

STATUTORY DEFINITION OF TAX RESIDENCE



BRIEFING

OVERVIEW

In the 2011 Budget statement the Chancellor announced:

- that there is to be a statutory residence test (SRT); and
- reforms to the taxation of foreign domiciliaries.

Separate Consultation Documents on the two topics were issued jointly by HM Treasury/HMRC on 17 June 2011 with the deadline for comments set at 9 September 2011. The level of responses received for both Consultations was unusually high. The Government's response came on 6 December 2011 in the form of a Written Ministerial Statement which addressed both issues, and a Response Document and draft legislation in connection with the reforms to the taxation of foreign domiciliaries.

The proposals for a statutory definition of tax residence will be taken forward. However, to allow time for appropriate consideration of the various issues raised in the many consultation responses received, the test will not now be introduced until 2013/14. The Government's Response to the SRT Consultation, a further SRT Consultation Document on policy detail, draft legislation and draft explanatory notes are expected to be released as part of the 2012 Budget (Wednesday 21 March 2012).

The Government's proposals for reforms to the taxation of foreign domiciliaries will be enacted in two stages with the main reforms being included in Finance Bill 2012 and effective from tax year 2012/13 onwards. They are the subject of a separate briefing.

January 2012

1. THE SRT PROPOSALS AT A GLANCE

The main points, within the proposals for a statutory test of tax residence, as set out in June are:

- A detailed framework for a SRT
- Statutory split year rules
- Anti-avoidance provisions for temporary non-residents in respect of some forms of investment income (along the lines of the current anti-avoidance rules for Capital Gains Tax)
- Ideas as to how the issue of ordinary residence should be addressed

The Government rejected the idea of a residence test based purely on the amount of time spent in the UK. It is proposed that the test should recognise:

- time spent in the UK;
- a limited number of defined connections; and
- that residence should have an adhesive nature. There should be a more stringent test for those previously resident who seek to leave the UK (referred to as “leavers”) than for those who come to the UK, but have not been UK resident in any of the three preceding tax years (referred to as “arrivers”).

Rawlinson & Hunter comments

We support the concept of a statutory residence test, and broadly welcomed the proposals set down in the Consultation Document. However, we have some concerns which we raised in our response.

Our key concerns are:

- *That certain terms need to be defined more clearly. We feel it is vital that all the terms used in the legislation are workable, realistic and objective, so that the legislation can stand on its own without taxpayers requiring HMRC Guidance to understand how such terms will be interpreted. The present law on residence is notoriously uncertain and the new test should be clear and comprehensive so that taxpayers have no need to resort to HMRC Guidance which has no statutory authority and can change.*
- *That the proposed Part C connection factors could lead to an element of double counting (the UK resident family and accessible UK accommodation factors being effectively a single factor which, under the proposals in the Document, would constitute two separate connection factors).*
- *That under the current proposals there are not to be any transitional rules.*

We consider that abolishing the concept of ordinary residence would simplify the legislation. However, whilst we think the concept of ordinary residence should be abolished it is linked to a number of provisions which are favourable to the taxpayer. We think the reliefs/carve outs (such as, but not limited to, overseas workday relief) should be retained; however, rather than being linked to ordinary residence they should depend upon an ‘arriver’ being resident for no longer than a specified number of tax years. The consultation document refers to residence throughout two full tax years, but we think that a more appropriate period would be three full tax years. This would ensure that foreign work day relief will always apply throughout a three year secondment. We believe this is important to ensure the UK continues to be attractive as a place for multi-nationals to send foreign employees on secondment.

2. WHEN WILL THE SRT APPLY?

The proposal is that the SRT will apply from 2013/14 onwards for the purposes of Income Tax, Capital Gains Tax (“CGT”) and Inheritance Tax. For these purposes it will supersede all existing legislation, case law and guidance. The current intention is that there will be no transitional provisions so an individual’s residence status for 2012/13, this current tax year (2011/12) and previous tax years will continue to be determined under the existing laws, despite the lack of clarity and certainty which is recognised to subsist.

It is not envisaged at present that the SRT will be applied for other purposes where residence is a determining factor. In particular the SRT will not apply for the purposes of National Insurance contributions.

The Constitutional Reform and Governance Act 2010 has priority, so MPs, and active members of the House of Lord will continue to be deemed UK resident.

3. HOW DOES THE NEW SRT WORK?

The proposed test is divided into three parts: Part A, Part B and Part C. These parts set out the component elements of the test, arranged in order of priority. An individual seeking to determine his position should start with Part A which contains three conditions. If one or more of these conditions applies, the taxpayer will not be UK resident and need go no further. The SRT will have produced an answer.

It is only where Part A does not provide an answer that the individual has to go on to Part B. Part B

also contains three conditions. In contrast to Part A if one or more of the Part B conditions are met then the individual will be UK resident. Again the SRT will have produced an answer, and the taxpayer should go no further.

The individual should only have to progress to Part C when neither Part A nor Part B has provided an answer (that is not one of the six conditions applies in the year in question). Part C looks at UK days and a small number of Connection Factors. It is based on two underlying principles:

- The more time an individual spends in the UK, the fewer Connection Factors are required for the individual to be UK resident.
- The test for “leavers” should be more stringent than for “arrivers”.

To fuse physical presence (day count) with Connection Factors into a composite tiebreaker test, “scales” are proposed to determine whether an individual who has had to refer to Part C is or is not UK resident. Days spent in the UK are banded, with each band being allocated a specified number of Connection Factors which, if met or exceeded, result in the individual’s being UK resident. The lower the day count, the more Connection Factors an individual can have and still be non UK resident.

To reflect the principle that it should be harder for a leaver to break UK residence than for a new arrival to avoid acquiring it, there are different scales for “leavers” and “arrivers”. “Leavers” have one additional Connection Factor to consider.

Part C has been designed so that it will always produce a clear result, assuming that Connection Factors can be clearly identified.

To assist taxpayers in determining their residence status, H M Revenue & Customs proposes to make available an interactive online programme. A prototype is now available at www.hm-treasury.gov.uk/consult_statutory_residence_test.htm

4. SRT: Part A

4.1 Explanation

As an invariable rule, an individual will not be UK resident if one of the following conditions applies:

- He or she is present in the UK for FEWER than 10 days (meaning presence in the UK at midnight on the day concerned)
- He or she is:
 - present in the UK for FEWER than 45 days (again counting only midnights); and
 - not UK resident in ANY of the previous three tax years

- The taxpayer leaves the UK to carry out full time work abroad (a special definition is provided) and ALL of the following conditions are met:
 - present in the UK for FEWER than 90 days (again counting only midnights);
 - no more than 20 days are spent working in the UK in any one UK tax year (special definition of working days is provided). The time limits are reduced pro rata if the split year rules apply.

The time limits are reduced pro rata if the split year rules apply.

Rawlinson & Hunter comments

Whilst we do not think it appropriate to add a fourth condition within Part A we have suggested that there be a streamlined process where someone claims to be treaty resident in a different jurisdiction. Under the current provisions, the compliance burden facing an individual who is treaty resident outside the UK is on a par with that of someone who is UK resident, as a claim for relief has to provide details of all the income and gains for which relief is being claimed. We have suggested that:

- *a stand-alone form is produced to claim treaty relief, so that an individual whose claim is accepted does not have to complete a full self-assessment return; and*
- *rather than having to provide a full return of the income and gains taxable in the other state, the individual should only be required to provide a round sum indication of the amount of income or gains in point.*

4.2 Special definitions

The Consultation Document specifically envisages that the definitions will be refined through the consultation process. This has been one of the areas where most time has been devoted to refining the proposals. The difficulties in arriving at workable definitions are understood to have been important in the decision to defer the introduction of the SRT to allow further consideration of the various issues.

UK days

The current statutory definition of UK days is to be retained. This means that a day will count as one of UK presence where the individual is in the UK at the end of that day (meaning at midnight). Exceptionally, a day will not be counted if the transit exemption applies, that is where:

- the individual arrives in the UK on day one;
- leaves the UK the next day (day two); and
- during the time between arrival and departure the individual only engages in activities that are related substantially to their passage through the UK.

There is no mention of the current non-statutory disregard for any days spent in the UK because of exceptional circumstances beyond the individual's control (such as transport disruptions or illness). This does not apply for the purposes of the statutory 183 day test, and it appears that under the SRT the concept may fall away entirely, although many representations have been made in support of its retention.

Full time work abroad (FTWA)

A person qualifies as having FTWA where he or she leaves the UK to work abroad and the following conditions are met:

- The individual either:
 - works for at least 35 hours a week as a result of being employed or holding offices abroad (under one or more contracts of employment including consecutive employments); or
 - carries out one or more trades or professions wholly abroad, involving on average at least 35 hours of work per week
- The work must be carried out for at least one complete UK tax year.

Working day

A working day is defined as any day on which at least three hours of work is carried out. As such, for a day to be a UK working day, at least three hours of work must be carried out in the UK. Where an individual works less than three hours, the day is not counted. Where the three hour limit is breached the day is counted, even if the taxpayer is not in the UK at midnight.

Since the definition looks simply at hours worked, it follows that Saturdays, Sundays and Bank Holidays can count as working days.

The Consultation Document states that: "Where individuals work in the UK for less than three hours on a particular day, they would be expected to have sufficient records to demonstrate that fact". This will involve having to demonstrate a negative.

Rawlinson & Hunter comments

In summary we suggested that the definition of FTWA should include:

- *Any case where the individual works full time (as defined) abroad, whether paid or on a voluntary basis.*
- *Where there is both employment and self-employment, the cumulative hours of work should be combined in looking at the 35 hour target.*
- *For the avoidance of all doubt the definition of "full time" should make provision for holiday and sickness leave.*

With respect to the definition of working day, we expressed concern over what would constitute work for the purposes of the test. It will be very difficult to formulate a definition of working day which does not result in practical problems. We have suggested that any definition should make it clear that incidental activities, and the sort of monitoring that is expected of professionals and senior executives, even when on holiday, should be excluded. These would include:

- *training (including technical reading);*
- *casual conversations such as during a social event where work issues are briefly discussed;*
- *monitoring e-mails, forwarding e-mails to colleagues to deal with in the individual's absence and providing non-substantive responses.*

Proving a negative is notoriously difficult. We suggested that, as a matter of practice, where the individual is able to provide clear, prima facie evidence to show that he or she was not formally working (such as timesheets or other internal data of the business normally required for recording work carried out), HMRC should seek further evidence only in cases of serious doubt or uncertainty.

5. SRT: Part B

5.1 Explanation

Where the SRT is being applied and one of the Part A conditions is not met, Part B provides that a taxpayer will ALWAYS be UK resident if one of the following conditions applies:

- the taxpayer is present in the UK for 183 days (counting only midnights) or more;
- the taxpayer has a his or her "only home" (or homes) in the UK and not in any other country. There is no specific definition of "home";
- the taxpayer carries out full time work in the UK (special definition).

5.2 Part B - special definitions

As discussed at 4.2 the definitions will be refined through consultation. We have made the points set out below.

Only home

We are told that the term "only home" covers two situations. The first is where the individual only has one home and this "only home" is situated in the UK. The second is whether the individual has more than one home, but all are situated in the UK.

For the purposes of the SRT, residential accommodation will not be treated as the individual's home if that accommodation is being advertised for sale or let and the individual lives in another residence

No definition of the term “home” is given, which implies that the dictionary definition must be used. This introduces an element of subjectivity. For young adults in particular there is uncertainty over whether the parental home would count if they could still have a room or rooms available there.

Rawlinson & Hunter comments

We understand why the Government would wish to include a condition in Part B which would result in an individual being treated as resident if his (or her) only residential accommodation is located within the UK. However, the term “home” is subjective, emotive and uncertain, and is inappropriate in a test which aims to provide objective certainty.

We suggested that the condition be changed so that it applies to individuals who “only have accessible accommodation in the UK”. “Accessible accommodation” is a connection factor for Part C of the SRT and we feel that, in the interests of simplicity, it would be helpful to have consistent terminology and use as few new terms as possible within the SRT.

Full time work in the UK

A person qualifies as having full time work in the UK where the following conditions are met:

- The individual either:
 - works for at least 35 hours a week as a result of being employed or holding an office in the UK (under one or more contracts of employment, including consecutive employments); or
 - carries out one or more trades or professions in the UK where on average at least 35 hours of work per week is undertaken
- The work must be carried out in the UK over a continuous period in excess of nine months (excluding short breaks such as illness or holiday).
- Not more than 25% of the duties are undertaken outside of the UK within that period.

6. SRT: Part C

6.1 “Arrivers”

The term applies to individuals who were not UK resident in all of the previous three tax years. The following are Connection Factors for “arrivers”:

- a UK resident family
- a substantive UK employment (including self-employment)

- accessible accommodation in the UK
- 90 days or more spent in the UK in EITHER of the previous two tax years.

All these terms are defined (see 6.3 below).

A Connection Factor will count if the relevant condition is met at ANY point in the relevant tax year. It does not need to apply throughout the tax year. As such an individual who needs to reduce his Connection Factors for a specific tax year (perhaps because he foresees having to spend more days in the UK) will have to ensure that adjustments to other Factors (such as moving his family out of the UK or ensuring that he does not have accessible UK accommodation) are effected in the previous tax year.

Provided the 183 day test is never broken, the lower the number of Connection Factors, the higher the number of UK days the individual can spend in the UK without being UK resident.

The “arrivers” table:

UK days	Impact on Connection Factors
Fewer than 45 days	Should not have progressed to Part C as one of the Part A tests is met and the taxpayer is not UK resident
45 to 89 days	Can have three Connection Factors and still be not UK resident
90 to 119 days	Can have two Connection Factors and still be not UK resident
120 to 182 days	Can have one Connection Factor and still be not UK resident
183 days or more	Should not have progressed to Part C as one of the Part B tests is met and the taxpayer is UK resident

It is important to recognise that even where the individual is non-resident, a UK presence in excess of 89 days in any tax year will automatically count as a Connection Factor for the following two tax years. This might mean that the individual has to take action so as either to lose another Connection Factor in those years, or reduce their day count.

6.2 “Leavers”

The term applies to individuals who have been UK resident in one or more of the previous three tax years. Consequently, under the current proposals, becoming UK resident for just one year will result in the individual being classed as a leaver for the next

three UK tax years. The following are Connection Factors for “Leavers”:

- a UK resident family (special definition)
- A substantive UK employment (including self-employment)
- Accessible accommodation (special definition) in the UK
- 90 days or more spent in the UK in EITHER of the previous two tax years
- More days spent in the UK in the tax year than in any other single country.

As discussed at 6.1 a Connection Factor will count if the relevant condition is met at ANY point in the relevant tax year. It does not need to apply throughout the tax year.

Note that it is likely that anyone who has been UK resident in one or more of the previous three tax years will have spent 90 days or more in the UK in one or other (or both) of the previous two tax years. Such individuals will, therefore, have already racked up one Connection Factor which they can do nothing about. If, for example, they want to be able to visit the UK for between 45 and 89 days in each of the next two tax years they will have to ensure they only have one further Connection Factor.

The “leavers” table:

UK days	Impact on Connection Factors
Fewer than 10 days	Should not have progressed to Part C as one of the Part A tests is met and the taxpayer is not UK resident
10 to 44 days	Can have three Connection Factors and still be not UK resident
45 to 89 days	Can have two Connection Factors and still be not UK resident
90 to 119 days	Can have one Connection Factor and still be not UK resident
120 to 182 days	Can have no Connection Factors if UK residence is to be avoided
183 days or more	Should not have progressed to Part C as one of the Part B tests is met and the taxpayer is UK resident

6.3 Part C - special definitions

Again, the Consultation Document anticipates that the definition of certain terms will need to be refined.

Family

An individual has family in the UK in a tax year if either of the following applies:

- The individual's spouse, civil partner or common law equivalent is resident in the UK in any part of the relevant tax year. This does not include a spouse, civil partner or common law equivalent from whom the individual is separated under a court order, or separation agreement, or where the separation is likely to be permanent.
- The individual has a child or children under the age of 18 who is or are resident in the UK in any part of the relevant tax year and the individual:
 - spends 60 days or more with such child or children; or
 - lives with the child or children for 60 days or more.

For the purposes of the 60 day test, a day is counted if any part is spent with the child, whether in the UK or abroad.

However, a child's UK presence will for this be disregarded if it results mainly from being at a UK educational establishment, provided:

- the child spends fewer than 60 days in the UK in addition to those at the educational establishment; and
- the child's main home is outside the UK.

Note the child will not personally be excluded from UK residence by this exemption (so it appears).

The factor and definition of “UK resident family” could imply a circular test where different “family” members have similar circumstances and all have to use Part C to determine whether they are UK resident. There could be some uncertainty if each is one Connection Factor short of being UK resident and the only other potential factor that could apply is “a UK resident family”. The language in the Consultation Document suggests that in such a situation other factors would have to determine the issue but it is hoped that this will be made clear.

Rawlinson & Hunter comments

Circularity

A UK family was included as a connection factor in relation to an individual whose spouse (or partner) and children are clearly UK resident. However, it is hoped that the draft legislation will make it clear that the connection factor will only apply where the spouse or minor children are UK resident as a result of their independently meeting one of the Part B conditions.

Double Counting

Where an individual meets the UK resident family condition, it is overwhelmingly likely that he or she will also meet the accessible accommodation condition. As such unless the Government specifically wants to weight the test against individuals with UK resident families, it seems unfair that UK resident family and accessible accommodation should count as two connection factors. To avoid the double counting problem we suggested that the two factors be merged such that there is just one factor which is: "UK resident family and/or accessible UK accommodation".

Minor children

We understand why the Government would want to count a UK resident child as a connecting factor where the father has responsibility for the child in the UK and the exclusion for UK schooling does not apply.

We have, however, made strong representations about the need to adjust the definition where the individual does not have parental responsibility since it seems to us unreasonable that a parent who does not have custody is deemed to have a connection factor to the UK because he or she sees their child on at least sixty days in the tax year (particularly since the suggested provision would count offshore days so that a parent who only ever spends time with their UK resident child outside the UK would still be caught by the sixty day rule).

Common law equivalents of spouses/civil parents

For the purpose of the SRT we have asked that there be a level playing field. In other words, if "common law" partners/civil partners can constitute a connecting factor for the purposes of Part C of the test, the benefits that can accrue to a spouse/civil partner of an employee who leaves the UK for Full Time Work Abroad should be extended to "common law" equivalents.

Accommodation

For the purposes of the SRT, it is proposed that an individual be treated as having UK accommodation if residential property:

- is accessible to be used by him or her as a place of residence; and
- is used by him or her or their family in the year as a place of residence.

It is assumed that for these purposes "family" has the same meaning as the specific definition discussed above.

It would appear that, where an individual's spouse/civil partner/common law partner is living in the UK, that individual will automatically have accessible accommodation.

However, certain categories of accommodation will not constitute UK accommodation for these purposes:

- accommodation provided by an employer where the accommodation is also accessible to, and used by, other employees of that employer who are not connected to the individual;
- any accommodation held on a lease of six months or less, except where there are consecutive leases with less than a six week break between. The leases need not be of the same property;
- accommodation provided to a minor child at a UK educational establishment;
- short-term accommodation in hotels; and
- lodging with relatives, where staying in the home of a relative is for a temporary short-term visit only.

Rawlinson & Hunter comments

We have expressed the view that the proposed definition is insufficiently clear, and needs to be both comprehensive and objective.

We have suggested that the statutory definition should provide for specific exclusions and that a property should not be considered as accessible if:

- The taxpayer has no assured right of use, so, for example:
 - the parental home will not count if an adult taxpayer with a home elsewhere visits; and
 - hotel or apartment accommodation will not count if the taxpayer has to book on each occasion of stay.
- It is let or on the market for letting (and is not actually used by the taxpayer in the relevant tax year).

Substantive employment (including self-employment) in the UK

An individual will be said to have substantive employment or self-employment in the UK if he or she works in the UK for 40 days or more in the tax year. A working day is a day on which three hours or more is worked.

Rawlinson & Hunter comments

We understand that the Government does not want the definition of UK working day to prevent individuals working on a voluntary basis for charities. We have suggested that where the work is unpaid any time spent working in the UK for a charity should be disregarded when it comes to the UK days figure.

SRT PART C - ILLUSTRATION

Until 2013/14 Joyce has been resident in Utopia and has never before been UK resident. Her UK days in 2011/12 and 2012/13 were between 10 and 25.

In the next two tax years (2013/14 to 2014/15) she

will have to come to the UK for between 95 and 110 days. In the 2015/16 her UK days will drop down to between 30 and 40 and in the years after that she may not come to the UK at all.

Her family will remain resident in Utopia and her main home will be there throughout.

From tax year 2013/14 onwards she knows that she will have a substantive UK employment (but it will not equate to working full time in the UK) and she expects to have available UK accommodation.

For 2013/14 she can use the “arrivers” table (in 6.1), and identify the applicable factors:

- a UK resident family - NO
- a substantive UK employment (including self-employment) - YES
- accessible accommodation in the UK - YES
- 90 days or more spent in the UK in EITHER of the previous two tax years - NO

She will, therefore, have two Connection Factors and, as her day count will be in the 90 to 119 days band, she is permitted two such factors. She will, therefore, be non-resident for 2013/14.

For 2014/15 she can again use the “arrivers” table, and identify the relevant factors:

- a UK resident family - NO
- a substantive UK employment (including self-employment) - YES
- accessible accommodation in the UK - YES
- 90 days or more spent in the UK in EITHER of the previous two tax years - YES

She will thus have three Connection Factors. Her presence in the UK for more than 89 days in the previous year has tipped the balance and for 2014/15, unless she can make changes either to reduce her day count or remove one of the connecting factors, she will be UK resident.

For 2015/16 (having been UK resident in one of the previous three tax years) she will have to refer to the “leavers” table (see 6.2). She will again have three Connection Factors (as nothing will have changed apart from her reduced day count). However, provided she keeps her day count to below 45, these three Connection Factors will not make her resident for the tax year (see the table in 6.2).

7. TRANSITIONAL PROVISIONS

The Government does not propose allowing the new SRT to be applied to determine residence for 2012/13 or earlier years, whether for the purposes

of ascertaining liability for these years, or retrospectively in identifying Connection Factors when considering residence status in 2013/14 onwards.

In the first few years of the new test, some of these factors require an individual’s status in earlier tax years to be ascertained. For example, to determine which Part C test to apply, the taxpayer needs to know his or her residence status in the previous three tax years. Individuals will be expected to apply the current law in determining their status for 2012/13 and earlier years. The Government considered allowing individuals to elect to apply the SRT for these purposes but has provisionally decided not to do so despite recognising the lack of clarity in the present position. However, it is one of the questions highlighted for consultation, so this may be reconsidered.

Rawlinson & Hunter comments

We accept that an individual who has self-assessed on the basis that he or she was UK resident for a tax year prior to 6 April 2013 should be regarded as UK resident for all UK tax purposes, including the application of the look-back provisions in the SRT.

However, we have suggested that when applying the SRT for tax years 2013/14 to 2015/16 taxpayers should be able to elect to apply the SRT tests for the purposes of the look back provisions so as to be certain of their status where:

- *they were not required to submit a tax return for one or more of the relevant tax years; and/or*
- *for one or more of the relevant tax years a tax return was submitted on the basis of their being non-UK resident.*

In some cases the SRT will allow taxpayers to retain connection factors which they would have been advised to shed under the current provisions (for example UK accommodation). We understand that, when considering the residence status of an individual for a tax year prior to 6 April 2013, HMRC will not seek to argue that actions taken after 5 April 2013, by someone who would be considered as non-resident under the SRT, might undermine the distinct break achieved in a tax year prior to 2013/14.

Now that the SRT has been postponed, so that it will only be effective from 2013/14, this year and 2012/13 will be the two look back years for the purposes of the Part C “90 days relevant factor”. As such, it might be possible to modify behaviour now to avoid having this as a connection factor in 2013/14.

8. SPLIT YEARS

For 2013/14 onwards, the current Extra Statutory Concessions are to be withdrawn and replaced by legislation. There are five situations which will allow a tax year to be divided between periods of residence and non-residence. Three of these relate to arrivals. The tax year will be split where an individual:

- becomes resident in the UK by virtue of his/her only home being in the UK; or
- becomes resident by starting full time employment in the UK; or
- returns to the UK following a period of working full time abroad.

For a leaver the UK tax year will be split where the individual:

- loses UK residence by virtue of working full-time abroad; or
- meets all three of the following conditions:
 - establishes his/her only home in a country outside of the UK;
 - becomes tax resident in the country outside the UK where his/her only home has been established; and
 - does not come back to the UK in that tax year.

It should be noted that, as presently proposed, it appears that a leaver must both establish a single home abroad and become “tax-resident” there. Moving to a country which does not impose tax on residents may not, therefore, allow the year of departure to be split, even if the leaver does not return to the UK during the remainder of the year.

If an individual leaves for full time work abroad, an accompanying spouse or civil partner will also be able to split the year of departure, but only if his or her main home is outside the UK.

Rawlinson & Hunter comments

We understand that HMRC do not intend the relief to be denied, where the individual has more than one house outside the UK, or the country concerned does not impose tax generally, or the individual does not meet local conditions for being tax resident in the year of arrival, provided that it is clear that a permanent home has been established. This will need to be clarified in the legislation.

We assume that the proposal which allows an accompanying spouse to be non UK resident where the conditions for full time work abroad are met by the spouse/civil partner will also apply to accompanying minor children of the couple. We hope the draft legislation will make this clear.

9. ANTI-AVOIDANCE PROVISIONS

Leaving the UK clearly allows UK tax to be avoided. In 1998, anti-avoidance rules were introduced to prevent avoidance by taxing on return certain gains realised during a period of temporary absence (meaning fewer than five complete tax years). These rules were extended to offshore income gains from 1 December 2009. The Finance Act 2008 also introduced rules specifically targeted to prevent foreign domiciliaries avoiding UK tax by using a short period of non-residence to remit pre-departure relevant foreign income. Currently, however, there are no rules to tax income arising in the non-resident period itself.

To prevent individuals using the certainty provided by the SRT to avoid substantial amounts of UK tax on income, it is proposed to introduce anti-avoidance provisions which will apply to some forms of investment income arising during a temporary period of non-UK residence. The rules are to be based on the current CGT provisions. This means that it is likely that the test will only apply where:

- the individual was UK resident and/or ordinarily resident (assuming that this concept is retained) in the UK in at least four of the seven tax years of assessment immediately preceding the year of departure; and
- the number of whole tax years in the years falling between the tax year of departure and the tax year of return is fewer than five.

In addition it is thought that the Income Tax charge will only be triggered where the income source was held prior to the individual's departure from the UK. Where the provision applies it is likely that the income which will be taxable will be brought into charge as a lump sum in the tax year of return. The Consultation Document states that the anti-avoidance provision will not apply to:

- earnings from employment or self-employment; or
- normal types of regular investment income (such as bank interest and dividends from listed companies).

It is clear that the key objective is to catch dividends paid by closely controlled companies out of profits built up during a period of residence. It is assumed that any legislation will catch such income whether paid directly or through overseas structures.

Rawlinson & Hunter comments

We understand why the Government feels that it is necessary to introduce an income tax anti-avoidance rule and prefer the targeted approach outlined in the Consultation Document to a provision which catches all income received in the period.

10. ORDINARY RESIDENCE

In the UK tax system there are three concepts that determine the liability of an individual to direct taxation: residence, ordinary residence and domicile. Of these, residence and domicile are the more important, but being not ordinarily resident in the UK can reduce an individual's liability to tax. Where someone is resident but not ordinary resident in the UK:

- the rules are more favourable when applying the remittance basis to foreign employment income (applying what is referred to in the Consultation Document as “overseas workday relief”);
- the anti-avoidance code relating to the transfer of assets abroad cannot apply; and
- a UK domiciled individual is able to claim the remittance basis with respect to foreign income.

Liability to CGT is determined by whether a taxpayer is UK resident or ordinarily resident in the UK. It is, therefore, envisaged that an individual might be not resident but remain ordinarily UK resident.

The Consultation Document recognises that the issue of ordinary residence must be tackled at the same time as residence. The importance of overseas workday relief is acknowledged in the Consultation Document and there is a commitment to preserving this relief for foreign domiciliaries. Two options are suggested:

1. Abolish ordinary residence for all tax purposes except in relation to overseas workdays.
2. Retain ordinary residence for all current tax purposes.

Under either option it is suggested that there will be a statutory definition of ordinary residence. The suggested definition is a negative one, starting from the premise that individuals who are resident in the UK will also be ordinarily resident unless:

- the tax year under consideration is the tax year of arrival in the UK, or the first or second full tax years following the year of arrival
- in the relevant tax year the individual has a home in a country other than the UK; and
- in respect of the year of arrival the individual had NOT been resident in the UK in any of the preceding five tax years.

The consultation paper considers the issue of UK domiciled individuals who might currently claim the remittance basis and overseas workday relief. The Government is currently minded to limit the definition so that only foreign domiciliaries can enjoy the status of being not ordinarily resident in the UK.

Rawlinson & Hunter comments

We have suggested that the concept of ordinary residence be abolished in its entirety. We recognise that “ordinary residence” is important in certain areas, but believe that the concept could be replaced by residence for more than a specified number of tax years (see below). We think that this would be easier for taxpayers to understand.

The main provisions which depend upon the concept of “ordinary residence” are as follows:

- *overseas workday relief (as highlighted in the Consultation Document);*
- *the “transfer of assets abroad” charging provisions, which do not apply unless the taxpayer is ordinarily resident in the UK;*
- *Inheritance Tax and Income Tax provisions with respect to exempt gilts.*

We feel that it would be appropriate that all these benefits should continue to accrue to individuals who are short-term UK residents.

We have no objections to restricting the reliefs granted to those not “ordinarily resident” (or short term residents if our suggestions above are preferred) to foreign domiciliaries. We believe that this would in practice cover most cases where there is an economic justification (such as encouraging short term secondment of foreign employees).

On the basis that the Consultation Paper makes it clear that the Government is not minded to have a test based purely on residence status, and wants the test to include a reference to accommodation, we have suggested that the benefits referred to above could be restricted to:

- *individuals who have been UK resident throughout no more than three of the five preceding tax years;*
- *have accessible accommodation outside of the UK; and*
- *who are domiciled outside the UK.*

11. NEXT STEPS

The Government has made it clear that it is committed to enacting an SRT and that the test will be along the lines set out in the June Consultation Document. The one year delay is to allow sufficient time to refine the proposals and it seems unlikely that the underlying principles will change. Specific practical points of detail such as the definitions and when a taxpayer should be allowed to split a UK tax year have been the subject of extensive comments and it is here that it is thought that the need to work through and address these detailed points has resulted in the legislation being delayed. It is hoped, particularly with respect to the definitions of the key terms, that the concerns raised in the course of the

consultation process and in the representations will be addressed.

The 2012 Budget is thought to be the time when the Government will publish: a Response Document which will discuss the SRT representations made, a further SRT Consultation Document on policy detail, draft SRT legislation and accompanying draft explanatory notes. We will provide an updated briefing paper at that time.

To date this exercise has been positive with goodwill on all sides. It is unfortunate that the legislation has had to be delayed and we have one more year to ensure the uncertainty with respect to the residence rules. This is, however, preferable to hurried legislation which could have made the situation worse. It is hoped that the test enacted in Finance Act 2013 will be the transparent, objective and internationally competitive test that everyone hopes for.

12. THE CURRENT POSITION ON RESIDENCE AND THE POSITION FOR 2012/13

The position for the current tax year and for 2012/13 is unchanged by the fact that there will be a statutory residence test enacted in 2013/14. Individuals seeking to leave the UK need either:

- to come within the full time work abroad criteria, such that HMRC will accept that a distinct break has been made without having to show other evidence of the loosening of social and economic ties with the UK; or
- to loosen social and economic ties with the UK, to a degree sufficient to demonstrate that there has been a distinct break.

Full time work abroad

To satisfy HMRC that an individual comes within the full time working abroad criteria he or she needs to comply with the conditions set down within HMRC 6. At 8.5 of HMRC6 it is stated that if an individual is leaving the UK to work full time abroad he or she will become not resident and not ordinarily resident from the day after the day of departure, as long as the individual:

- is leaving to work abroad under a contract of employment for at least a whole tax year;
- has physically left the UK to begin the employment abroad and not, for example, to have a holiday prior to the employment commencing;
- will be absent from the UK for at least a whole tax year;
- visits to the UK after the individual has left to begin their overseas employment will

- total less than 183 days in any tax year, and
- average less than 91 days a tax year.

The average referred to above is taken over the period of absence up to a maximum of four years.

A specific formula is provided within HMRC6 to calculate annual average visits to the UK:

$$\frac{\text{Total days visiting UK}}{\text{Tax years you have visited (in days)}} \times 365$$

HMRC are known to challenge claims where a different formula is used if average visits computed using this HMRC formula would exceed the 90 days figure.

HMRC will accept that the concession for full time work abroad will also be met if an individual is self-employed and works full time abroad. HMRC will seek to challenge a situation where it feels that the work is not genuinely full time. For these purposes “full time” means normally 35 hours, although a shorter time may be accepted if, by looking at the local conditions and practices of the particular occupation, it is appropriate to the country concerned.

It is important that any UK duties are only incidental to the foreign duties. As a general rule HMRC will argue that the term “incidental” should be construed strictly, stating at 10.6 of HMRC6:

“If the work that you perform in the UK is the same or is of similar importance to the work that you do abroad, it will not be merely incidental. You will have to show that there is a purpose to the work you did in the UK which enabled you to do your normal work abroad and which you could only do in the UK.”

The following are given as examples of incidental work:

- time spent in the UK by an overseas sales representative of a UK company to make reports or receive fresh instructions
- a short period of time spent training in the UK by an overseas employee, provided that no productive work is carried out in the UK by the trainee

With examples of non-incidental work being:

- time spent in the UK as part of the duties of a member of the crew of a ship or aircraft
- attendance at directors’ meetings in the UK by a director of the company who normally works abroad.

Whilst it is not said in HMRC6, it is known (see www.ion.icaew.com/TaxFaculty/22023) that HMRC have stated that where an individual has spent less than 10 working days in the UK in a tax year it will accept that the UK duties are incidental without further query. Where this de minimis level is exceeded it will be a question of fact as to whether the UK duties are incidental.

Loosen substantially social and economic ties with the UK

Where an individual does not work full time abroad, it will be necessary to show that there has been a distinct break, through a distinct change in social and economic ties with the UK.

Specific advice should always be taken but as a general guide an individual should seek to demonstrate that there has been a substantial loosening of ties. This was the term Lord Wilson preferred to “severing” in the Supreme Court decision in the case of Gaines-Cooper and others and indicates a less fundamental break with the UK. To be on the safe side, individuals leaving the UK, for permanent residence abroad, should consider:

- avoiding return visits to the UK at all in the tax year of departure and keeping visits in the next three years well below 90 days;
- ensuring that all immediate family members leave the UK with them;
- relinquishing a UK employment;
- either selling their UK residential property or ensuring that it cannot be used for residence or to store belongings, by making it available for letting and surrendering the keys (where property is rented out it will be necessary to register under the Non-Resident Landlords Scheme);
- not leaving personal possessions in the UK;
- not returning habitually to the UK to pursue a hobby;
- if at all possible, having family visits outside of the UK at the new home or at an alternative mutually convenient location;
- cancelling UK mobile telephone and e-mail contracts;
- attending to formalities, such as cancelling registration with UK doctors and dentists, as well as ensuring that tax compliance is up to date and HMRC are informed of the change of address;
- closing UK bank accounts and surrendering UK credit, debit and store cards;
- cancelling UK club memberships or switching to international member status.

As well as being able to demonstrate a loosening of ties with the UK it will be helpful to show the acquisition of ties with the new territory.

Good record keeping is essential and it will be important to acquire and retain supporting documentation. If helpful, professional advisers could keep copies of such documentation (as a back up) and put together a file both showing the steps taken to make the distinct break and providing appropriate supporting evidence that these steps have occurred.

Rawlinson & Hunter Chartered Accountants

Eighth Floor
6 New Street Square
New Fetter Lane
London EC4A 3AQ

And at

Lower Mill
Kingston Road Ewell
Surrey KT17 2AE

T +44 (0)20 7842 2000

F +44 (0)20 7842 2080

firstname.lastname@rawlinson-hunter.com

www.rawlinson-hunter.com

Partners

Chris Bliss FCA
Simon Jennings FCA
Philip Prettejohn FCA
Mark Harris FCA
Frances Jennings ACA
David Barker CTA
Kulwam Nagra FCA
Ben Melling FCA
Paul Baker ACA
Sally Ousley CTA
Derek Rawlings FCA
Andrew Shilling FCA
Craig Davies ACA

Directors

Lynnette Bober ACA
Phil Collington CTA
Mike Cunningham ACA
Karen Doe
Chris Hawley ACA
Nigel Medhurst AIT

Consultants

Ken Dent FCA
Bob Drennan FCA
Ralph Stockwell FCA

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