Restricting non-residents' entitlement to the UK personal allowance

Updated 4 August 2014

1. Introduction

At Budget 2014 the government announced it would consult on whether entitlement to the UK Personal Allowance should be restricted for non-residents and how this might be done. This consultation will be used to help the government understand the impacts and feasibility of any change and to make a balanced decision as to the desirability of a policy change.

Increasing the Personal Allowance has been a key government priority since 2010. It has been increased by more than 60 per cent over this Parliament. It is currently set at £10,000 and is due to rise to £10,500 from April 2015. The government wants a tax system that is simple to understand and administer. It is also committed to ensuring that everybody benefitting from the UK's economic and social environment pays a fair amount of tax in the UK.

Most countries allow individuals the benefit of a certain level of income before tax is charged. In a significant and growing number of countries, including most of the EU, Australia, Canada and the United States, this benefit is restricted so that it is principally available only to individuals who are resident for tax purposes. In the UK, with some exceptions , non-residents with taxable income arising from the UK currently benefit from the UK's generous Personal Allowance.

This consultation explores whether the UK should also take steps to restrict non-residents' entitlement to the Personal Allowance; the options for doing so and the impacts it would have.

The high level objectives for this consultation exercise, and any policy going forward, are given below in Box a.

Box a: High level principles

- fairness: the effect of the UK Personal Allowance must be fair for all UK taxpayers and the Exchequer
- simplicity: any change must be as simple as possible for those people and businesses who would be affected to understand and implement

- competitiveness: any restriction to the UK Personal Allowance must not undermine the competitiveness of the UK as an international destination for work and investment

Chapter 2 of this consultation sets out the current rules for how non-residents are entitled to the UK Personal Allowance.

Chapter 3 explores the case for restricting the entitlement of non-residents to the UK Personal Allowance. This includes comparing the UK to other jurisdictions, looking at the UK tax benefit that individuals with limited economic ties to the UK can secure and explores the different tax outcomes that can result from the same economic activity.

Chapter 4 provides a summary of how other countries operate a restriction on non-residents' entitlement to equivalents to the UK Personal Allowance.

Chapter 5 asks for views on a possible model for restricting entitlement to the UK Personal Allowance for non-residents.

Chapter 6 sets out the government's initial assessment of the impact of any change in entitlement on individuals and businesses. Given the complexity of international tax provisions, it breaks this down by different types of taxpayer and different forms of taxable income.

This consultation is at stage 1 of the government's Tax Policy Consultation Framework (setting out objectives and identifying options). Officials will work with interested parties and stakeholder groups over the course of this consultation to discuss the issues and inform the government's view on the options available.

The government welcomes stakeholder views on the questions raised in this document.

To respond to the consultation questions, please send comments to nonresidentspersonalallowanceconsultation@hmtreasury.gsi.gov.uk or write to:

Specialist Personal Tax consultation
HM Treasury
1 Horse Guards Road
London SW1A 2HQ

Please send comments in response to the consultation questions by 9 October, accompanied by evidence to support your answers.

2. Who is entitled to the UK Personal Allowance?

This section of the consultation sets out the current rules on how non-residents are entitled to the UK Personal Allowance. It starts by briefly setting out the principles of residence and domicile in the UK tax system and goes on to discuss the two routes to entitlement to the UK Personal Allowance. 2. Under the current rules, a broad group of individuals, residents and non-residents, are entitled to the UK Personal Allowance which they may make a claim for or receive automatically in their tax code.

There are two routes to entitlement:

- UK domestic statute
- the interaction of this statute with the UK's tax treaties

2.1 Residence and Domicile

Tax residence is the most direct indication of a person's connection to a jurisdiction and hence is the principal means of assigning taxing rights between countries in a particular year. Tax residence in the UK is determined by the UK's Statutory Residence Test (SRT) which uses a selection of tests to decide if individuals are resident or non-resident in the UK. This consultation does not consider the SRT.

Domicile is a concept of general law and reflects a person's long term home and connections. It is quite separate from a person's residence status. Where someone is domiciled can affect the way that someone pays tax in the UK. UK resident non-domiciles can elect to pay income tax on the remittance basis rather than the arising basis. This consultation does not concern domicile in relation to taxation or the remittance basis.

2.2 Current statute and the Personal Allowance

UK Personal Allowances provide an amount of income free from Income Tax. UK domestic law (Section 56 Income Tax Act 2007) provides an Income Tax Personal Allowance to an individual who is UK Resident, or where the individual, at any time in the tax year:

- is a national of a European Economic Area state
- is resident in the Isle of Man or Channel Islands
- has previously resided in the UK but lives abroad for the sake of their own health or that of a member of their family who is resident with them

- is a person who is or has been employed in the service of the Crown
- is employed in the service of any territory under Her Majesty's protection
- is employed in the service of a missionary society
- is a person whose late spouse/civil partner was employed in the service of the Crown

This list reflects changes to eligibility conditions over 10 years, which have expanded entitlement. Although most non-residents have no UK income, there are a significant number who do use their UK Personal Allowance to set against income from the UK, either by virtue of UK domestic law or as a consequence of the interaction of this with the UK's tax treaties. HMRC estimate that this costs the UK exchequer approximately £400m a year.

2.3 Tax Treaties

Most tax treaties between the UK and other states extend entitlement to UK Personal Allowances to nationals of those states who are not entitled to claim a UK Personal Allowance under UK domestic statute. This is because of the interaction between the UK domestic statute and the UK's obligations under the non-discrimination articles in those tax treaties.

Current UK statute provides that UK nationals are entitled to UK Personal Allowances wherever they are resident. The non-discrimination provisions found in most UK tax treaties extend the entitlement to UK Personal Allowances to nationals of the treaty partner state who are also resident there. Some of the UK's tax treaties also expressly provide that UK Personal Allowances will be granted to residents of the partner state regardless of nationality, or nationals of the partner state wherever they are resident.

Tax treaties allocate taxing rights between the state of source and the state of residence to avoid individuals and other persons facing double taxation. Depending on the nature of the income, double taxation is avoided either by conferring upon a state an exclusive right to tax or providing that both states can tax, but that the state of residence must relieve the tax levied in the state of source. Where an exclusive right to tax income is conferred upon one of the states, this is generally on the state of residence. Where the UK retains a taxing right over the income of non-residents under a tax treaty, such as income from UK property or certain employments exercised in the UK, non-residents entitled to a UK

personal allowance may currently set it against these forms of income. It is therefore these non-residents who would be impacted by any restriction on non-residents' entitlement to the UK personal allowance.

The UK's tax treaties do not all entitle overseas residents to a UK Personal Allowance. Some, such as that with the United States, do not contain a non-discrimination article of this sort or specifically exclude entitlement to Personal Allowances from the non-discrimination article. Also, whilst the UK's network of tax treaties is one of the most extensive in the world, it does not have a tax treaty with every country, for example there is currently no UK-Brazil tax treaty.

3. Rationale for Change

This chapter examines the case for change to the current entitlement of non-residents to the UK Personal Allowance. The government has compared the UK to other jurisdictions, set out the UK tax benefit that individuals with limited economic ties to the UK can secure and explored the different tax outcomes that can result from the same economic activity.

3.1 Most other countries restrict entitlement

Most countries have a Personal Allowance or equivalent in their income tax system. However, few are as generous as the UK which has the highest personal allowance in the G20 and one of the largest in the OECD and the EU.

The UK grants a Personal Allowance to more non-residents than many other tax jurisdictions. Many other countries, including the US, Australia, Canada and most of the EU, restrict non-residents' entitlement to their equivalents to the UK Personal Allowance. The ways and extent to which other countries implement a restriction for non-residents are discussed in chapter 4.

The difference between the UK tax system and our comparator countries means that where the UK entitles a non-resident to the UK Personal Allowance they may have a more generous tax outcome than a comparable individual would receive in those other countries. The examples below illustrate this further.

Jan is an EEA national who is not resident in the UK but is engaged in temporary employment in the UK for a UK employer. Jan is eligible for a full UK Personal Allowance. As his earnings from that employment are below £10,000, Jan's liability to UK income tax is nil. Jan is also liable to

tax on his UK employment income in the country in which he is tax resident and pays any liability he has on these earnings to the tax authority of that country.

In contrast Niki, who is resident in the UK, is similarly engaged in temporary employment overseas for an overseas employer. As a non-resident in the country in which she works, Niki is not eligible to receive that country's basic tax deduction. Niki is therefore taxed on the full amount of her overseas income in that country. Niki is also liable to UK tax on this income, and depending on the amount of her total income and the extent to which it exceeds the UK Personal Allowance, this liability will be reduced or eliminated by Niki claiming a credit for the tax she has paid overseas.

In the examples above, double taxation relief means that the individuals' total tax liabilities across jurisdictions will be broadly the same whatever their entitlements to the UK Personal Allowance or equivalents. However, as shown above, the current UK system of allowing most non-residents to claim a UK Personal Allowance results in the UK is collecting less tax on the income of non-residents than a comparable jurisdiction, which restricted non-residents entitlement to the Personal Allowance, would.

3.2 Link between economic activity and taxation

Based on the data available to the government, it understands that most non-residents receive only a small portion of their income in the UK and most non-residents will typically only be liable to UK tax on that portion of their income arising in the UK. Whilst non-residents are generally subject to taxation on their global income (including their UK income) in their country of residence, their UK tax liability often does not reflect the extent of their economic link to the UK.

Michael, an overseas resident and EEA national, is an engineer based overseas where he works for an overseas manufacturer. He also occasionally works at an office that his employer has in the UK. His annual salary is £100,000 of which £10,000 relates to duties performed in the UK which is taxable in the UK. Although Michael will pay overseas tax in full on his earnings, he receives a full UK Personal Allowance and so pays no UK income tax – despite 10 per cent of his earnings relating to his UK work.

Whilst it may not affect the overall amount of tax that Michael pays in total, for non-UK residents like Michael the division of taxation between countries will often not reflect the way that the income actually arises in

those different countries. In cases like Michael's, the tax paid in the UK does not reflect the proportion of an individuals' income liable to UK tax. Non-residents like Michael can face little or no UK tax on the small proportion of their income that is liable to UK tax. This situation is obviously more significant now that that the UK has the highest Personal Allowance in the G20.

In most of the UK's comparator countries there is no entitlement to an equivalent to the UK Personal Allowance based on nationality. Entitlement is generally based on tax residence or another measure of economic connection to the country. Removing the connection between nationality and entitlement to the UK Personal Allowance would remove the obligation of the UK under the non-discrimination provisions of many of its tax treaties to grant Personal Allowances to resident-nationals of its treaty partners.

Most of the UK's comparator countries already prevent non-residents from claiming an equivalent to the UK Personal Allowance. In such cases individuals are generally liable to taxation on their income arising in those countries, and receive a credit in their country of residence.

Sam is a UK national, resident in the UK earning £100,000. She sometimes works in an office of her company overseas. £10,000 of her income is chargeable to tax overseas in a country where she is not entitled to an equivalent to the UK Personal Allowance. Sam pays full tax in the overseas country on her £10,000 of overseas earnings. She is also liable for worldwide taxation on her income in the UK and receives a credit against UK tax for the amount of tax paid overseas.

As these examples demonstrate, the current UK rules on the Personal Allowance can, in certain cases, mean that there is little correlation between economic activity in the UK and a tax liability in the UK.

3.3 Different outcomes in similar circumstances

The current rules can create scenarios where individuals in similar situations are treated differently for tax purposes in the UK.

One of the government's aims is for the UK tax system to deliver similar outcomes for individuals in similar positions. The current entitlement to the Personal Allowance on the basis of EEA nationality does not apply equally to all the UK's non-resident taxpayers and takes no regard of their connection to the UK. The examples below illustrate the where current situation means that similar outcomes can result from different circumstances:

Lucia, a UK national born overseas who has never lived in the UK, is resident in an overseas country where she derives her primary income from employment. Lucia receives some income from a property she inherited in the UK. As a UK national, Lucia is entitled to set the full UK Personal Allowance against this income and so receives the rental payments free of UK tax if they are less than £10,000 per year.

Hugo is a non-UK but EEA national and has always been resident overseas but has a portion of his income from earnings in the UK which constitute UK taxable income. As an EEA national, Hugo is entitled to the UK Personal Allowance and is able to set the UK Personal Allowance against his UK earnings.

As previously mentioned, entitlement to a UK Personal Allowance on the basis of nationality also extends UK Personal Allowances to resident-nationals of many, but not all, of the UK's tax treaty partners. This increases the number of non-residents entitled to a UK Personal Allowance, and the number of people for whom the rules result in different outcomes from similar circumstances:

Charlotte is a non-EEA national who frequently visits the UK and derives her primary income from UK investments and property but remains resident overseas. Charlotte is not entitled to the UK Personal Allowance by virtue of the tax treaty between the UK and her country of residence, and her UK income is taxed without the deduction of the full UK Personal Allowance.

Jenny is a non-EEA national who, like Charlotte, frequently visits the UK and derives her primary income from the UK but remains resident at in her home country overseas. Jenny does not live in the same country as Charlotte however. As a result of non-discrimination article of the relevant treaty with Jenny's country of residence she is entitled to the same UK Personal Allowance as a UK national resident in that country. Jenny's UK income is therefore taxed after deduction of the full UK Personal Allowance.

The current system has the advantage of familiarity and for many UK non-residents presents an internationally competitive tax offering. However there is a case for arguing that, as these examples demonstrate, the UK's current provisions for entitlement to the UK Personal Allowance could be more equitable and straightforward.

4. International comparisons

This chapter provides a summary of how other countries restrict the entitlement of non-residents' to equivalents of the Personal Allowance.

There are broadly five approaches to restricting such allowances. These are briefly explored below. Summaries of key comparator countries' restrictions on equivalents to the UK Personal Allowance are included at annex A.

4.1 A test to determine extent of tie to that country

Many countries, particularly Member States of the EU, incorporate a test into their tax legislation to distinguish which non-residents should retain entitlement to equivalents to the UK Personal Allowance.

European law considers that residence can be a proxy for nationality, and that in some situations discrimination on the grounds of residence can be a form of disguised discrimination. European law does not however require that non-residents receive the same tax treatment as residents. The European Court of Justice has held on a number of occasions that Member States granting tax-advantages to residents is not, as a rule, discriminatory, having regard to the objective differences between the situations of residents and non-residents.

However, the Court has found that there can be discrimination between residents and non-residents if, notwithstanding their residence in different Member States, taxpayers are in a comparable situation.

A common example of where a non-resident is in a comparable situation to a resident is where that individual's main source of income is from employment which they undertake in a different state to their state of residence. Other situations include an individual whose income is dependent upon property which is not in their country of residence or some situations where the individual has a very low worldwide income.

Within this legal framework twenty EU Member States, including Denmark and Germany, have a form of restriction on non-residents' entitlement to tax free income based upon a test, this is also used outside the EU in Canada. There are a number of tests used. Some are linked to an individual having a home in the country (the UK already incorporates a similar provision in its Statutory Residence Test). The most widely used test compares non-residents to residents on the basis of where the overwhelming portion of their income is located.

The most common way to test which non-resident individuals are in comparable situations to residents is to consider the percentage of the individual's worldwide income which arises in that country. This can be considered to measure economic connection to a country as an alternative to tax residence. The value of this percentage in other countries is almost always either 75 or 90 per cent of an individual's worldwide income. Those non-residents with more than the given percentage (75 or 90 per cent) of their income in a country 'pass' the test and are eligible for an equivalent of the UK Personal Allowance.

The Government consider this approach to be the most effective, linking entitlement to economic connection to the UK and to balance simplicity and fairness. However, the alternatives used elsewhere are also explored below.

4.2 Minimum effective rate

A small number of countries, including France, levy a minimum effective rate of tax on non-residents. For example, although a non-resident is theoretically taxed on income in the same way as a resident, statute dictates that the effective rate of taxation may not be less than, for example, 20 per cent, despite reliefs and allowances etc. This is generally accompanied by a provision that a taxpayer can pay less tax if they declare their worldwide income and prove that the overall rate of income tax on that income would be lower than 20 per cent.

A system with a minimum effective tax rate will ensure that all non-residents pay a minimum level of tax in the countries in which their income arises. This applies unless a non-resident individual is willing to declare their worldwide income for comparison and it helps to ensure governments receive comprehensive and reliable information on non-residents and that all non-residents contribute at least some tax.

Such a system does however place a significant administrative burden on individuals to both declare their worldwide income to the tax authorities and calculate hypothetical effective rates of taxation. This burden, particularly of computing what a cross-border tax liability might have been, is significant and could represent an undue intrusion into a non-resident individual's affairs. The government believes that these burdens and the small number of countries pursuing such a policy make it unattractive.

4.3 More generous treatment

In some countries, such as China, non-residents can have access to an especially favourable tax regime advantaging them over residents. These countries do not generally have economies that are comparable to the UK economy and this tax treatment is understood to be part of a package to attract key skilled workers and direct foreign investment to support economic advancement.

The government does not believe this model is appropriate for the UK. The UK already operates a competitive tax regime for resident non-domiciles to support competitiveness and attract individuals to the UK.

4.4 No restriction

Some countries, such as Cyprus and South Africa, entitle all non-residents to equivalents to the Personal Allowance. The government understands that such a system could make visiting a country for work, investing, or leaving the country temporarily significantly easier for individuals and may help to promote the positive economic benefits of incoming and outgoing expatriates.

However as discussed above in section 3, the government is using this consultation to explore whether and how a restriction on non-residents' entitlement to the UK Personal Allowance might be introduced. It is not considering extending it.

4.5 Total restriction

Other countries, such as the United States and Australia, have a total restriction on entitlement to Personal Allowances (or the equivalent) for non-residents. This is a clear and simple policy with the advantage of preserving the benefits of 'allowances' for only those individuals who are resident.

The government considers however that such a restriction may be unduly harsh and not reflect that some non-residents have a significant economic connection to their host country. The government believes that such a policy would not be compatible with European law and could damage the UK's international competitiveness as a place to live, work and do business, and so is not attracted to such a policy for the UK.

5. Restricting access to the Personal Allowance in the UK

This chapter seeks views, on a possible model for restricting entitlement to the UK Personal Allowance for non-residents, should the government decide to change the existing policy.

5.1 Economic connections test

As discussed in chapter 4 of this consultation, amongst the UK's comparator countries, most attach entitlement to a Personal Allowance to tax residence. Additionally, within the EU, most countries have a test which distinguishes non-residents who have a strong economic connection to that country, that is, those who are in a comparable situation to residents. These non-residents are entitled to allowances in the same way as residents.

The government wants to ensure that individuals with strong economic connections to the UK, continue to benefit from our competitive tax rules and generous Personal Allowance.

QUESTION 5.1: Do you agree that, if the government decides to introduce any restriction on non-residents' entitlement to the Personal Allowance, this should not apply in circumstances where individuals have strong economic connections to the UK? If you do not agree please explain your reasoning.

5.2 Percentage test

The most common restriction on non-residents entitlement to the equivalent of the UK Personal Allowance is to introduce a percentage test. This test would identify non-residents with the strongest economic connections to the UK by measuring where most of their income arises.

A percentage test would introduce relatively few new concepts into UK tax law and is a widely used test in other countries. It therefore has the attraction of bringing the UK into line with a number of other tax jurisdictions. For most taxpayers it would be clear that their income fell on either side of the percentage threshold; only those close to the threshold would need to make a more detailed calculation for UK tax purposes.

As set out in Chapter 4, most countries with a percentage test set the value of the threshold at either 75 or 90 per cent. A 75 per cent threshold would protect more people's entitlement to the UK Personal Allowance although it presents a larger cost to the Exchequer. However, the further

a person's income is from a threshold, the clearer their tax position is and the easier it is to determine their eligibility for the allowance. For example, non-residents with either 60 or 80 per cent of their income from the UK would be further from the threshold and their position more certain if the threshold were set at 90 per cent than it would be if the threshold were to be set at 75 per cent of income.

QUESTION 5.2: Is a percentage test for the location of income the simplest and least burdensome basis upon which to identify circumstances where individuals have strong economic connections to the UK? Do you have any views on what level such a percentage should be set at? Please explain your reasoning.

6. Impact of a change

This chapter of the consultation sets out the government's initial assessment of the impact of any change in entitlement on individuals and businesses. It explores the financial impact on individuals (as described in Chapter 2, principally those with UK employment or property income) in different circumstances. Given the complexity of international tax provisions, the chapter breaks this down by different types of taxpayer and different forms of taxable income.

It then goes on to assess what might be required of individuals and businesses as part of changes to the administration of the tax system.

6.1 Impact on individuals

HMRC estimate there to be at least 400,000 individuals claiming Personal Allowances in the UK who are non-resident for tax purposes. Based on the data available, if non-residents were not entitled to the UK Personal Allowance most of them would face increased UK tax liabilities. However most of these individuals would be able to claim relief overseas either in the form of a credit for tax paid in the UK or exemption from tax in their home state. Therefore most individuals would not generally pay more tax overall than they do now. However this will depend on the relative level of tax rates and allowances between the UK and their country of residence. Those living in low tax jurisdictions are likely to pay more tax overall than they do now if they were not able to claim the UK Personal Allowance than they do now.

In assessing the impacts of any restriction on the Personal Allowance the government has looked to separate the affected population into cohorts. The government's view on the impacts on each of these is

summarised with examples below. The government has broken the affected individuals down into:

- Individuals with different levels of employment income
- Non resident landlords or others with UK property income
- Individuals with UK pension income (state and private)

6.2 High income individuals

Around 5,000 high earning non-residents already have their Personal Allowance tapered away because their UK income is greater than £100,000. Highly paid individuals coming into the UK often lose entitlement to the Personal Allowance in this manner as a result of benefit packages (accommodation, school fees, travel etc) paid by their employers which take their total taxable income, including benefits-in-kind, over £100,000.

Danny is a UK national resident overseas for tax purposes. Danny earns £150,000 in the UK; as a result he is not currently entitled to the UK Personal Allowance and would not be affected by any policy change in this area.

6.3 Middle income individuals

There are more than 110,000 migrant taxpayers with incomes over the level of the Personal Allowance and a significant proportion of this group are middle income non-residents. This includes, for example, professionals or managers seconded to the UK for a few months to work on specific projects. Individuals in this cohort who are not tax resident in the UK but pay UK tax on their earnings are likely to earn in excess of the Personal Allowance, so they have UK tax to pay on their earnings. Even without any policy change they are likely to claim double taxation relief in their country of residence to offset the UK taxation on their UK earnings. These individuals will not generally face a significant cash loss from the withdrawal of the UK Personal Allowance; however this will depend on the relative level of tax rates and allowances between the UK and their country of residence. Those living in low tax jurisdictions may face a cash loss.

Ollie is an EEA national resident overseas. He works for 4 months in the UK for a UK employer and this income is taxable in the UK. For the remaining 8 months of the year he earns broadly the same level of remuneration in his country of residence. Under the UK's current provisions he is entitled to the UK Personal Allowance on his UK income. Ollie pays tax on his earnings to the extent they exceed the

level of the Personal Allowance (£10,000 in 2013/14) and he claims a credit for this amount in his country of residence. Without the UK Personal Allowance he would pay an increased amount of UK tax on his UK income and would claim a larger credit in his country of residence.

6.4 Low income individuals

Around 250,000 migrants, many of whom are non-residents, receive UK income below the Personal Allowance. Although some will have higher incomes overseas, some of this group will have a very low overall income. This group includes a significant group who may not pay sufficient tax overseas to claim relief for any UK tax payable and might face a cash loss if their entitlement to a UK Personal Allowance is withdrawn.

Rob is an EEA national who is resident overseas. He works for 2 months in the UK as a temporary labourer for a UK employer. His earnings from this work are taxable in the UK. For the remaining 10 months of the year Rob has casual work in his country of residence. Rob is currently entitled to the UK Personal Allowance on his UK income and as his income is below the level of the Personal Allowance he does not pay UK income tax. Without the UK Personal Allowance, Rob would pay UK tax on his UK earnings. Although his total worldwide income is taxed in his country of residence, his overseas tax payable is sufficiently low that Rob would not pay enough tax to claim full relief for the UK tax he also has to pay.

To mitigate the impact on low earners, some countries' restrictions on their equivalents to the UK Personal Allowance, such as in Germany, are subject to a de minimis and do not apply to non-residents with very low global incomes. This level is often set at the same level as the Personal Allowance.

Edward is a UK national who is resident overseas. He has a third of his income in the UK and two thirds in his country of residence, and the global total of which is below the value of both the UK and overseas Personal Allowances. Therefore although he is liable to tax in both countries he is not taxed in either. If non residents with very low global incomes were entitled to a Personal Allowance Edward would remain entitled and would not pay UK tax on his UK income. This would be because even though most of his income is overseas, his total global income is so low that he would not pay tax if it all arose in the UK.

If the government were to restrict non-residents' entitlement to the Personal Allowance, it would consider a de minimis provision as a

possible protection for non-residents with very low global incomes. However, doing so would not be straightforward.

Asking non-residents to forecast their worldwide income, and hence whether they fall below a de minimis limit, is challenging. This would therefore be an administratively burdensome relief which would be available to people who might have no significant connection to the UK. An alternative implementation option of asking individuals to reclaim the allowance once their circumstances are known at the end of the year is also burdensome and does not prevent the significant cash flow challenges potentially faced by those with very low incomes. A de minimis would also create a strong 'cliff edge' in the tax system beyond which individuals' tax liability could increase significantly.

QUESTION 6.1: Are there unfair outcomes for those with globally low incomes from a broader policy of restricting non-residents' entitlement to the UK Personal Allowance? Could a de minimis limit of global income below which non-residents would automatically be entitled to the UK Personal Allowance help mitigate these unfair outcomes? If so, is there a way to design this so that the administrative burdens are not disproportionate?

6.5 Non-resident landlords and others with UK property income

There are around 175,000 non-UK resident taxpayers with rental income. Non-resident landlords will generally be taxed on their UK rental income in their country of residence as well as the UK. Although some may currently not need to claim double taxation relief as their UK income is below the Personal Allowance, many non resident landlords would be able to claim double taxation relief and so should not face an overall cash loss without a UK Personal Allowance.

Sean is a UK national resident and employed overseas. Sean owns several properties in the UK which he rents out and which provide his only UK income. After deductions, the income from these properties is below the level of the UK Personal Allowance. Currently therefore Sean pays no UK income tax on these rents, although they are taxed in his country of residence. Without the UK Personal Allowance Sean would pay UK income tax on this income and would need to claim relief in his country of residence.

6.6 Pensioners

Pensioners who live overseas are a significant group of British national expatriates, estimated by DWP at around 1,200,000 individuals. Most UK national pensioners living overseas would not be affected by any restriction on non-residents entitlement to the Personal Allowance. This is because:

- some are still resident in the UK for tax purposes and so would not be affected by any change
- provisions of tax treaties generally mean that UK state pensions, personal pensions or private sector occupational pensions are only taxable in recipients' states of residence and not in the UK
- many non-resident UK national pensioners do not have any other income (i.e. employment or property) which is taxable in the UK and would not be affected by losing their Personal Allowance

However, under double tax treaties, UK sourced government service pensions (a wide category which includes, amongst others, some NHS staff and those employed by local authorities) are generally only taxed in the UK, regardless of recipients' residence status. This can also be the case with some other forms of income under specific treaties. The withdrawal of the UK personal allowance from non-residents in receipt of a UK government service pension would result in them paying more tax overall as there is no overseas tax liability against which the additional UK tax could be relieved.

The government is concerned that individuals, like those in receipt of government service pensions, who are not eligible for double taxation relief, would be disproportionately affected by the removal of the UK Personal Allowance.

The government does not intend to raise taxes on vulnerable groups or in situations where the UK is the principal taxing authority and an individual has no recourse to relief as a result of the UK having sole taxing rights under a tax treaty. If the government were to restrict non-residents' entitlement to the Personal Allowance, it would intend this to apply to types of income which are taxable both in the UK and overseas (such as that from immovable property) but to retain the Personal Allowance on income that is taxable exclusively in the UK.

QUESTION 6.2: Do you agree that retaining the UK Personal Allowance in respect of the income of non-residents which is by treaty subject exclusively to UK taxation would help mitigate unfair outcomes from a

broader policy of restricting non-residents' entitlement to the UK Personal Allowance?

6.7 Other affected groups

As set out in paragraph 5 of Chapter 2, UK statute (Section 56 Income Tax Act 2007) provides that most taxpayers with an entitlement to the UK Personal Allowance currently receive this by virtue of residence in the UK. Most non-residents are currently entitled either by virtue of nationality under domestic legislation or as a consequence of the interaction of this with the UK's tax treaties. However as mentioned above, a number of specific groups are also entitled directly to a Personal Allowance without reference to residence or nationality.

These groups include, amongst others, those employed in crown service overseas or those employed by missionary societies. As part of this consultation the government is seeking the views of respondents on whether any of these criteria remain relevant protections.

QUESTION 6.3: Are there any other hard cases or unfair outcomes you believe that the government may not have considered if the Personal Allowance for non-residents were to be withdrawn?

QUESTION 6.4: In practice are non-resident individuals claiming the UK Personal Allowance on the basis of criteria other than UK residence or EEA nationality?

QUESTION 6.5: If the government were to remove the entitlement to the UK Personal Allowance by virtue of EEA nationality to what extent would non-residents you are familiar with claim the UK Personal Allowance on the basis of other criteria currently in Section 56 Income Tax Act 2007? Please provide what evidence you can in support of your answer.

QUESTION 6.6: Which, if any, of the criteria other than UK residence or EEA nationality in Section 56 Income Tax Act 2007 do you think are relevant to the in the 21st century? Should these criteria be repealed? Are there any other criteria in Section 56 on which individuals should be entitled to the UK Personal Allowance? Please provide evidence in support of your answer.

6.8 Administrative impacts

Should the government decide to introduce a policy to restrict non-residents' entitlement to the UK Personal Allowance, significant changes would be needed to the Pay As You Earn (PAYE) and Self Assessment

(SA) systems affecting people who are self-employed; employees; and those with pension, rental or other investment income as well as employers and pension providers operating PAYE.

The government would not want any changes made to the UK system to be an administrative burden on the majority of UK taxpayers who are and have always been resident in the UK. The government wants to avoid having to make any significant alterations to the PAYE system and does not want to require all or most non-residents in receipt of UK income to have to file self-assessment tax returns.

6.9 Pay As You Earn

Depending on the policy design, employers of people who either come to the UK to work for a short period of time or who change jobs frequently could need to review their employees' residence position, global income and entitlement to a UK Personal Allowance for each tax year as appropriate.

Employers are not currently required to ask the tax residence status of their employees. Despite this the government has anecdotal evidence that many employers, particularly large employers, are aware of their employees residence status.

Under the provisions of the UK's tax treaties, most pensions paid to non-residents are not taxable in the UK and the government is aware that pension providers track the residence status of those individuals who notify them that they should not have UK tax deducted at source. The government is interested in knowing how widespread knowledge of employee's residence status is amongst those organisations required to operate PAYE, particularly employers, and how large a burden would be presented by establishing and reporting residence to some extent.

QUESTION 6.7: How widespread is knowledge of residence status amongst PAYE scheme operators, particularly employers? How easy would asking employees to declare their tax residence be for employers?

The government is aware that when a new employee joins an organisation most employers ask additional questions of their own alongside those required by HRMC and is interested in knowing if the current 'new starter process' for PAYE could be used to help identify non-residents. The government recognises this is only one part of the PAYE process however and that there is a small population of

established non-residents in the PAYE taxpaying population. Some of these established non-residents might not remain entitled to a UK Personal Allowance and a different process would be required to identify them. However the starter process is a fundamental part of the PAYE system and one in which non-residents with PAYE income will all have to engage with.

Although often residence status can only be finally determined at the end of a tax year the government would aim to use the PAYE starter process to provisionally identify residence status. For the average resident the government would intend that this would require only one additional question on top of those asked already. The government recognises that it will not be possible to identify all individuals from a single question however and would aim to produce a sensible indication of the position of everybody with no more than 3-5 questions. The question would be designed to exclude most people from the requirement to answer further questions.

QUESTION 6.8: How could the PAYE starter process be best used to ensure that most people get the correct tax code at the start of the employment if the government decides to restrict the availability of PAs to non-residents? What questions could be used to indicate residence status? Is the new starter process a sensible way to identify non-residents? What other processes could be adapted, with minimal additional burden, to identify non-residents?

The government accepts however that any process to identify non-residents in PAYE will not be perfect for a number of reasons; including individuals answering incorrectly or having their circumstances change. Accepting that some individuals will initially receive the incorrect treatment the government sees there to be a choice in any such a system between two broad options.

The system could lean in favour of restricting individual's entitlement and then offer end-of year recompense for those who should have been entitled. The government sees this as easier to implement and less administratively burdensome as it could make more use of existing processes, it would however have a negative financial impact on more individuals.

Alternatively the system could lean towards granting entitlement and 'clawing-back' money not due at the end of the year. The government sees that this would be less financially punitive initially but is aware that identifying and contacting non-residents to successfully 'claw-back'

monies due would be very administratively burdensome and could prove a financial burden on individuals who had thought their tax position secure.

QUESTION 6.9: Although the government will consult on detail if it decides to restrict non-residents' entitlement to the UK Personal Allowance do you have any preliminary views as to whether any system should lean toward restriction or entitlement?

6.10 Self Assessment

The government would hope that that people who make annual returns of income would see little change administratively on their SA return were the government to restrict non-residents' entitlement to the UK Personal Allowance. SA taxpayers are already required to consider what income to report on the form and how this should be reported.

However, for non-residents, and again depending on the design of any new policy, an additional box may be needed on the tax return so that they could declare the necessary information to determine whether they were eligible for the UK Personal Allowance. Presently there is no requirement to report global income for non-residents and in most cases the government would not seek to ask non-residents to provide full and comprehensive details of their global income.

Guidance and help would be needed so that people understand what income to include or exclude; how to calculate their global income and its location and what records to keep as evidence – record keeping is already an integral part of the UK tax system in claiming allowances, reliefs and expenses.

7. List of consultation questions

QUESTION 5.1: Do you agree that, if the government decides to introduce any restriction on non-residents' entitlement to the Personal Allowance, this should not apply in circumstances where individuals have strong economic connections to the UK? If you do not agree please explain your reasoning.

QUESTION 5.2: Is a percentage test for the location of income the simplest and least burdensome basis upon which to identify circumstances where individuals have strong economic connections to the UK? Do you have any views on what level such a percentage should be set at? Please explain your reasoning.

QUESTION 6.1: Are there unfair outcomes for those with globally low

incomes from a broader policy of restricting non-residents' entitlement to the UK Personal Allowance? Could a de minimis limit of global income below which non-residents would automatically be entitled to the UK Personal Allowance help mitigate these unfair outcomes? If so, is there a way to design this so that the administrative burdens are not disproportionate?

QUESTION 6.2: Do you agree that retaining the UK Personal Allowance in respect of the income of non-residents which is by treaty subject exclusively to UK taxation would help mitigate unfair outcomes from a broader policy of restricting non-residents' entitlement to the UK Personal Allowance?

QUESTION 6.3: Are there any other hard cases or unfair outcomes you believe that the government may not have considered if the Personal Allowance for non-residents were to be withdrawn?

QUESTION 6.4: In practice are non-resident individuals claiming the UK Personal Allowance on the basis of criteria other than UK residence or EEA nationality?

QUESTION 6.5: If the government were to remove the entitlement to the UK Personal Allowance by virtue of EEA nationality to what extent would non-residents you are familiar with claim the UK Personal Allowance on the basis of other criteria currently in Section 56 Income Tax Act 2007? Please provide what evidence you can in support of your answer.

QUESTION 6.6: Which, if any, of the criteria other than UK residence or EEA nationality in Section 56 Income Tax Act 2007 do you think are relevant to the in the 21st century? Should these criteria be repealed? Are there any other criteria in Section 56 on which individuals should be entitled to the UK Personal Allowance? Please provide evidence in support of your answer.

QUESTION 6.7: How widespread is knowledge of residence status amongst PAYE scheme operators, particularly employers? How easy would asking employees to declare their tax residence be for employers?

QUESTION 6.8: How could the PAYE starter process be best used to ensure that most people get the correct tax code at the start of the employment if the government decides to restrict the availability of PAs to non-residents? What questions could be used to indicate residence status? Is the new starter process a sensible way to identify non-residents? What other processes could be adapted, with minimal additional burden, to identify non-residents?

QUESTION 6.9: Although the government will consult on detail if it decides to restrict non-residents' entitlement to the UK Personal

Allowance do you have any preliminary views as to whether any system should lean toward restriction or entitlement?

7.1 Annex A

The following table presents a broad overview of tax free treatment of income and its accessibility to non-residents in EU, G8 and OECD countries.

Country	Tax free treatment of income	Available to non-residents
Australia	Nil-rate band	No
Austria	Nil-rate band	Test
Belgium	Allowance	Test
Bulgaria	None	
Canada	Wasteable Credit	Test
Chile	Nil-rate unit system	No
Croatia	Allowance	Yes
Cyprus	Nil-rate band	Yes
Czechia	Wasteable Credit	Test
Denmark	Wasteable Credit	Test
Estonia	Allowance	Test
Finland	Nil-rate band	Test
France	Nil-rate band, Deduction and Income splitting	Yes but non-residents subject to a minimum effective tax rate of 20%
Germany	Nil-rate band	Test
Greece	Credits	Test
Hungary	Credit and Deduction	Test
Ireland	Wasteable Credit	Test
Israel	Wasteable Credit	No
Italy	Wasteable Credit	Yes
Japan	Allowance	No
Korea	Allowance and Deductions	No
Latvia	Allowance	Test
Lithuania	Tapered allowance	Yes
	Additional allowance, special allowance and	No

Country	Tax free treatment of income	Available to non-residents
	Deductions	
Luxembourg	Allowance, Non-wasteable credit and Nil-rate band	Test
Malta	Nil-rate band	No
Mexico	Allowance and Non-wasteable credit	No
Netherlands	Wasteable Credit	Test
New Zealand	Credits	Yes/No – each credit differs
Poland	Wasteable Credit	Yes
Portugal	Wasteable Credit	Test
Romania	Tapered allowance	Yes
Russia	Deductions	No
Slovak Republic	Allowance	Test
Slovenia	Two allowances	Test
Spain	Allowance	Test
Sweden	Allowance and Nil-rate band	Yes – although not available in a special non-resident regime
Switzerland (federal)	Deduction, Allowances	No
	Nil-rate band	Yes
Turkey	Wasteable Credi	No
United States	Deduction	No