Taxation of non-residents in the UK: domestic aspects

This article summaries the most relevant income categories realized by non-residents individuals and companies in the UK, providing general rules and compliance aspects

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This article sets down the principles of taxation of non-residents in the UK describing the main categories of income relevant for non-resident individuals and companies assuming a prevalent domestic point of view. We have first introduced the concept of "trading in the UK": since a trade in the UK is the pre-requisite for any tax charge, it is relevant to understand in depth such concept, which being not provided by law, shall be shaped by reference mainly to law cases. We have analysed in detail also some practical consequences of "trading in the UK" concept, for instance in relation to non-resident partners and investment manager exemption regime. After having outlined the main tax aspects of investment income, the article eventually deals with capital gain taxation with specific reference to disposal of real estate and "rich properties" company`s shares.

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I. General principles on taxation of non-residents

Non-residents taxation is based on domestic rules and on international provisions contained in double tax treaties. The focus of this article would be on domestic laws and practices. There are four main categories of income[1] that non-residents may be taxed on:

a) Profits of a trade or profession which is not carried out wholly outside the UK;
b) Earned income on UK pensions and employments where duties are carried out in the UK (Income Tax Earnings and Pensions Act [ITEPA] 2003, s. 27);
c) Investment income (Income Tax Act [ITA] 2007, s. 811);
d) Income deriving from real estate activities and assets (rents and capital gains).

While categories *sub* b), c) and d) are subject to a set of statutory rules quite well-defined, it is complex to determine whether a trade or profession – concepts barely defined in the legislation – is carried out in the UK, being the area rich in law cases and different nuances and perspectives.

It is of paramount importance to understand, for those not accustomed to deal with UK tax laws, two basic principles: firstly, that there is no charge to UK tax if there is no trade therein (ITTOIA05/S6(2) and secondly that the concept of trade may be not necessarily linked to the existence of a permanent establishment[2].

For procedural and compliance purposes, it is worth summarizing the decisional process in a four basic questions steps as follows: *(i)* there is a charge under domestic legislation on the activities?; *(ii)* if yes, if the non-resident is a resident of a state with which the UK has a double taxation agreement, such a treaty restricts the domestic charge?; *(iii)* how much

[1] For more general overview, please see HMRC, Self-Assessment, SALF700 – Self Assessment for non-residents and Anne Fairpo/David Salter, Revenue Law: Principles and Practice, II Taxation of the non-resident taxpayer, November 2021.

[2] HMRC, International Manual, INTM262200: Trading in the UK. For understanding the complexity of the issue, please refer for instance to Judy Harrison and Chris Bates, Samarkand: a question of trading, in: Tax Journal, November 2011.

are the chargeable profits that can be taxed in the UK?; *(iv)* having established that there is a domestic charge and having taken account of the effects of the relevant treaty, how do we assess and collect any tax that is due?

II. Trading in the UK

Carrying out a trade in the UK is the prerequisite for a UK charge (ITTOIA05/S6(2). There is very little guidance on the meaning of the concept of "trade" in legislation.

ITA 2007, s. 989 and Corporation Tax Act (CTA) 2010, s. 1119 say that trade includes any "*venture in the nature of trade*"**[3]**. As a result, guidance shall be found at a vast number of law cases, to which also HMRC is inspiring on.

In this article, we would try to summarize, privileging an international business perspective, which are the "badges" for considering a non-resident trading in the UK.

For determining trading, please find below some basic non-exhaustive points**[4]**:

- The isolated activity of buying goods in the UK does not necessarily amount to trading in the UK;
- The place where contracts are regularly made still represents strong evidence of trading in the UK (but, also on the grounds of new global business environment, that fact is becoming less and less decisive);
- Identifying the profit-making activities and where performed may be a decisive factor, even if the formal conclusion of a contract takes place abroad;
- The place of contract is the same as the buyer's location when he receives the seller's acceptance. The place of contract will therefore be obvious where a transaction is agreed between the seller and buyer in person: in all other forms of communication (for example by email), the same principle apply and the location of the buyer when he receives the acceptance from the seller is the place of contract but in some cases, it may be very difficult to ascertain such condition;
- Making of a contract depends upon the surrounding facts and circumstances, including the usual conduct of a trade;
- In e-commerce transactions, it is often difficult to evaluate where the contract is executed, even if usually it is considered crystallized the offer when the customer makes a payment and or when the order confirmation is sent out;
- The better test is whether the trading operations giving rise to the profits take place in the UK: "*there is no exhaustive test of what constitutes trading in the United Kingdom by a non-resident and that regard must be had to the whole of the circumstances in order to see where the operations take place from which the profits in substance arise*"**[5]**.

The place of contract is a very important element but never to be considered decisive while trading operations test appears to be deemed more comprehensive (in some effects, such last test seems to include and embrace indirectly also the place of contract test).

As a general rule, all facts and circumstances shall be object of analysis and in this sense, rules affecting a branch and or a permanent establishment may be of great assistance in order to ascertain the conditions upon which a trade in the UK may exist from a tax point of view. In other words, a trade in the UK would be possible theoretically without the existence of a branch, agency or permanent establishment, but the existence of a branch, agency or permanent establishment may be a decisive factor to ascertain that a trade in the UK exists and links a profit from a possible UK trade to a non-resident taxpayer**[6]**.

Once having established that there is a trade in the UK and therefore a possible UK charge, one shall investigate how such trade shall trigger UK taxation.

For non-resident companies, being trading in the UK, the existence of a permanent establishment can be the condition upon which there is a UK charge and for determining how much the profits of a non-resident company measured on an arm's length basis are to be taxed in the UK.

For assessment and collection purposes, a non-resident trading in the UK may be taxed through branch or agency for income tax, while in case of non-resident companies, through permanent establishment.

Agency and permanent establishment (and their individual representative) may be considered as "UK representative" for the non-resident for tax purposes. The UK representative has a personal responsibility for all matters relating to the assessment of tax and to the collection and recovery of tax (so called "machinery provisions"**[7]**) (for more details see below).

A. Branch, agency and permanent establishment

CTA 2009, s. 5 and 19 introduce the concept of permanent establishment (PE) for non-resident corporate taxpayers: the definition and content rules of domestic permanent establishment are very similar to those contained in double tax treaties and related OECD commentaries.

The new concept of permanent establishment generally substitutes and absorbs that one of branch or agency, even if all reference made by courts to branch or agency may be considered still valid as for domestic PE purposes.

In addition to that, the concept of branch or agency still maintains in some degree its autonomous role for income tax

[3] For the definition of trade, including a vast reference to law cases, please refer to HMRC, Business Income Manual, BIM20050 and Direct Tax Report, 293-500.

[4] For more details see HMRC, International Manual, INTM263000.

[5] Firestone Tyre and Rubber Co Ltd v Lewellin (1957).

[6] For instance, a business carried out by a resident, as a partnership, may not constitute of a UK trade.

[7] For more details, please refer to HMRC, International Manual, INTM268000.

purposes. In fact, while for corporation tax purposes, FA2003 has set off the PE concept over branch/agency (for which basically a non-resident company can in general terms trade in the UK only and to the extent through a PE), branch and agency are still valid criteria to determine a trade in the UK for corporate without a PE or for an individual and indeed, for the purpose of determining profits.

Whether a person is trading in the UK through a branch or agency is a question of fact, but the distinction has to be made between trading with the UK and trading in the UK: soliciting orders in the UK will not by itself constitute trading in the UK.

Representatives and independent agent do not create a permanent establishment: whether an agent or representative is of independent status shall be tested by reference to all legal, financial and commercial circumstances of the business relationship between the agent and the non-resident.

Usually, factors to be taken into consideration are as follows:

a) The extent of the obligations;
b) Whether the agent is subject to detailed instructions of comprehensive control;
c) Whether the agent bears the entrepreneurial risks for the business;
d) The degree of reliance on the agent's special skill and knowledge;
e) The degree of approval requested for conducting business.

B. Partnerships and non-resident partners

Partnership taxation is a quite complex area[8]: here I would focus on non-resident partners. A partnership with non-resident partners is taxed if and to the extent that its income arises from a trade in the UK. Therefore, in such a case, a non-resident partner is required to file a tax return on their pro-quota apportioned income.

Trading in the UK is a prerequisite to the existence of a UK charge: it results that where all partners are non-resident, a partnership shall report in its tax return only the profits arising from UK trades. However, should all partners be non-resident and partnership business be considered a UK trade, all partners are required to file a tax return.

In case of "mixed" partnership, compliance issues arise when such partnership accrues profits of UK and non-UK sources: in such a last case, the partnership shall file 2 different tax returns, the first one to report its worldwide (UK and non-UK) profits for resident partners, and the second to report only UK profits for non-resident partners.

Should the mixed partnership be managed and controlled "outside" the UK, the partnership shall report only UK sourced profits both for resident and non-resident partners[9].

C. Compliance requirements

As a rule, under the self-assessment mechanism, taxpayer is fully responsible for its own tax filing and payment of related taxes. However, in case of non-residents, there are several cases where a resident may be requested (and therefore be responsible) for non-residents tax obligations.

FA1995 for income tax and FA2003 for corporation tax contained the rules relating to non-residents and their UK representatives tax obligations. These rules set off who is liable to UK tax, who is responsible for complying with the tax obligations and the nature and extent of those obligations[10].

The obligations of UK representatives for non-resident individuals are broadly equivalent with those for non-resident companies, being such rules applicable to all non-residents.

Under "UK representative" rules, a UK representative may be the UK branch or agency for income tax purposes, the permanent establishment for corporation tax purposes and in all other cases directly the non-resident[11].

The general rule is that UK representatives are jointly responsible with the non-resident for all their tax obligations and liabilities. This joint responsibility extends to all matters relating to the assessment of tax and to the collection and recovery of tax.

D. Investment manager exemption

There are specific cases where the general rules pertaining to trading in the UK are disallowed. One of the most interesting case is the Investment Manager Exemption (IME), a set of rules specifically aimed at creating a favourable business environment and legal framework for international financial investment firms and activities[12].

While an international offshore fund is used as investment instrument and or a non-resident investment manager

[8] For more information on partnerships taxation please see Gabriele Schiavone, UK Partnerships: a non-resident entrepreneur perspective. A tax summary, 9 February 2021, on: www.sgs-partners.com (accessed on 2nd December 2022).

[9] In such a last case, special attention shall be paid to the role of resident partner: playing the resident partner a material role in managing the partnership (for example because he is the only bank signatory and sign the most important contracts, while all meetings have been held in the UK), overseas profits may be attributed to UK resident partners.

[10] Even if there are some slight differences between income tax and corporation tax obligations, for the purposes of the present article, we treat the two areas under the same description.

[11] In some cases, a UK representative may be also a resident: for example, in case of partnership, there can be situations where a resident partner may be considered as fiscal representative for a non-resident partner.

[12] For more details please see, inter alia, HMRC, Statement of Practice 1 (2011): treatment of Investment Managers and their overseas clients (updated on 3rd November 2016) and HMRC, International Manual, INTM269000. The main goal of this special legislation is to allow non-residents to appoint a UK investment manager, without being taxed in the UK, in such a way that profits realized by the investors would be taxed only in their residence countries while remuneration arising from the investment activities would be properly apportioned to resident and non-resident managers.

are involved in its management, it may happen that a UK investment manager or advisor activities may integrate a trade in the UK and may be seen as a UK representative, triggering potential tax liabilities in the UK for non-resident.

At certain conditions, UK representative and the fund are not subject to UK tax, despite the presence, the role and the involvement of the resident investment manager, safeguarding tax and corporate features of offshore fund and preserving tax neutrality for investors.

IME applies in relation to investment transactions carried out by the investment manager on behalf of the non-resident if the investment manager meets certain tests.

The tests are the following:

a) the UK investment manager is in the business of providing investment management services;
b) the transactions are carried out in the ordinary course of that business;
c) the investment manager acts in relation to the transactions in an independent capacity;
d) the requirements of the 20% test are met and
e) the investment manager receives remuneration for provision of the services at not less than the rate that is customary for such business.

It is worth providing some more details of the "independence test". In other terms, the relationship between the UK manager and the non-resident, having regard to its legal, financial and commercial characteristics, shall be carried out on arm's length terms.

Interestingly, according to HMRC, a subsidiary may be considered independent of its parent company for the purposes of the test, irrespective of shareholders structure of the non-resident and therefore even if the UK controls the subsidiary.

There are some circumstances where, in addition to what stated above, the non-resident shall be considered as independent: for example, when the-resident is a widely held collective fund or when less than 70% of the UK resident investment business arise from activities with the non-resident.

For 20% test, it is required that the UK investment manager and persons connected with it, must not have a beneficial entitlement to more than 20% of the non-resident's chargeable profit arising from transactions carried out through the same investment manager.

III. Employment income and artists/sportsmen remunerations

A foreign resident taxpayer is chargeable to UK tax on emoluments he receives for duties performed in the UK. If from a pure tax perspective, it would be possible that a UK company may have a non-resident employee, immigration laws following Brexit has de facto established that for being employee in the UK, a person shall be therein resident after having obtained a visa**[13]**.

For entertainers and sportsmen, it has been established that the payer of fees to a non-resident in connection with a relevant activity performed in the UK, shall withhold an amount of taxes corresponding to the first rate of income tax, based on grossing up of the actual worth of what has been paid or transferred**[14]**.

Being subject to a withholding tax in the UK, it does not mean that the non-resident has complied with all domestic laws. In fact, if there is a withholding tax, it means that some activities have been performed in the UK: if some activities have been performed in the UK there is a trade, and when there is a trade, there is a charge (being compulsory, *inter alia*, to file a self-assessment return if all other conditions are met).

IV. Investment income and outbound payments

A. Dividends

According to ITTOIA 2005, s. 399 (as amended by Finance Act [FA] 2016), non-resident individuals are now treated as receiving dividend income on the basis that tax at the dividend ordinary rate has been paid and thus they have no further UK tax liability (and therefore the payer has no obligation to apply any withholding taxes, irrespective of the residence of the receiver).

B. Interests

Interests paid to non-residents are subject to a withholding tax of 20%. There are a number of exceptions to such a rule and in addition such deduction is not due should an applicable tax treaty be in charge**[15]**.

C. Royalties

There is an obligation to deduct income tax at source (in a rate equal to 20%) from payments to a non-UK resident person in respect of royalties and other income from intellectual property as set out in ITA 2007, ss 899–909. Where an applicable double tax treaty is in place such deduction may be reduced or not be applied at all.

The government introduced legislation in FA 2019 that extends the types of income on which non-UK residents are liable to UK income tax, known as "*offshore receipts in respect of intangible property*" (ORIP). This legislation, entered on April 2019, imposes income tax on amounts received by persons resident in low tax jurisdictions for intangible property where those amounts may be referrable to the sale of goods or services in the UK. Income tax, charged at the basic rate, is

[13] It is important therefore to note that an employee commuter may not be subject to tax for working duties performed in the UK if he is not resident in the UK and for being resident in the UK, after Brexit you shall enter into the UK with some type of visa. However, it is still possible, once entered in the UK, and spending a part of its working duties abroad, to ask for a partial reduction of taxation at the hands of the employer.

[14] See ITA 2007, s. 966 and Income Tax (Entertainers and Sportsmen) Regulations 1987 (SI 1987/530).

[15] For more details, please refer in this review to Gabriele Schiavone, Tax aspects of UK debt financing, November 2020.

imposed on the full amounts of UK-derived income arising in a tax year and charged on the person receiving or entitled to those amounts.

V. Rental income

Profits from letting property in the UK are subject to income tax at marginal rates**[16]**.

For rental income, save for an agreement reached with HMRC, the rental income shall be paid net of income tax (at basic rate) should the landlord be a non-resident and or be a person whose usual place of abode is outside the UK.

For assessment purposes, the tax deduct at source is not representing in most of the cases the definitive liability. The non-resident landlord shall in fact file a self-assessment return, where rental income – net of expenses – is reported and where tax deduct by tenant and or an agent may be recovered against total income tax.

As from 2020, non-resident corporate subjects are liable to corporation tax (instead to income tax).

VI. Capital gain taxation

Non-residents are taxed on disposal of assets only in determined cases set down in Taxation of Chargeable Gains Act (TCGA) 1A, 1B, 1C and 1D for individuals and in 2B for companies.

Therefore, save for several cases, a non-resident is not liable to Capital Gain Tax (CGT)**[17]**. The cases where a non-resident is liable to CGT are as follows:

- Disposals realized by through or in connection with a branch, an agency and or a permanent establishment**[18]**;
- Direct and indirect disposals of interests in the UK land;
- Disposals by a non-resident "close" company;
- Ceasing to be within CGT scope.

While disposal of interests in the UK properties would be treated in details in the next chapter, for the other cases it is worth to draw some very brief lines.

Annual Tax on Enveloped Dwellings (ATED) related Capital Gains Tax is payable mainly by companies that own UK residential property valued at more than £ 500,000. ATED related Capital Gain Tax is applicable up to 5 April 2019: since such a date, all gains realized by non-resident companies are liable to Corporation tax and therefore they need to be reported in a CT self-assessment and taxed at ordinary rate (19%)**[19]**.

Special rules of anti-avoidance nature apply to some chargeable gains to a company not resident in the UK and being considered "close" (as if it were resident in the UK). Such provisions aimed at triggering CGT to UK resident participator in a non-resident company where from one hand the resident participator has at least a 25% of shareholding (direct or indirect) and from the other hand the accruing gains are connected to an avoidance scheme and are not connected to a (genuine) foreign trade or other non-UK activities. In this regard, due to several new laws introduced as from 2013, UK resident participators rules set down in CGTA 3A are of limited application since most of circumstances where they may be applied are indeed covered by other special rules (for example the indirect disposal of UK land provisions).

Eventually, there can be a CGT charge in case of UK "exit": a UK "exit" charge is applicable in a number of occasions, for example when a company becomes non-resident or when a non-resident trader ceases to trade in the UK (and where a deemed disposal of assets is figured out)**[20]**.

A. Disposal of UK land and properties

Non-residents are liable to capital gai tax and corporation tax on any direct and indirect disposals of an interest in the UK land. An interest is defined as an estate, right to power in or over UK land and any benefit deriving from any obligation, restriction or other condition affecting a property**[21]**.

The charge to non-residents is extended also to indirect disposals, *i.e.* disposal of assets that derives at least 75% of their value from UK land. Such rules apply to disposals of assets consisting of a right or interest in a company, wherever resident, that meet two basic conditions: *(i)* the asset derives its value at least 75% from UK land: *(ii)* the person disposing such asset has a "substantial indirect interest" in the land (25%)**[22]**.

As far as condition a) above, one shall note that value shall be determined at market value, the 75% test shall be calculated considering all assets (and therefore through a coherent tracing process) being not relevant finance liabilities, the main exemption is where the assets are used for trading purposes (with a cap fixed at 10% for non-trading purposes).

For double tax conventions point of view, UK double tax conventions follow OECD model standards and therefore

[16] For more information, please see in this review Gabriele Schiavone, Investing in the UK real estate: tax aspects and planning considerations, nr. 4/2022.

[17] As a consequence, a sale of shares in a UK company is not generally within CGT scope of application, irrespective of the status and the residence of the seller, being irrelevant de facto any double tax convention reliefs.

[18] While the general rule is quite simple to understand, practical cases may be quite complex (see for example Puddu v Doleman [HMIT] [1995] Sp C 38). It is worth outlining that such cases may be quite extended on the grounds that branch or agency are UK concepts which in some circumstances may differ from the international notion of "personal" permanent establishment and often their scope of application is more extensive.

[19] For more information, please see in this review Schiavone (note 16).

[20] A detailed analysis of "exit" charges is out of scope of the present article.

[21] Basically, an interest in the UK land has a very large meaning; the main exemptions are rights for securing the payment of money or other obligation and licenses to use or occupy land. For example, freehold and leasehold are interest in a UK land but not the right to a tenant in a property he is renting.

[22] For more details please refer, *inter alia*, to HMRC, Guidance HS307 Non-resident Capital Gains on direct and indirect disposals of interest in UK land and property (2022) and to HMRC, Capital Gains Manual, CG73930P.

indirect disposal in rich properties company are usually within the scope of domestic provisions since most UK double tax conventions provide that capital gains realized on the disposal of shares or rights in these companies are taxed also in the UK.

There are some significant exemptions that are under review and object of re-negotiation: for example, Luxembourg/UK double tax treaty contains a capital gain clause assigning all tax powers to the country where the seller is resident. Such convention is under reviewing and as from 2023, it would to be amended as to including in the scope of application of indirect disposal domestic provisions also capital gain realized by a foreign entity when disposing of a rich properties company**[23]**.

B. Non-resident capital gain tax and compliance aspects

Computational rules (TCGA1992\Sch4AA) apply to non-resident both for direct and indirect disposals. As from 6 April 2019, computational regime is the same, irrespective if the non-resident is an individual or a company.

For administration and compliance purposes, the relevant provisions set down in TCGA 1992 Sch. 2, deal with both resident and non-resident taxpayers.

For compliance purposes, resident and non-resident taxpayers shall file a specific tax return for declaring (and paying) their CGT.

Companies shall file a Corporation tax return: in this regard, a non-resident company shall open a UK tax position receiving a unique tax number, if not already requested. It is not compulsory to appoint a tax representative while, in many cases, it would be advisable to appoint a UK tax agent in order that the latter may on behalf of the non-resident taxpayer file the related tax return and represent it in front of HMRC.

For all other taxpayers, it is compulsory to submit a non-resident Capital Gains (NRGCT) tax return where reporting the relevant transactions and your non-resident Capital Gains Tax.

As from 6 April 2020, the charge to NRCGT is due on several transactions, including sale and or disposal of residential, non-residential and mixed-use UK properties and rights to assets that derive at least 75% of their value from UK land (indirect disposals).

From 27 October 2021, reporting and payment of NRCGT is due within 60 days of completion of conveyance. It is interesting to note that NRCGT report shall be filed also when no capital gain is realized (or a loss is accrued) and when the same taxpayer is requested to file a self-assessment return. Penalties and interests are due when report and payment are done not in time.

[23] For more information, please see Emily Clark, Jonathan Woodall, New UK/Luxembourg double tax treaty, in Tax Journal, 22 June 2023.