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INCOME TAX CONSEQUENCES IN THE UNITED KINGDOM

Military Members and Civilian Component DoD Compensation

Military members receiving military pay incidental to their military duties performed within the U.K. will continue to pay United States (U.S.) state and federal income taxes even after they enter the U.K. and work here. Furthermore, military pay received in the U.K. for work performed in the U.K. does not subject a U.S. military member to income tax liability within the U.K. tax system, and the same may be true for members of a federal civilian component who are employed by the Department of Defense. Specifically, this issue is addressed by Article X of the North Atlantic Treaty Organization Agreement which states, "Members of a force or civilian component shall be exempt from taxation in the receiving State on the salary and emoluments paid to them as such members by the sending State or on any tangible movable property the presence of which in the receiving State is due solely to their temporary presence there."

However, this Agreement also notes that nothing in Article X shall prevent taxation of a military member or civilian component with respect to any profitable enterprise, other than his employment as such member, in which he may engage in the receiving State. Therefore, any income (aside from your DoD pay) that is realized by a military member or civilian component member in the U.K. is not automatically exempt from the U.K. tax system by virtue of the Status of Forces agreement. In addition, except as regards DoD pay, this Agreement does not automatically prevent taxation of income simply because a military member or civilian component member claims residence or domicile outside the territory of the U.K. This determination is more complex and is considered throughout this handout.

Filing U.S. State Tax Returns/Paying State Income Taxes

Unlike almost everywhere else in the world, American citizens and lawful permanent residents (green card holders) are required to pay U.S. income taxes while living abroad. This is true even if you are a permanent resident, or citizen of a foreign country who receives U.S. income. Whether you need to file for or pay state income taxes depends on the state you lived in prior to moving abroad as the tax residency rules vary by each state. Many states will also allow the foreign earned income exclusion, which can affect your taxable income payable to that state.

Under recent changes in the Military Spouses Residency Relief Act, military spouses can choose to file state tax returns in their service member's home state whether they have ever lived there or not. Beginning with the 2018 tax year, military spouses can file taxes in the same state as their service member -- claiming the same domicile -- without ever having set foot in the state. Alternatively, they can also choose to file in the state in which they have established their own domicile.

Filing U.S. Federal Tax Returns/Paying U.S. Federal Income Taxes

The following link to the U.S. Internal Revenue Service website should be your first visit to learn more about the international income tax issues such as those raised in this handout: https://www.irs.gov/individuals/international-taxpayers/frequently-asked-questions-about-international-individual-tax-matters.

U.S. citizens, as well as permanent residents, are required to file expatriate tax returns with the U.S. federal government every year regardless of where they reside. If you remain a U.S. citizen or green card holder who works abroad, you are still required to file U.S. taxes and report your income to the U.S. annually. Along with the typical tax return for income, many people are also required to submit a return disclosing assets which are held in bank accounts in foreign countries by using FinCEN Form 114 (FBAR). Generally, U.S. taxpayers with more than $10,000 in foreign bank or financial accounts are subject to FBAR filing and reporting requirements.

The United States is among only a few governments who tax international income earned by their citizens, as well as permanent residents, residing overseas. However, there some provisions stemming in part from a U.K./U.S. Double Taxation Convention that help protect from possible double taxation. These include:

- The Foreign Earned Income Exclusion. This exclusion allows one to exclude USD 103,900 (this amount is for 2018 taxes) in earned income from foreign sources.
- A tax credit allowing tax on remaining income to be reduced based on the taxes paid to foreign governments.[1]
- An exclusion on foreign housing that allows additional exclusions from their income for some amounts paid to cover household expenses due to living abroad.

You may need to report your U.K. financial accounts and assets. Generally, U.S. taxpayers with more than $10,000 in foreign bank or financial accounts are subject to FBAR filing and reporting requirements. You may also be subject to FATCA reporting requirements if you have foreign assets valued at $200,000 and higher.

You can lower your U.S. bill and avoid dual taxation with certain tax strategies. Expats may take advantage of one of two options, detailed below, to lower their taxes.

[1] See Article 24, Relief from Double Taxation, of the UK/USA Double Taxation Convention, effective 31 Mar 03 for more details.

- The foreign earned income exclusion allows you to exclude your wages from your U.S. taxes. This option is available to those who meet certain time-based residency requirements.
- The foreign tax credit lets you claim a credit for income taxes paid to a foreign government.

Your U.K. tax-free investments are not tax-free in the United States. Americans living in the U.K. may consider investing in an Individual Savings Account (ISA). However, you should know that these accounts are not tax-free as far as your U.S. taxes are concerned — regardless if these investments are made up of cash or stocks and shares.

Your U.K. retirement investments can get special treatment. Thanks to the United States - United Kingdom tax treaty, you can deduct your contributions to a qualified U.K. pension scheme on your U.S. taxes. Plus, your account is treated similarly to a 401(k) or IRA, letting your retirement investments grow tax free.

In most cases, your U.K. pension is subject to FBAR reporting and, depending on the amount in the account, it may be subject to FATCA reporting as well.

Note for self-invested pension plans (SIPPs) participants: If your SIPP is wrapped into a U.K. pension plan, you can choose to claim tax treaty protection. Thus, if you do not claim the protection, the tax-free treatment will not apply. Additionally, you'll need to report your SIPP as a foreign grantor trust, which will require additional filing.

Filing for Taxes in the U.K./Paying Income Tax to the U.K. Government

Working as an American in the U.K. can affect your taxes even if you do not stay for very long. **Your U.K. income taxes are based on your residency and domicile status.** Where U.K. taxes are concerned, your domicile is generally where you have your permanent home and your residency is where you spend your most of your time. You can be a resident in more than one country, but you can only have one domicile.

- Residents of the U.K. who are domiciled in the U.K. pay taxes to the U.K. government on all their income and capital gains, regardless of where it is earned.
- Residents of the U.K. who are not domiciled in the U.K. pay taxes to the U.K. government on U.K. source income and a remittance basis — meaning you are only taxed on foreign income or gains brought to the U.K. This "remittance basis" could be to your advantage but you need to carry out detailed planning and preparation to ensure the correct steps are followed.
- Nonresidents are taxed on U.K.-sourced income but not on capital gains in most cases. Non-residents only pay tax on their U.K. income - they do not pay U.K. tax on their foreign income.

So, how do you know if you are a resident? Her Majesty's Revenue Customs (HMRC) defines residency requirements in the United Kingdom. In general, residency is determined by the longer term intentions of the taxpayers, along with the number of days they are physically in the United Kingdom. You can determine your U.K. residency if you pass one of the four Automatic Residence Tests or the Sufficient Ties Test.

You can learn more about these tests at the HMRC U.K.Gov website: https://www.gov.uk/government/publications/rdr3-statutory-residence-test-srt.

"U.K. Statutory Residence Test"

You're automatically considered a U.K. **resident** if either:

- you spent 183 or more days in the U.K. in the tax year
- your only home was in the U.K. - you must have owned, rented or lived in it for at least 91 days in total - and you spent at least 30 days there in the tax year

You're automatically **non-resident** of the U.K. if either:

- you spent fewer than 16 days in the U.K. (or 46 days if you haven't been classed as U.K. resident for the 3 previous tax years)
- you work abroad full-time (averaging at least 35 hours a week) and spent fewer than 91 days in the U.K., of which no more than 30 were spent working

So, how do you know if you have a U.K. domicile? When considering taxes in the U.K., domicile is an important issue for factoring in worldwide income. A taxpayer's domicile is the place where they have their permanent, long-term home. Domicile is different than residence, citizenship, or nationality.

A person's domicile is identical to their father's domicile as of their birth. If their father changed his domicile while they were still dependent, their domicile changes as well. Otherwise, this domicile remains unless they acquire a domicile that is different. It is difficult to change a domicile of origin but this is possible if you acquired a new domicile of dependency as a child or a domicile of choice in later life. To do this, they must sever ties with their previous domicile, relocate to a different jurisdiction, and maintain a permanent residence in the new jurisdiction. Acquiring a domicile of your choice rather than the domicile of your origin is difficult. You must prove your domicile changed.

The majority of expatriates in the U.K. are classified as domiciled outside of the U.K. HMRC is constantly making changes to the U.K. domicile and residence regulations, and in April, 2008 made the system much more complicated. Therefore, you will most likely want to contact a tax expert to determine your domicile while you live in the United Kingdom.

What are the income tax rates within the U.K.? The U.K. income tax rates range from 0% to 45%. Similar to taxes in the U.S., the percentage of tax that you pay increases as your income increases into different bands (known as brackets in the U.S.). Due to the wide ranges of the U.K.'s top bands, many Americans would pay higher income tax rates than at home.

2019 U.K. Income Tax Rates

Band	Tax Rates	Taxable income
Personal allowance	0%	$0-$12,500
Basic rate	20%	$12,501-$50,000
Higher rate	40%	$50,000-$150,000
Additional rate	45%	$150,000 and up

The tax year is different than in the United States. The U.K. tax year starts on April 6 each year and ends the next year on April 5. If you file your U.K. taxes by paper, they are due to the HMRC by October 31. If you file electronically, you will have until January 31. It is not possible for married couples to file joint returns in the U.K. income tax system. Each person must submit their own returns as required for their personal income. There is an allowance that permits one spouse the ability to transfer personal allowance of theirs to one another

Who is Required to Submit Tax Returns in the U.K.?

HMRC sends tax forms to each individual. If they determine a taxpayer has paid sufficient tax using payroll withholding, you may not receive a form, and don't have to submit a return if there is no other income or applicable circumstances.

Other income, like investment income or self-employment income, requires a taxpayer to file their return and submit the taxes due on the income. Some cases that require the filing of a return include:

- Property rental income
- Profits from the sale of shares, second homes, and other capital gains
- Income from sources outside the U.K. while living in the United Kingdom
- Claiming child benefits if you or a partner's income is over GBP 50,000
- Income of GBP 100,000 or more

Taxpayers may also choose to file in order to claim any deductions. Common deductions include donations, contributions to private pensions, and employment expenses exceeding GBP 2,500. **If tax forms are not received from the government, but you need one, register online. The process can take up to 14 days, since a PIN number must be mailed. If you register online, do it early to help avoid late penalties.**

U.K. Social Security

Generally speaking, expats are required to participate in the U.K.'s National Insurance after they have started employment (including self-employment). This covers the cost of welfare, health insurance, pension plans, unemployment insurance, and workers compensation, along with other various social programs in the U.K. There is an agreement between the U.S. and the U.K. concerning Social Security. This agreement requires people to pay tax for Social Security in the country in which they are working. But, if you are sent to the United Kingdom by your employer for five years or fewer, you continue coverage in the U.S. Social Security system on your United States expat taxes, with an exemption from coverage by the U.K. program. For the self-employed, they pay in the country they reside in.

Does the U.K. Tax Foreign Income?

The tax requirements on taxpayer worldwide income depend on U.K. domicile and residency status. If a taxpayer is a U.K. resident, they must pay taxes on total investment income, regardless of location. This is the same amount that is reported on U.S. expatriate taxes.

A taxpayer who is a resident not domiciled within the U.K. is able to submit taxes using remittance basis on both their foreign income as well as capital gains. A taxpayer who is resident as well as domiciled, but is not considered ordinarily resident, is allowed to use remittance on foreign income, but not on capital gain income. Remittance basis means you can choose to pay U.K. tax on your income from investments remitted in U.K. Your income is required to be remitted when the income is brought into the U.K., or when paid in the U.K. to you. It is advisable to speak with a competent tax advisor about bank accounts overseas to help avoid expensive mistakes for taxpayers not domiciled in the U.K.

Other U.K. Taxes

Along with income tax imposed on non-DoD salaries, there are additional types of income taxed by the U.K. Compensation that is not in cash is taxable. Examples include non-DoD relocation expenses, housing stipends, meal allowances, clothing allowances, club memberships, commuting costs, payments for home leave, and educational reimbursements.

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RAF Lakenheath Legal Assistance App

For a copy of this pamphlet, as well as other helpful pamphlets, please go to the 48 FW Phone App, click on “J.A.G.” at the bottom, and then click on “forms and documents."

RAF Lakenheath Legal Office Hours

Legal Assistance/Wills **(By appointment only)**

Tuesday 0900-1100 and Thursday 1300-1500

Call **0163852-3553 (226-3553)** or email 48fw.ja@us.af.mil

Powers of Attorney/Notary Service (No appointment necessary).

Monday-Wednesday & Friday 0830 – 1530; Thursday 0930-1530

Current as of April 2020