Winter
International Tax
Services

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LOSING YOUR PERSONAL ALLOWANCE?

Historically the UK tax regime has been designed to attract investment into the UK. However in recent years there have been changes (the reduction in reliefs for the non UK domiciled; charges aimed at residential property owners etc.) cutting down the reliefs available. This is quite simply to raise money as the UK Government is still running a deficit.

Latest proposed change

The Government has recently released a consultation paper aimed at taking away the UK personal allowance currently available to many non UK residents against their UK income (rental income for example).

Currently the personal allowance (£10,000, and due to rise to £10,500 from April 2015) is available to anyone in a tax year who is:-

- UK resident
- UK nationals wherever resident
- a national of an EEA member state
- resident in the Isle of Man or Channel Isles
- was previously UK resident but lives abroad for the sake of their own health or that of a family member who lives with them
- a person who is or has been employed in the service of the Crown, or whose late spouse/civil partner was so employed
- a person employed in the service of any territory under the Crown's protection
- a person employed by a missionary society
- nationals (and in some cases residents) of states with which the UK has an appropriate Double Tax Agreement

Why does the UK Government want to change this?

Money is the simple answer, (and one might argue a fairly desperate need if it is looking at a few thousand pounds per individual) though the consultation paper wraps it up in more elaborate language. The stated argument for change is that:-

- the UK has the highest Personal Allowance in the G20, and one of the largest in the OECD and EU
- the UK grants a Personal Allowance to more non residents than many other countries.
- the US, Australia, Canada, and most of the EU restrict their equivalent allowances to non residents
- the UK's system means the UK loses tax revenue to other countries. For example a national of another country works for a very short period in the UK and earns less then £10,000. They pay no UK tax as they claim their Personal Allowance here but pay tax in their home country. By contrast a UK national working elsewhere who cannot claim the equivalent pays tax in the country they are working in and claims credit for that tax paid against their UK tax.

- Many of the countries with which the UK has a Double Tax Agreement give a Personal Allowance equivalent based on residence status not nationality. If the UK were to do the same then this would reduce the number of individuals the UK would have to give the relief to under the Double Tax Agreement.
- The current system gives different outcomes in the same circumstances for different individuals.

What changes is the UK Government considering?

The Government is suggesting an economic connections test. The test would be what percentage of that individual's income is derived from the UK? The threshold could be set at, for example 75% or 90% of income being derived from the UK to be able to qualify for the Personal Allowance.

Who will be affected?

HMRC estimates that at least 400,000 non residents claim a Personal Allowance. They argue that many may be able to claim a credit for the increase in UK tax against tax on that income in the country they are resident in. This may or may not be true. HMRC's view of who will be affected and how is roughly as follows:-

- Employees
  - A small number of individuals earn over £100,000 when they work for short periods in the UK and would see their Personal Allowance reduce and disappear above that level of income.
  - Many more fall in the middle income category. HMRC's argument is that many of these would be able to claim credit in their home country so won't lose out unless they live in a country with a lower tax rate than the UK.
  - Low income individuals who may not pay tax in their home country because their income generally is so low will be real losers from this measure. The Government might consider a de minimis measure but it is hard to see how this would easy to deal with from an administration viewpoint.

- Non residents with UK property income
  - HMRC's view is that many will be able to claim credit in the country they are resident in.

- Pensioners
  - The DWP estimates that there are 1.2 million pensioners who are UK nationals who live outside the UK. In HMRC's view many will not be affected as:-
    - some are still classed as UK resident
    - tax treaty provisions mean pensions are only taxable in the state of residence and not the UK
    - many have no UK income beyond their pension so would not be affected by the loss of the Personal Allowance.
  - However pensioners receiving pensions for Government service may lose out as under many tax treaties these will only be taxable in the UK so the loss of a personal allowance would have a real cash cost for people at a vulnerable time in their life. The Government might seek to include some element of protection here.

- UK employers operating PAYE
  - There would be an increased burden placed on employers in having to clarify the tax residence position of employees. Depending on exactly what employers responsibilities would be this could be particularly burdensome for small and medium sized companies. Even with the new statutory residence rules tax residence status remains a complex area.

Conclusion and next steps

This runs the risk of significantly increasing the complexity of the UK tax system for many individuals for relatively little gain to the Exchequer, especially if there are exclusions for some of the groups referred to above. There is also a fairness argument in that the only economic test suggested by the Government relates to the income level in a given tax year. That doesn't reflect past economic contribution (in the case of pensioners or individuals who may work outside the UK for only a year or two and rent their UK home out while they are gone), or economic contribution in the form of a investment in assets.

The consultation runs until 3 October so if you have any views on this either way then it is important to feed those views back.

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