

# Statutory residence test and the remittance basis

## Two Treasury Consultations - an update

October 2011

With the aim of making the UK more attractive to foreign investors, this year's Budget announced two consultations: one on the introduction of a statutory residence test and the other on a number of changes to the remittance basis rules.

The consultations were published in June and closed on 9 September. Responses are to be published by 6 December, the date on which draft legislation for the proposed changes is also to be published. The draft legislation will itself be subject to consultation until 10 February and is expected to take effect from 6 April 2012.

## Outline of the principal proposals

### Statutory residence test

The proposed new test for residence is in three parts:

- Part A: conclusive non-residence factors (time in the UK or full-time work abroad), the existence of one of which will make an individual non-resident in a tax year;
- Part B: conclusive residence factors (183-day test, home in the UK or full-time UK work), the existence of one of which will make an individual resident in a tax year; and
- Part C: tie-breaker test combining UK presence with other 'connection factors': family, accommodation, substantive work in the UK, UK presence in earlier years and time spent in the UK compared with other countries.

### Reform of taxation of non-domiciled individuals

- Increased remittance basis charge – an annual charge of £50,000 for individuals resident in the UK in 12 of the preceding 14 tax years.
- Encouraging business investment – tax-free remittance of income or gains to be permitted for the purpose of investing in companies operating in the UK in certain circumstances.

- Simplification of the remittance basis rules – adjustments to be made to the current remittance basis rules for nominating income and gains, foreign currency bank accounts, taxation on the sale of exempt assets in the UK and Statement of Practice 1/09 in relation to employees with duties in the UK and overseas.

## The proposed statutory residence test

The existing rules for determining whether an individual is or is not resident in the UK for tax purposes consist of a mixture of case law (some dating back to the 19th century), HMRC guidance of questionable assistance and a few broad statutory provisions. As such, it can be difficult to advise with confidence as to whether someone is UK resident. Therefore, the proposed introduction of a statutory residence test is to be welcomed.

### Proposals

The proposed test combines a presence test and a connections' test. It will apply only to individuals and will cover income tax, capital gains tax and inheritance tax. It will supersede all existing legislation, case law and guidance for tax years following its introduction.

For the purposes of the test, the definition of a day of presence in the UK will be the same as that which applies for the remittance basis of taxation, (that is, one on which an individual is in the UK at midnight at the end of the day). A day spent in transit, where the individual arrives in the UK as a passenger, departs

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on the next day and does not engage in any activity substantially unrelated to their passage through the UK, will not count as a day of presence in the UK.

The proposed residence test is divided into three parts, as follows:

**Part A** sets out 'conclusive non-residence factors', the existence of any one of which will make an individual non-resident in a tax year:

- he/she was not resident in the UK in all of the previous three tax years (defined in the consultation as an 'arriver'), and is present in the UK for fewer than 45 days in the current tax year; or
- he/she was resident in the UK in one or more of the previous three tax years (defined in the consultation as a 'leaver') and is present in the UK for fewer than 10 days in the current tax year; or
- he/she leaves the UK to carry out full-time work abroad, provided he/she is present in the UK for fewer than 90 days in the tax year and no more than 20 days are spent working in the UK in the tax year.

**Part B** sets out 'conclusive residence factors'; the existence of any one of which would be sufficient to make an individual resident in the UK in a tax year:

- he/she is present in the UK for 183 days or more in a tax year (the old statutory test);
- he/she has only one home and it is in the UK (or has two or more homes, both or all of which are in the UK); or
- he/she carries out full-time work in the UK.

If an individual satisfies a condition in both Part A and Part B, Part A will prevail and the individual will be non-resident in that tax year.

**Part C** acts as a tie-breaker where neither Part A nor Part B has determined the position. It looks at four or five relevant UK 'connection factors' and compares them with the number of days that the individual spends in the UK in a tax year.

The factors are as follows:

- Family – the individual's spouse or civil partner or 'common law equivalent' (which was not defined in

the consultation), unless they are separated, or minor children, are resident in the UK;

- Accommodation – the individual has accommodation in the UK which is accessible to him or her as a place of residence and is so used by the individual or his or her family during the tax year (subject to exclusions for some types of accommodation);
- Substantive work in the UK – the individual does substantive (but not full-time) work in the UK, defined as 40 days or more in a tax year on which more than three hours work is undertaken during the day;
- UK presence in a previous year – the individual spent 90 days or more in the UK in either of the previous two tax years; or
- More time in the UK than in other countries (only relevant to 'leavers') – the individual spends more days in the UK in the tax year than in any other single country.

For an 'arriver', the test will work as follows in any tax year using the first four of the above five factors:

- Fewer than 45 days in the UK – always non-resident (Part A);
- 45 to 89 days in the UK – only resident if four factors apply;
- 90 to 119 days in the UK – only resident if three or more factors apply;
- 120 to 182 days in the UK – only resident if two or more factors apply; or
- 183 days or more in the UK – always resident (Part B).

For a 'leaver', the test will work as follows in any tax year using the five factors above:

- Fewer than 10 days in the UK – always non-resident (Part A);
- 10 to 44 days in the UK – only resident if four or more factors apply;
- 45 to 89 days in the UK – only resident if three or more factors apply;
- 90 to 119 days in the UK – only resident if two or more factors apply;

- 120 to 182 days in the UK – only resident if one or more factors apply;
- 183 days or more in the UK – always resident (Part B).

The consultation requested views on and other suggestions for the tests in Parts A, B and C.

## Additional issues

- **Split-year treatment** – HMRC's existing concessions, enabling a tax year to be split into periods of residence and non-residence when individuals leave the UK or arrive here during a tax year, will be replaced by statutory rules. These rules will apply where an individual's arrival in or departure from the UK relates to full-time employment or they have their only home either in the UK or outside it in a country in which they become tax resident and from which they do not return to the UK in the relevant tax year.

The rules for accompanying spouses or civil partners of individuals who leave the UK for full-time work abroad will also apply provided their sole or main home is outside the UK.

- **Anti-avoidance** – to prevent short periods of non-residence being used to avoid a liability to UK income tax, certain types of investment income accruing during a period of non-residence of fewer than five tax years to an individual who has been UK resident in four out of the previous seven tax years are likely, for tax purposes, to be deemed instead to accrue to the individual in the year in which he or she returns to the UK.
- **Transitional rules** – the consultation did not propose any transitional rules. Instead, the existing rules should apply for tax years up to and including 2011/12. It is possible that responses on this point may result in this issue being revisited.

## Planning points

Unless transitional rules are introduced, if the Part C test is relevant to an individual, his or her residence status in 2012/13 and 2013/14 will depend partly on the number of days spent in the UK in one or both of tax years 2010/11 and 2011/12. If he or she has exceeded 89 days presence in the UK in either 2010/11 or 2011/12, this connection factor will be an issue. Whilst

nothing can be done about 2010/11, if possible, individuals may wish to consider arranging their affairs to ensure that they do not exceed 89 days of UK presence in 2011/2012.

As the proposed test is drafted, 'arrivers' will be able to maintain their non-residence status by ensuring they spend fewer than 90 days in the UK in every tax year (including 2010/11 and 2011/12, if relevant), effectively a pure presence test. However, such individuals must bear in mind that an average of 90 (now 89) days in the UK over a number of years will no longer be relevant. Each year's day count will stand alone.

## Ordinary residence

Ordinary residence is a different concept from residence and is primarily relevant to an individual's liability to tax in two situations. Individuals who are not ordinarily resident may claim or otherwise be entitled to the remittance basis of taxation for:

- foreign investment income; and/or
- overseas workday relief in relation to income from foreign employment duties paid by a UK employer which is, accordingly, UK source income.

The residence consultation proposed a new statutory definition of 'ordinary residence', according to which an individual who is resident in the UK should also be treated as ordinarily resident unless he or she has been non-resident in all of the previous five tax years, in which case he or she may be treated as not ordinarily resident.

After a maximum of two tax years following the individual's tax year of arrival, he or she would become ordinarily resident in any event.

Notwithstanding an individual's residence status in previous years, it was proposed that he or she will be ordinarily resident if the individual:

- is resident in the UK on the basis that his or her only home is there; or
- has more than one home and all of his or her homes are in the UK.

The consultation also proposed that the concept of ordinary residence could be scrapped other than in relation to overseas workday relief and might be restricted to non-domiciled individuals.

## Conclusion

The proposed residence test will introduce a welcome level of certainty. The scope of the existing lifestyle connection factors has been narrowed. Social ties have been eliminated from the test, meaning that individuals seeking to leave the UK will no longer have to consider ending memberships of UK based clubs and associations etc, nor will they need to close UK accounts. Equally, those coming to the UK may make such connections without risking becoming resident on the basis of them alone.

Some of the definitions require clarification – for example, what counts as 'work' for these purposes? However, it is hoped that, having taken into account responses to the consultation, issues such as these will be addressed by the Treasury in the draft legislation.

Additionally, a number of the time limits for days which can be spent in the UK, both working and generally, are rather tight: 10 days and 20 working days in Part A for example. Again, it is hoped that these deadlines will be extended before the test is finalised.

## The proposed reform of the taxation of non-domiciled individuals

The principal proposals in this consultation, to introduce a higher £50,000 remittance basis charge for longer-term UK residents and to encourage business investment in the UK by permitting tax-free remittances for this purpose, were announced in the Budget. Measures announced to simplify the current remittance basis rules were also included.

### Increased remittance basis charge

From 6 April 2012, an individual who has been resident in the UK in 12 of the preceding 14 tax years will pay an annual charge of £50,000 in order to claim the remittance basis of taxation. Individuals who have been resident in the UK in seven of the preceding nine tax years will continue to pay £30,000. In all other respects, the rules for claiming the remittance basis will be unchanged.

## Encouraging business investment

To encourage non-domiciliaries to invest in UK businesses, the consultation proposed to allow tax-free remittances of overseas income and gains for this purpose. The requirements proposed in the consultation to qualify for tax-free remittance were as follows:

- There will be no upper or lower limit to the amount which can be remitted for investment.
- The exemption is to be limited to investment in companies (including non-UK companies with a permanent establishment in the UK and where trades are carried on outside the UK) to avoid tax avoidance or the use of funds for non-commercial purposes.
- Listed companies and those quoted on exchange-regulated markets, such as AIM and PLUS quoted, may be included, subject to the results of the consultation.
- A substantial proportion of the activities of a company (or its subsidiary in the case of investment in a holding company) must involve either carrying out trading activity or undertaking the development or letting of commercial property.
- Investment in businesses holding and letting residential property or leasing tangible movable property (e.g yachts, cars, pictures) or the provision of personal services (e.g nannies, cooks, chauffeurs) will not be permitted, to avoid the incentive being used for the direct personal benefit of investors or other non-commercial purpose.
- Investment in businesses which build and develop residential property will be permitted, as will investment in certain types of residential property such as nursing homes and hospitals, where a commercial trade is also undertaken.
- The exemption will extend to offshore trustees and companies as well as individuals and will include investment in loans as well as shares.
- Connections to the business, whether of the investor him or herself or of family, will not be a bar to investment, although receiving non-commercial payments from a company (as

opposed to commercial remuneration, dividends or interest from profits) will be restricted.

- The proceeds of sale of an investment, up to the value of the original remitted income or gains, must either be taken out of the UK or re-invested in another qualifying business within two weeks of receipt, or they will be liable to tax under the remittance basis rules.
- Further anti-avoidance provisions will prevent the exemption from applying where the value of the investment 'leaks out' to the investor by means of non-arm's length loans or payments or transactions designed to pass value to the investor, and will prevent circular investment in pre-owned businesses.
- Use of this exemption will have no effect on the requirement to pay the annual remittance basis charge.

## Simplification of the remittance basis rules

The consultation proposed a number of minor provisions intended to simplify the remittance basis rules:

- **Nominated income** – the first £10 of income or gains nominated by a taxpayer electing to pay the remittance basis charge may be remitted to the UK free of tax and without triggering complex identification rules.
- **Foreign currency bank accounts** – to avoid the administrative burden of calculating gains and losses on foreign currency bank accounts, which often ultimately balance out, all sums in foreign currency bank accounts held by individuals will no longer be within the scope of capital gains tax. This will apply regardless of domicile.

Whilst this proposal is welcome, it is hoped that in the draft legislation the exemption will be extended to all foreign currency bank accounts, including those held by trustees.

- **Taxation of exempt assets sold in the UK** – assets which are otherwise exempt from tax as remittances when brought to the UK (works of art or antiques brought here to be displayed in public, items of personal clothing, footwear or jewellery, items brought

here temporarily for up to 275 days in total or for repair, or items worth less than £1,000) are currently liable to tax if sold in the UK. This tax charge is to be removed, provided the proceeds of sale are taken out of the UK (or, presumably, invested in a UK business under the new rules) within two weeks of being received.

Again, it is hoped that this deadline will be extended in the draft legislation, and that to make the exemption more valuable, an additional exemption will be introduced for the charge to capital gains tax, which would otherwise potentially arise on such a sale.


- **Statement of Practice 1/09: employees with duties in the UK and overseas** – this is to be put on a statutory footing. It applies to employees who are resident but not ordinarily resident in the UK, who are taxed on the remittance basis on their overseas earnings and who carry out duties both in the UK and overseas under a single contract of employment. Typically, such earnings are paid into a single bank account which, as it holds a mixture of UK and overseas earnings, becomes a "mixed fund". Without SP1/09, employees would have to apportion each individual salary payment over a tax year between UK and overseas earnings in order to establish their UK tax liability.

SP1/09 simplifies this exercise by allowing them to apportion their income over a tax year on the basis of the number of days worked in the UK compared with those worked overseas and to calculate their tax liability by reference to the total amount transferred out of the account during the whole tax year rather than by reference to individual transfers.

The consultation requested views on whether the proposed legislation should cover situations in relation to employees becoming non-resident part way through a year who continue to deposit money in a bank account and employees holding bank accounts containing employee share scheme transactions in respect of non-UK situs assets.

## Conclusion

The proposals in the consultation were helpful, although they did not address the overall complexity of the current



remittance rules, compliance with which deters wealthy overseas individuals from living and investing in the UK. The consultation did, however, ask for other suggestions to simplify the rules so there may be scope for more sweeping changes in the future.

In the meantime, the proposal to permit investment in UK businesses shows that the Government is alive to the need to encourage foreign investment in the UK.

It is hoped that some of the more restrictive elements of the proposals will be reviewed in light of the responses to the consultation, particularly in relation to the provisions of the exemption for remittances for investment purposes, and that greater flexibility will be built into the draft legislation.

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