be aware of the rules

One of the key questions in respect of UK tax is “Residence”.

From 6 April 2013 the UK introduced a new Statutory Residence Test (SRT) for tax purposes. Previously, there had not been a set of coherent rules, just a mix of Case Law and Extra Statutory Concessions. The old rules led to uncertainty and then current cases demonstrated that reliance could not be placed on published HMRC guidance in this area.

However, the new rules open the possibility that non-residents could now inadvertently trigger UK tax liability whereas under the old “rules” this would not have been the case. If you have recently become an ex-pat and/or make regular trips back to the UK you should be aware of the rules so as not to inadvertently miss filing your Tax Return and incurring a liability. The rules are explained in more detail here.

Chapter Two

Income Tax

There was a 10% "wear and tear allowance", but this has been withdrawn from 6 April 2016.

As noted in the introduction, any income-producing assets in the UK are taxable on the owners to UK income tax. By far the most common scenario is let property, so this section uses this situation as an example. However, the principles apply to all UK income sources.

Income tax is payable on the "profit" from a tenancy. All direct costs used to secure and support the letting, e.g. agents' fees, tenancy agreement fees, repairs and renewals, ground rents, Council taxes etc. are allowable to reduce that taxable profit. Mortgage interest is currently allowable, but the rules are changing. From April 2017 over the next 4 years rules will be changed so that interest will only be allowable at the basic rate of income tax come 2021.

There was a 10% “wear and tear allowance”, but this has been withdrawn from 6 April 2016. Since this date, all landlords (providing furnished or unfurnished accommodation) now have to make a claim under the new renewals basis. To qualify for a revenue deduction, you must have a residential property business and be replacing furniture, furnishings, household appliances and kitchenware that were already in use at this date.

British passport holders, as well as nationals of a whole raft of other countries, are entitled to claim a UK personal allowance, which currently stands at £11,00. Each owner is entitled to claim the allowance, so for a property with 3 owners total personal allowances will amount to £3,000.

However, the personal allowance is for use against all UK income, so profits from other sources are aggregated before deducting the personal allowance to give the net taxable figure.

Basic rate tax in the UK is currently 20% payable on taxable income up to £32,000.

Chapter Three

Inheritance Tax

Inheritance Tax is payable at 40% on amounts above the threshold, so people with sizeable estates should consider planning to mitigate this.

Inheritance Tax is payable by UK-domiciled individuals and on UK property held by non-domiciled individuals. Domicile is a general legal concept. It describes the country that you consider to be your home and is not the same as nationality, citizenship or residence.

Domicile is acquired three ways – domicile of origin (usually your father's domicile when you were born), domicile of dependence (the domicile of your legal guardian until you reach the age of 16) and domicile of choice. For this you have to prove that you have chosen to live in the new country on a permanent basis, and provide strong evidence of your intention to stay there permanently or indefinitely.

For many years, a UK domiciled individual’s estate will owe tax at 40% on anything above the £325,000 inheritance tax threshold when they die – for married couples this figure is £650,000.

However, in the Summer 2015 budget plans were announced to allow parents or grandparents to pass on homes worth up to £1,000,000 to direct descendants – children, step-children and grandchildren. A new “main residence” band will be introduced in 2017 at £100,000, which will increase by £25,000 until 2020 when it will be capped at £175,000. At that point an individual will have £325,000 inheritance tax threshold plus £175,000 “main residence” threshold, creating £500,000 relief per individual or £1,000,000 for a couple.

However, on properties worth £2,000,000 or more, homeowners will lose £1 of the allowance for every £2 of value above £2,000,000 – so, couples with houses worth over £2,350,000 will get no additional allowance.

Inheritance Tax is payable at 40% on amounts above the threshold, so people with sizeable estates should consider planning to mitigate this. See notes on that topic here.

Chapter Four

Capital Gains Tax

Tax is chargeable on individuals at either 18% or 28%.

As noted above, prior to 6 April 2015, non-residents were not subject to Capital Gains Tax in the UK. However, this changed from that date.

CGT is now charged on disposals of UK property by non-residents. The charge relates to Non Resident Capital Gains Tax (NRCGT) gains made by individuals, trustees and closely held non-resident companies and funds that are not widely marketed.

The gain is calculated by taking the sale proceeds, less any selling expenses, and deducting the purchase price plus any acquisition expenses and subsequent capital expenditure.

Any capital gain on properties owned pre 6 April 2015 is not taxed as the "cost" of the property is taken at that date (by valuation or reference to Stamp Duty records).

Tax is chargeable on individuals at either 18% or 28% according to their status as basic or higher rate taxpayers.

Chapter five

Reporting and Compliance

This is important now as some deadlines are approaching fast. For the 2016 tax year, individuals need to register for self-assessment by 5 October, file a paper return by 31 October, file an online return by 31 January 2017 and pay any taxes due by that date.

There is a penalty of £100 if your tax return is up to 3 months late and from this point a daily charge of £10 is added up to a maximum of £900. If the return is 6 months late a further £300 is added (or 5% of the tax owing, whichever is greater) and if the return is 12 months late another £300 is added (or 5% of the tax due, whichever is greater).

It is possible to appeal if is a reasonable excuse, but as can be seen late filing is potentially an expensive business so if in any doubt seek advice. Ignorance of the law is no excuse……

Conclusion

Basic UK tax laws for individuals is not a minefield. There are some fairly straightforward rules to the game and, contrary to popular belief, HMRC does its best to assist taxpayers.

However, you must come with “clean hands” – willfully ignoring or avoiding issues is bad form and will quickly create a less than helpful attitude from HMRC staff.

Contact me neil@justservicehk.com if you have any concerns or questions over the above. I am always happy to talk through clients’ issues on a no obligation basis.