

STATUTORY DEFINITION OF TAX RESIDENCE



BRIEFING

OVERVIEW

On 17 June 2011 two Consultation Documents were issued:

- Statutory definition of tax residence
- Reform of the taxation of non-domiciled individuals

The proposals for the reform of the taxation of foreign domiciliaries are the subject of a separate briefing.

These documents set out the Government's underlying policy and suggestions for legislation. The timetables for both consultations are identical. Views are sought on the design and implementation of the policy by close of business on Friday 9 September 2011. A summary of responses will then be produced in the autumn with draft legislation published for comment later in 2011. The objective is for final legislation to be included in Finance Bill 2012, to take effect for tax years from 2012/13 onwards.

The proposed statutory test of tax residence comprises:

- A detailed framework for a statutory residence test (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 has 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").

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

June 2011

1. WHEN WILL THE SRT APPLY?

The proposal is that the SRT will apply from 2012/13 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 proposal is that there will be no transitional provisions (this is one of the points where comments have been requested), so an individual’s residence status for this and previous tax years will continue to be determined under the existing laws, notwithstanding the lack of clarity and certainty which is recognised to subsist.

It is made clear that there will be no attempt to align this new residence definition with that used by other Government services where residence is separately defined. In particular the SRT will not apply for the purposes of National Insurance contributions. In addition 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.

2. 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. All affected taxpayers should start with Part A which contains three conditions. If one or more of these conditions applies, the SRT will have produced an answer, the taxpayer will not be UK resident and need go no further.

It is only where Part A does not provide an answer that the taxpayer should progress 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 taxpayer will be UK resident. Again the SRT will have produced an answer, and the taxpayer should go no further.

The taxpayer 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 to the individual). 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 to be present 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 one tiebreaker test, “scales” have been created to determine whether an individual who progresses 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.

3. SRT: Part A

3.1 Explanation

A taxpayer will ALWAYS be non-UK resident if one of the following conditions applies:

- The taxpayer is present in the UK for FEWER than 10 days (current definition of UK days, so only midnights counted)
- The taxpayer is:
 - present in the UK for FEWER than 45 days (current definition of UK days, so only midnights counted); 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 (current definition of UK days so only midnights counted);
 - no more than 20 days (special definition of working days is provided) are spent working in the UK in any one UK tax year

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

3.2 Special definitions

The Consultation Document specifically envisages that the definitions will be refined through the consultation process.

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 does not engage in activities that are to a substantial extent unrelated to 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 will fall away entirely.

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 would appear 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.

4. SRT: Part B

4.1 Explanation

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

- the taxpayer is present in the UK for 183 days (current definition, so only midnights counted) or more
- the taxpayer has a home or homes (no specific definition of home provided) in the UK and not in any other country
- the taxpayer carries out full time work in the UK (special definition)

4.2 Part B - special definitions

Again, the Consultation Document foresees that the definitions will be refined through consultation.

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.

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.

5. SRT: Part C

5.1 "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 5.3 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 Factors 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.

5.2 “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 5.1 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 both of the previous two 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 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 Factors 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

5.3 Part C - special definitions

Again, the Consultation Document is expected to result in definitions being 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 one or more child under the age of 18 who is 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 living with or spending time with the child, whether this takes place in the UK or abroad.

However, a child's UK presence will 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.

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

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 (see 3.2).

ILLUSTRATION

Until 2012/13 Joyce has been resident in Utopia and has never before been UK resident. Her UK days in 2010/11 and 2011/12 were between 10 and 25.

In the next two tax years (2012/13 to 2013/14) she will have to come to the UK for between 95 and 110 days. In the 2014/15 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.

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 2012/13 she can use the "arrivers" table (in 5.1), 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 2012/13.

For 2013/14 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 2013/14, unless she can make changes either to reduce her day count or remove one of the connecting factors, she will be UK resident.

For 2014/15 she will have to refer to the “leavers” table (having been UK resident in one of the previous three tax years). 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 5.2).

6. TRANSITIONAL PROVISIONS

The Government does not propose allowing the new SRT to be applied to determine residence for 2011/12 or earlier years, whether for the purposes of ascertaining liability for these years, or retrospectively in identifying Connection Factors when considering residence status in 2012/13 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 2011/12 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.

7. SPLIT YEARS

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 arrivers. 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.

8. 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 statutory residence test 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 likely 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 that reflect 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.

9. 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. For example, where an individual 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 liable to UK tax solely because he or she is 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, in that it starts 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 claiming 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.

10. NEXT STEPS

The Government wants to enact an SRT with effect from tax year 2012/13, and we now have the broad details. It is unlikely that the underlying principles will change. Views have, however, been sought on design and implementation. In particular comments are requested to ensure all aspects of the SRT are:

- clearly defined
- simple; and
- do not produce unintended or unreasonable outcomes.

The document acknowledges that work is needed to clarify some of the definitions. The tone of the Consultation Document is positive and with goodwill on all sides it is hoped that the test enacted in Finance Act 2012 will be the transparent, objective and internationally competitive test that everyone hopes for.

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