US dividend income of UK resident US citizen

Background
A US citizen, X, who is a UK resident may receive US dividends. X would be taxable in the UK, as a UK resident, and in the US, as a US citizen, but with the benefit of the UK/US double tax treaty. This note outlines the basis of the taxation of dividends in these circumstances.

Remittance basis user
X may be domiciled outside the UK, possibly in the US. If so, X may claim to be liable to UK tax on non-UK source income on a remittance basis.

If X claims the remittance basis and does not remit the US dividends, then X would not have any UK tax liabilities. X's only concerns would then be US tax.

If X were to claim the remittance basis and remit the US dividends, X would have UK tax liabilities in the same way as a non-remittance basis user, as analysed below. However, this would be with the exception that general rates of tax would apply and not special dividend rates.

UK domestic rules
UK domestic tax rules would apply if either-

- X is not a remittance basis user.
- X is a remittance basis user, but remits the US dividends.

Under UK domestic rules UK dividends, most non-UK dividends and distributions from non-UK offshore funds are taxed in a different way from all other income.

- The dividends are deemed to carry a 10% notional tax credit.
- The dividends are taxed at the special (lower) rates applying solely to dividend income.

For instance, if X generally paid UK tax at a marginal rate of 40%, the effect of these two factors is that X's dividends would effectively be taxed at a rate of 25%. As mentioned above, if X were a remittance basis user but remitted the dividends, then the dividend rates of tax would not apply. However, the 10% notional tax credit would apply.

US domestic rules
As a US citizen, X would be liable to US tax on his worldwide income, including the dividends, irrespective of whether or not X is a US tax resident. US domestic rules are not further explored in this note.

US withholding tax

The normal position of US dividends paid to a UK resident may be summarised as follows-

- The US imposes a withholding tax on US dividends paid to non-residents of 30%.
- Under the UK/US double tax treaty, the rate of withholding tax for dividends paid to UK residents is reduced from 30% to 15%, on making an appropriate claim.

The US does not apply withholding tax on its non-resident citizens. However, X might need to complete a form confirming his beneficial ownership and citizenship to prevent the imposition of a withholding tax.

UK/US double tax treaty (DTR)

The position on the application of the UK/US double tax treaty to the US dividends can be summarised as follows-

- As X is a US citizen, the full terms of the DTR do not apply, as a result of the savings clause in Article 1(4) of the treaty. Instead, as a US citizen, X benefits only from the limited provisions listed in Article 1(5). The only one of the limited provisions relevant to the taxation of the US dividends is Article 24, which gives relief from double taxation. In particular, Article 24(6) deals with the taxation of UK resident US citizens.
- Under Article 24(6)(b), the UK is required to give credit for the US tax that would have been imposed on US source income if that income had been paid to a non-US citizen.
- As noted above, the US would have imposed a withholding tax at the rate of 15% if the US dividends had been received by a UK resident; this would have represented the final liability on these dividends. Therefore, the UK is required to give credit for a notional US tax at the rate of 15%. For example, if X generally pays UK tax at a marginal rate of 40%, then as noted above the effective UK rate of tax under the domestic rule is 25%. The application of the DTR reduces the tax by the notional US tax of 15%, to bring about a reduction of the UK tax payable to 10% of the US dividends.
- Article 24(6)(d) then requires the US to treat part of the US dividends as if they were UK source income, to prevent the double taxation of this income. The precise working of this depends on the rates of US tax payable by X.

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