These notes refer to the Income Tax (Earnings and Pensions) Act 2003 (c.1) which received Royal Assent on 6th March 2003

INCOME TAX (EARNINGS AND PENSIONS) ACT 2003

EXPLANATORY NOTES

COMMENTARY ON SECTIONS

Glossary

Part 2: Employment income: charge to tax

Chapter 5: Taxable earnings: rules applying to employee resident, ordinarily resident or domiciled outside UK

Overview

80. This Chapter sets out, in cases not covered by Chapter 4, how to determine what general earnings from an employment are within the charge to UK tax in any particular year. The rules are set out for each category of employee in succession.

81. The residence, ordinary residence or domicile status and the place of and, in some cases, nature of duties are all relevant in determining the tax treatment of earnings. In the Schedule E legislation these factors and their consequences are somewhat condensed and do not appear in any logical order. This Chapter is organised so that an employee can easily see which sections apply to the earnings for a year because they all contain in the heading a description of which residence, ordinary residence or domicile conditions apply and (if applicable) what type of earnings the section applies to.

Section 20: Taxable earnings under this Chapter: introduction

82. This introductory section sets out how the Chapter deals with the calculation of taxable earnings in a year when the employee is resident, ordinarily resident or domiciled *outside* the United Kingdom, showing which section applies in which combination of circumstances. For example, an employee who is resident and ordinarily resident, but not domiciled, in the United Kingdom, can see from *subsection (1)(a)* and *(b)* that sections 21 and 22 are the sections to use in calculating taxable earnings for the year. The list in subsection (1) also makes it clear that there are separate rules in separate sections to deal with chargeable overseas earnings, UK-based earnings and foreign earnings. Each of these terms is defined in the section dealing with that kind of earnings. This introductory material is new.

Section 21: Earnings for year when employee resident and ordinarily resident, but not domiciled, in UK, except chargeable overseas earnings

83. This section deals with those earnings that are, under the Schedule E legislation, still within Case I because they are not excepted from it as "foreign emoluments" by the operation of section 192 of ICTA. The label "overseas earnings" replaces "foreign emoluments" to describe earnings for a year in which the employee is resident and ordinarily resident but not domiciled in the United Kingdom that are from an

employment with a foreign employer where the duties are all performed outside the United Kingdom.

84. This section derives from section 202A(1) of ICTA and appears as a separate category for the first time here. See *Note 8* in Annex 2.

85. *Subsection (3)* sets out the rule that the receipts basis is not affected by the fact that earnings may relate to a different tax year to that in which they are received or to a year when the employment is not held. It derives from section 202A(2) of ICTA.

86. *Subsection (4)* is a signpost to section 23 which describes how to calculate the amount of *chargeable* overseas earnings to be excluded from this section.

Section 22: Chargeable overseas earnings for year when employee resident and ordinarily resident, but not domiciled, in UK

87. This section deals with those earnings that the Schedule E legislation excepts from Case I as "foreign emoluments" by virtue of section 192 of ICTA.

88. *Subsections (1)* and *(2)* explain that, where this section applies, "taxable earnings" are the full amount of overseas chargeable earnings that are remitted to the UK. See *Note 9* in Annex 2.

89. *Subsection (3)* sets out the rule that the remittance basis is not affected by the fact that the earnings may relate to a different tax year to that in which they are remitted or to a year when the employment is not held. It derives from section 202A(2) of ICTA. It also includes a signpost to possible relief under section 35 in the cases of delayed remittances.

90. *Subsection (4)* is a signpost to section 23 which describes how to calculate the amount of chargeable overseas earnings within this section.

91. Normally, any deductions available would be subtracted from taxable earnings, under section 11 to give "net taxable earnings" – the amount chargeable to tax in that year. However, deductions have already been taken off in arriving at the amount of "chargeable overseas earnings" according to the calculation set out in section 23. *Subsection (5)* sets out that deductions taken off in arriving at "chargeable overseas earnings" should not be taken off again in arriving at the "net taxable earnings" relating to those chargeable overseas earnings.

92. Those deductions are, however, still available to set against any taxable earnings that remain subject to section 21. See *Note 8* in Annex 2.

Section 23: Calculation of "chargeable overseas earnings"

93. This section sets out what overseas earnings are and how to calculate "chargeable overseas earnings". It derives from the description of "foreign emoluments" set out in section 192 of ICTA.

94. Section 192(5) of ICTA says that the *amount* of the excepted emoluments is the amount remaining after any capital allowance and after any deductions under a series of listed provisions. Those listed provisions do not include all the provisions under which deductions could be allowed if one were simply computing an amount of taxable income. It is not clear why some provisions are mentioned and others not.

95. Section 192(5) has therefore been rewritten in section 23(3) of the Act to allow a person's "overseas earnings" to be reduced by *any* deductions. See *Change 3* in Annex 1. An example may serve to illustrate the effect of this change:

96. Suppose a taxpayer has foreign emoluments (overseas earnings) of £1,000, and deductions within the section 192(5) list of £200 plus other deductions of £100.

97. Under section 192(5) of ICTA the amount of foreign emoluments excluded from Case I would be £800, leaving £200 chargeable under Case I against which £200 of the taxpayer's total £300 deductions can be set. The net result is Case I charge = Nil, Case III charge = £800.

98. Under the rewritten legislation the amount of chargeable overseas earnings within section 22 would be £700, leaving £300 within section 21 against which all of the taxpayer's total £300 deductions can be set. The net result is section 21 charge = Nil, section 22 charge = £700.

99. The outcome is clearly in the taxpayer's favour.

Section 24: Limit on chargeable overseas earnings where duties of associated employment performed in UK

100. This section contains the anti-avoidance rules for earnings from associated employments. They derive from paragraph 2 of Schedule 12 to ICTA.

101. The effect of these rules is to limit the amount of overseas earnings taxed on the remittance basis because of the operation of sections 22 and 23 in cases where there are associated employments. The reference in *subsection (3)* to "section 23(3)" means that this section adopts the same approach as described in paragraph 95. See *Change 3* in Annex 1.

102. Where this section does apply a limit to the amount of general earnings computed under section 23 to be within section 22, any excess of the overseas earnings above that limit falls within section 21. This is set out in *subsection (7).*

Section 25: UK-based earnings for year when employee resident, but not ordinarily resident, in UK

103. This section sets out how to calculate the taxable earnings in a year when the employee is resident but not ordinarily resident in the UK, and whose earnings are in respect of duties performed in the UK or from overseas Crown employment subject to UK tax (defined in section 28).

104. These rules derive from paragraph 1 of section 19(1) (Case II of Schedule E), section 132(4)(a) and section 202A(1)(a) of ICTA. See also *Note 10* in Annex 2.

105. *Subsection (3)* sets out the rule that the receipts basis is not affected by the fact that the earnings may relate to a different tax year to that in which they are received or to a tax year when the employment is not held. It derives from section 202A(2) of ICTA.

Section 26: Foreign earnings for year when employee resident, but not ordinarily resident, in UK

106. This section sets out how to calculate the taxable earnings in a year when the employee is resident but not ordinarily resident in the United Kingdom, when those earnings are neither in respect of duties performed in the United Kingdom nor from overseas Crown employment subject to UK tax, and so not within section 25.

107. These rules derive from paragraph 1 of section 19(1) (Case III of Schedule E) and section 202A(1)(b) of ICTA. See also *Note 9* in Annex 2.

108. *Subsection (3)* sets out the rule that the remittance basis is not affected by the fact that the earnings may relate to a different tax year to that in which they are remitted or to a year when the employment is not held. It derives from section 202A(2) of ICTA.

Section 27: UK-based earnings for year when employee not resident in UK

109. This section sets out what earnings are taxable earnings in a year when the employee is not resident in the United Kingdom. These rules derive from paragraph 1 of

section 19(1) (Case II of Schedule E), section 132(4)(a) and section 202A(1)(a) of ICTA. See also *Note 10* in Annex 2.

110. *Subsection (3)* sets out the rule that the receipts basis is not affected by the fact that the earnings may relate to a different tax year to that in which they are received or to a tax year when the employment is not held. It derives from section 202A(2) of ICTA.

Section 28: Meaning of "general earnings from overseas Crown employment subject to UK tax"

111. This section explains what is meant by "qualifying earnings from overseas Crown employment subject to UK tax" in sections 25 to 27. It derives from section 132(4)(a) of ICTA. See also *Note 10* in Annex 2.

112. *Subsections (5)* to *(8)* derive from ESC A25. That concession operates to remove from the scope of UK income tax locally engaged low paid staff employed overseas by the Crown, in accordance with long-standing practice and in keeping with international treaty obligations. See *Change 4* in Annex 1.

Section 29: Meaning of earnings "for" a tax year

113. This section explains what is meant by earnings "for" a tax year. It is a new section in response to requests made during the consultation leading up to this Act which suggested that it would be a good idea to have this kind of clarification about what earnings are "for" a tax year. See *Note 6* in Annex 2. The counterpart to this section in Chapter 4 is section 16.

114. *Subsection (2)* identifies the period that the earnings are "for", and *subsections (3)* and *(4)* explain how to work out the tax year that the earnings are "for" on the basis of the period determined in subsection (2). If the period spans more than one tax year then the earnings for that period should be apportioned between those years on a just and reasonable basis.

115. Some of the provisions in Part 3 that operate to treat income as earnings specify the year "for" which the income should be so treated. *Subsection (5)* makes it clear that section 29 does not displace the effect of those provisions in Part 3.

Section 30: Treatment of earnings for year in which employment not held

116. This section sets out how earnings from an employment should be treated if they would otherwise be considered as earnings for a year before or after that employment is held. It derives from paragraph 4A of section 19(1) of ICTA. Its counterpart in Chapter 4 is section 17.

117. Where the Schedule E legislation provides that an amount shall be treated as an emolument of an employment only if provided in a year when the employment is held, this Act reproduces that limitation. The sections in the benefits code make it clear that such amounts or benefits will only be treated as earnings if they are paid/provided in a year in which the employment is held. If they are paid/provided at any other time they will not be treated as earnings and will be outside "general earnings" to which section 30 applies. *Subsection (4)* makes it clear that this section does not apply in connection with determining amounts to be treated as earnings under the benefits code. See *Note 7* in Annex 2.

Section 31: Receipt of money earnings

118. This section sets out the rules for determining when money earnings should be treated as received, providing for the first time a single rule for all money earnings. It derives from the first half of section 202B of ICTA. See also *Change 1* in Annex 1. Its counterpart in Chapter 4 is section 18.

Section 32: Receipt of non-money earnings

119. This section sets out the rules for determining when non-money earnings should be treated as received, excluding any money earnings. The section derives from section 202B(7) to (11) of ICTA. The exclusion of money earnings is new. See *Change 2* in Annex 1. The counterpart to this section in Chapter 4 is section 19.

Section 33: Earnings remitted to the UK

120. This section deals with the remittance of general earnings to the United Kingdom. This is relevant for general earnings charged under section 22 (chargeable overseas earnings for year when employee resident and ordinarily resident, but not domiciled, in the United Kingdom) and general earnings charged under section 26 (foreign earnings for year when employee resident, but not ordinarily resident, in the United Kingdom).

121. *Subsection (2)* derives from section 132(5) of ICTA. Apart from using the term "remitted to" in place of "received in", the conditions are expressed in the same language. General earnings are treated as remitted to the United Kingdom if they are paid, used or enjoyed in the United Kingdom, or transmitted or brought to the United Kingdom in any manner or form.

122. Section 132(5) also contains a cross-reference to certain anti-avoidance measures contained in section 65(6) to (9) of ICTA dealing with constructive remittances to the United Kingdom that would not otherwise fall to be taxed under the general rule.

123. Instead of a cross-reference to those provisions, section 65(6) to (9) of ICTA have specifically rewritten, as they apply to remittances of general earnings, in *subsections (3)* to *(7)* of this section, and in section 34.

124. The provisions are concerned with anti-avoidance measures to counter the practice of taking out loans in the United Kingdom and subsequently arranging for the debt (or interest on the debt) to be repaid abroad out of unremitted general earnings. They also apply to loans taken out outside the United Kingdom, where the money borrowed is subsequently received in the United Kingdom. The provisions only apply if the taxpayer is ordinarily resident in the United Kingdom.

125. *Subsection (3)* states that the general earnings of a person who is ordinarily resident in the United Kingdom will be treated as remitted to the United Kingdom at the time when the general earnings are used outside the United Kingdom in or towards satisfying a UK-linked debt.

126. *Subsection (4)* explains what is meant by this new label "UK-linked debt". It is: (a) a debt for money lent to the employee in the United Kingdom, or for the interest on money so lent; (b) a debt for money lent to the employee outside the United Kingdom and received in the United Kingdom or (c) a debt incurred satisfying a debt falling within (a) or (b).

127. *Subsection (5)* states that, for debts falling within subsection (4)(b) or (c), it is immaterial whether the money lent is received into the United Kingdom before or after the general earnings are used to repay the debt. But, in the case of money received into the United Kingdom after the general earnings are used to repay the debt, the general earnings will not be treated as being remitted to the United Kingdom until the money lent is received there.

128. *Subsection (6)* extends the meaning of the reference to money being "received" in the United Kingdom in subsections (4) and (5) to include money being "brought to" the United Kingdom.

129. *Subsection (7)* is a pointer to the provisions of section 34, which also concern UK-linked debts.

Section 34: Earnings remitted to the UK: further provisions about UK-linked debts

130. This section contains more provisions about UK-linked debts.

131. *Subsection (2)* sets out the rules for determining when a person, defined as the "borrower", will be treated for the purposes of the section as using the earnings towards satisfying a debt. Two conditions must be met, Conditions A and B.

132. Condition A is that the earnings are so dealt with that the lender holds money or property representing the earnings in such a way that the money or property is available to the lender to satisfy, or reduce, the debt. This is set out in *subsection (3)*.

133. *Subsection (4)* sets out Condition B, that there is an arrangement between borrower and lender such that the quantum of the outstanding debt or the timing of the repayment of the debt depends on the amount or value the lender holds as mentioned in subsection (3).

134. *Subsection (5)* explains when a debt for money lent can be treated as incurred towards satisfying another debt.

135. *Subsection (6)* extends the meaning of lender to include any person for the time being entitled to repayment and *subsection (7)* extends the meaning of "satisfy" (also for the purposes of section 33) to mean satisfy wholly or in part.

Section 35: Relief for delayed remittances

136. This section provides relief for employees whose earnings are taxable when remitted to the United Kingdom and who have been unable to remit their earnings in an earlier year because of local law or the impossibility of obtaining currency that could be transferred to the United Kingdom.

137. It derives from section 585 of ICTA.

138. *Subsection (1)* allows a claim for relief for delayed remittances. The claim may be for all or part of the delayed remittances. See *Change 5* in Annex 1.

139. *Subsection (2)* defines "delayed remittances" as earnings which are taxable when remitted to the United Kingdom, were received in an earlier year but remitted to the United Kingdom in a later year and which could not have been remitted before that later year.

140. Section 585 refers to income "arising". This becomes "income received" in this section to reflect the receipts basis used for Schedule E. See *Change 6* in Annex 1.

141. In section 585(1)(c) the third condition for a claim to be made is that the inability to transfer the income to the United Kingdom "was not due to any want of reasonable endeavours" on the part of the employee. This condition has been omitted in rewriting this subsection. See *Change 5* in Annex 1.

142. The final condition in section 585(1)(b) is the impossibility of obtaining foreign currency in that territory. "Foreign currency" has been rewritten in subsection 2(c)(iii) as "currency other than the currency of that country or territory". See *Note 11* in Annex 2.

143. In rewriting that same condition the words "that could be transferred to the United Kingdom" have been added. See *Change 5* in Annex 1.

144. *Subsection (3)* explains the result of the claim for relief. The amount chargeable for the tax year in which the delayed remittances are received in the United Kingdom is reduced and the amount of the reduction becomes chargeable for an earlier year. The amount allocated to earlier years is in accordance with either subsection (4) or an election under section 36 (election in respect of delayed remittances).

145. *Subsection (4)* sets out the allocation to tax years if no election is made. In cases where the employment income of only one year cannot be remitted the amount of the income remitted in a later year is treated as if it had been remitted in the year in which it was received. The same applies when there is more than one year in which the income was received.

Section 36: Election in respect of delayed remittances

146. This section sets out in detail how the election allowed by section 35(3)(b) operates. It is new. See *Change 7* in Annex 1.

147. *Subsection (1)* explains that the section applies when a claim is made and the claimant has blocked earnings.

148. *Subsection (2)* defines "blocked earnings".

149. *Subsection (3)* allows the claimant to decide to which year the delayed remittances are to be allocated.

150. *Subsection (4)* places a restriction on the tax year to which the income can be allocated.

151. *Subsection (5)* requires the amount to be allocated to a particular year to be specified in the election if more than one year is specified.

152. *Subsection (6)* requires that the amounts allocated to an earlier year must not exceed the amount of earnings which could not be remitted in that year.

153. *Subsection (7)* makes the election part of the claim and irrevocable.

154. *Subsection (8)* ensures that personal representatives are able to make the election.

Section 37: Claims for relief on delayed remittances

155. This section sets out the administrative provisions regarding the claim under section 35.

156. It derives from section 585 of ICTA.

157. *Subsection (1)* sets out the time limit within which the claim must be made.

158. *Subsection (2)* allows tax adjustments to be made for earlier years to implement the claim and election.

159. *Subsection (3)* overrides anything in the Income Tax Acts which would otherwise prevent the adjustments from being made, such as time limits.

160. *Subsection (4)* allows the claim to be made by the personal representatives of someone who would have been entitled to make it.

161. *Subsection (5)* provides for the collection and repayment of tax in the case of someone who has died. The personal representatives are liable in respect of the tax which has become chargeable for an earlier year. This is the case, because of subsection (3), even where that year is otherwise time-barred.

162. *Subsection (6)* provides for additional tax to be assessed on the personal representatives and to be a debt of the estate.

Section 38: Earnings for period of absence from employment

163. The place where the duties of an employment are performed is relevant in determining which section in Chapter 5 applies for the purposes of calculating the taxable earnings for the year. This section sets out how to treat earnings for a period of absence from the employment, when there are, of course, no duties performed. It derives from section 132(1) of ICTA.

Section 39: Duties in UK merely incidental to duties outside UK

164. This section sets out that if the duties of the employment are performed outside the United Kingdom but there are some incidental duties performed in the United Kingdom, then those incidental duties are to be treated as being performed outside the United Kingdom. This section does not apply to employees claiming a deduction from seafarer's earnings, for which a separate rule appears in the Chapter dealing with that deduction. This section derives from section 132(2) and (3) of ICTA.

Section 40: Duties on board vessel or aircraft

165. This section sets out the rules for deciding where duties should be treated as being performed if they take place on a vessel or an aircraft. It derives from section 132(4)(b) of ICTA. Subsections (3) to (6) set out the rule for the treatment of seafarers carrying out duties on a ship. This derives from paragraph 5 of Schedule 12 to ICTA.

166. "Ship" takes its everyday meaning, subject to the exception in respect of an "offshore installation" as provided by the Mineral Workings (Offshore Installations) Act 1971. Further guidance on the meaning of those terms is given in the Inland Revenue Schedule E manual at paragraphs SE 33221 to 33222.

Section 41: Employment in UK sector of continental shelf

167. This section sets out that earnings from certain activities performed in the United Kingdom sector of the continental shelf are to be treated as earnings from duties performed in the United Kingdom. It derives from section 830(5) of ICTA.