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UK Taxation for Japanese individuals and businesses living in the UK

Residence and Domicile in UK Tax Law

Residence and domicile are two important and separate concepts in UK tax law which, to some extent, govern how people are taxed.

A person is resident in the UK if he spends more than 183 days in any tax year in the UK. A person can also become resident if he visits the UK regularly over a period of several years and the average days the person spends in the UK each year exceed 91.

A person's domicile is generally his permanent home and is usually where he will eventually return to. It is commonly where he was born. It is very difficult to change domicile and it would generally require a permanent move abroad with no intention of returning.

UK residents are liable to UK tax on their worldwide income and gains. However, individuals who are not UK domiciled are only taxable on non-UK income and gains to the extent that they are remitted to the UK. However, under Government proposals, these rules will change from 6 April 2008 and it is likely that many non-UK domiciled individuals will become taxable on their worldwide income and gains.

National Insurance Contributions (NICs)

National Insurance is a social tax designed to meet national state pension, benefit and healthcare costs.

NICs are levied on most UK employees (Class 1 NIC) and the self-employed (Classes 2 and 4 NIC). Class 1 contributions are levied on employees at 11% of earnings between £100 and £670 a week. For earnings above this level, there is further uncapped 1% charge. Employers must also make Class I NICs on behalf of all employees who earn over £100 per week at a rate of 12.8%.

However, most Japanese expatriates working in the UK will not be required to pay UK NICs by virtue of an agreement between the UK and Japanese governments. If a Japanese employee is seconded to the UK to work for the Japanese employer (or its overseas branch or subsidiary) for less than 5 years, neither the employee nor the employer is liable to pay UK NICs but will continue to pay into the Japanese system. If the intention is to stay for more than 5 years then UK NICs will be due from day one.

The above is only a summary and is not intended to be relied upon as constituting tax advice. No liability can be accepted by the author or Greenback Alan LLP for an act, or omission to act, based on this article.



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Under certain circumstances, the five-year period can be extended when it comes to an end.

Pay-As-You-Earn (PAYE)

PAYE is the mechanism by which all employers are required to account for tax on employees' earnings in the UK. Under PAYE, the employer is obliged to deduct tax and NICs at source from the employee's gross earnings and pay them over (usually monthly) to H M Revenue and Customs. The employee receives their salary net of tax and NICs and has no further tax reporting or payment requirements (providing they have no further sources of income or gains on which tax is due during the tax year and providing that the employer has made the correct deductions).

Many Japanese employees working in the UK will be subject to Tax Equalisation or Tax Protection agreements with their employers. This may affect the net salaries they receive in the UK as described below.

Tax Equalisation

Under this system, the employer ensures that the tax costs incurred by an employee seconded to the UK equal the costs which would have applied in Japan. This ensures that the employee neither suffers higher tax rates nor receives a sudden increase in net income, depending on the tax rate in the country he is sent to.

Under tax equalisation, the employer normally takes responsibility for paying the employee's worldwide taxes and filing any necessary returns. The employer is reimbursed on a monthly basis by deductions from the employee of the equivalent of the tax which would have been suffered in Japan. Therefore, although the employer is required to operate UK PAYE, the employee will not be affected by the rate of deduction.

As the employee is in a tax-neutral position throughout the assignment, Tax Equalisation promotes fairness and mobility.



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Tax Protection

An alternative to Tax Equalisation is Tax Protection. Under this system, the employee is responsible for the payment of worldwide taxes on his income. This would include UK PAYE although it would be the employer who would make the deductions. If the worldwide taxes exceed those payable in Japan on the same income, then the employee is refunded at the year-end but may suffer a cash-flow disadvantage during the year. If worldwide taxes are lower than those which would have been suffered in Japan, the employee is usually better off and will not need to refund the difference.

Under tax protection the employee is normally responsible for any local filings whereas under Tax Equalisation the employer normally takes care of this.

Personal Tax Returns

Some UK taxpayers (including those from overseas) are required to file an annual tax return. Most of those individuals fall into the following categories:-

- The self-employed
- Company Directors
- Those receiving income which has not suffered tax at source, for instance property income
- Higher Rate taxpayers who have a further tax liability on investment income
- Individuals making capital gains in the year
- Those who wish to make a particular claim. This can include claiming non-UK domicile if it affects your tax liability in the year.

These individuals are required to “self-assess” their liabilities to income tax and / or capital gains tax (CGT). The Return must report all income and gains arising in the UK and, for non-domiciliaries, all foreign income and gains remitted to the UK. This includes income already taxed at source (e.g. employment income) and it is therefore important to retain all records required to complete the return.



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Paper returns must be submitted to H M Revenue & Customs by (from 2007/08) the 31 October following the end of the tax year. The tax year ends on 5 April. Electronic filing is also available and the deadline for this method is 31 January following the end of the tax year. For both methods, the deadline for the payment of the tax is 31 January. If a refund is due, it is wise to file the return as soon as the tax year as ended, as it is likely that the refund will be made within a few weeks.

If the tax liability (after deduction of taxes already paid at source) exceeds £500 (£1,000 from 2009/10) and less than 80% has been paid at source, two payments on accounts of next year's liability are also required. These are required on 31 January and 31 July.

Employees under a tax equalisation agreement are likely to have their returns filed by the employer and any employment-related taxes paid on their behalf.

Income Tax

Income tax is assessed on all taxable income arising to individuals and trustees. This includes employment, trading and investment income. The rates of tax are, for 2007/08:

<i>Income, £</i>	<i>Tax Rate</i>
0 - 2,230	10%
2,231 - 34,600	22%
over 34,600	40%

A "personal allowance" of tax-free income is available to all UK residents and is currently £5,225 per annum.



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Capital Gains Tax (CGT)

CGT is due on the disposal of chargeable assets at a profit. It is only paid by UK residents. Chargeable assets include land, buildings, shares, businesses and chattels. CGT is currently charged at a taxpayer's marginal income tax rate, with some relief based on the length of ownership. Under Government proposals, from 6 April 2008, CGT will be charged at a flat rate of 18% and no account will be taken of length of ownership of the asset. Various reliefs are available, for instance the disposal of one's main residence.

Companies pay corporation tax at their marginal rate on chargeable gains.

Value Added Tax (VAT)

VAT is a sales tax which is charged on the supply of certain items or services (supplies). VAT can only be charged by those carrying on a business. Businesses are only required to register for and charge VAT when their turnover exceeds, or is expected to exceed, £64,000 per year. However, voluntary registration is permitted for any business making taxable supplies, whatever their turnover. This may facilitate the reclaim of VAT suffered on purchases (input tax) which would not be recoverable were the business not VAT-registered.

There are several rates of VAT depending on the nature of the supply

- Exempt. Those businesses making only exempt supplies cannot reclaim any input tax. Examples of exempt supplies are Insurance Services and Education.
- Standard-rated. Applies to the supply of most goods and services and is chargeable at 17.5%
- Zero-rated. Such supplies are taxable supplies but are taxable at 0%. Therefore, although no VAT is chargeable, input tax can be recovered. Examples include books and food.
- Reduced rate (5%). Applies in a limited number of cases, for instance in the supply of domestic fuel and power.



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VAT Returns are normally filed each quarter and any VAT due is paid over at the same time. If the business' input tax exceeds the tax charged on its supplies during the period, then a refund will be due once the return has been filed. Some small businesses can opt for an alternative basis of filing - for instance cash accounting.

Corporation Tax (CT)

CT is levied on the profits of companies trading in the UK from a Permanent Establishment (PE). This includes both UK companies and companies incorporated abroad but managed and controlled in the UK. It also includes the UK profits of branches of offshore companies trading through a UK PE.

A PE will include a branch, office, factory or other place of work which is actively involved in generating income. It does not include a storage facility such as a warehouse. A representative office is not a PE as long as it only carries out preparatory / auxiliary work and does not earn income.

The standard rate of CT is 30% (28% from 1 April 2008). There is also a small companies' rate of 20% (21 % from 1 April 2008 and 22% from 1 April 2009) applicable to taxable profits of up to £300,000. The £300,000 limit is reduced where a company has "associated companies" - broadly those which control it or which it controls, or those which are both under the control of the same person. For instance, a company controlled by a parent company with one other subsidiary would have two associated companies and the threshold for the small companies' rate would be reduced to £100,000.

Corporation Tax Returns must be filed one year after the end of the company's accounting period. Where a company's taxable profit is less than £1.5 million (as reduced for associated companies), the tax is due in one instalment nine months and one day after the end of the accounting period. For companies exceeding this profit level, 4 quarterly instalments are due throughout the year.



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Stamp Duty Land Tax (SDLT)

The main stamp tax in the UK is Stamp Duty Land Tax (SDLT). It is charged, broadly, when land and buildings are sold or exchanged for valuable consideration. As consideration is required, gifts are usually exempt.

The following rates of SDLT apply, based on the purchase price of the property. The purchaser is liable for the payment of SDLT.

<i>Residential Property</i>	<i>Commercial Property</i>	<i>Rate</i>
Up to £125,000	Up to £150,000	0%
£125,001 - £250,000	£150,001 - £250,000	1%
£250,001 - £500,000	£250,001 - £500,000	3%
£500,001 or more	£500,001 or more	4%

The above rates apply to the full consideration, not only to that in excess of the previous band.

There are certain anti-avoidance rules for linked transactions and transactions between connected persons. There are also reliefs - for instance the transfer of assets between group companies.

The purchaser (normally his solicitor) is required to make a Return to HMRC within a month of the transaction and pay the tax due.

Withholding Tax

The UK sometimes levies withholding tax on interest and royalties paid to overseas individuals or entities. Withholding tax is deducted at source by the UK payer of the interest or royalty and paid over to the UK Government. In this way the Government ensures it receives the tax that might be due on the income. There is no UK withholding tax on dividends.



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The general rate of withholding tax is 20% for interest and 22% for royalties. However, the UK-Japan Double Tax Treaty reduces these rates to 10% for interest and 0% for royalties, providing the beneficial owner of the income is resident in Japan.

Forms will need to be completed by the payee of the income and stamped by the Japanese tax authorities in order to claim the lower rate. The Japanese authorities must confirm that the payee is resident in Japan.

Interest and Penalties on Underpaid Tax

Interest will always be charged on underpaid tax unless a prior agreement has been made with HMRC. The current rate is 7.5% for all taxes.

Penalties may also be levied where errors are made in tax returns. A new penalty regime will be introduced on 1 April 2008 and it is that which is discussed here. It applies to all taxes. The “types” of error are divided into the four categories below. An error will not attract a penalty unless it has been made carelessly. Deliberate errors are treated more seriously, especially if there has been deliberate concealment. A “failure to notify” penalty can be issued where a tax liability arises but HMRC has not been advised of need for a tax return to be filed.

<i>Type of Error</i>	<i>Percentage Penalty</i>
Careless Error	0% - 15%
Failure to Notify	0% - 15%
Deliberate not Concealed	20% - 70%
Deliberate and Concealed	30% - 100%

The relatively large bands above reflect the fact that HMRC will have discretion to reduce the maximum rate of penalty for any error, based on whether the disclosure of the error was prompted or unprompted.



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Council Tax

Council tax is a local tax levied on residential property by the Council area in which the property is situated. The tax is payable in addition to national taxes. The tax is generally charged by property rather than by person. The payee is normally the owner of the property, but, where property is let, it is usually the tenant who pays. The tax is banded from bands A to H, depending on the value of the property. The amount also depends to some extent on the Council area. For instance, a band A property in Kensington would attract an annual charge of £687 in 2007/08, and a band H property £2,062.

Your Council will issue you a bill at the start of the tax year or when you move into a property. You will then have the option of paying the bill in full or making monthly payments either in person, over the telephone, by post or by direct debit.

Sole occupants of a property are entitled to a 25% discount on their bill. Properties are exempt for up to six months if they have been unoccupied and unfurnished or if they are undergoing major repair.