Institute of Advanced Legal Studies, University of London

The new statutory definition of residence for individuals in the UK in the light of the tax treaty dual residence rules.

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MA in Taxation (Law, Administration and Practice)

Abbreviations

(List of terms used)

CIOT	Chartered Institute of Taxation
December 2012 ConDoc	Consultation document "Statutory Definition of Tax Residence and Reform of Ordinary Resident: Summary of Responses to the June 2012 Consultation"
December 2012 Draft Legislation	Collective draft legislation published in December 2012
Draft Guidance	Draft Guidance Note: Statutory Residence Test (SRT) published on 18th December 2012
Draft June 2012 OR Schedule	Draft Schedule re: OR published in June 2012
Draft June 2012 SRT Schedule	Draft Schedule re: SRT published in June 2012
Draft OR Schedule	Draft Schedule re: OR published on 11th December 2012
Draft SRT Schedule	Draft Schedule re: SRT published on 11th December 2012
DTA	Double Tax Agreemant
SRT Explanatory Notes	Explanatory Note to the Draft Schedule re: SRT published on 11th December 2012
OR Explanatory Notes	Explanatory Note to the Draft Schedule re: OR published on 11th December 2012
FtT	Finance & Tax Tribunal
HMRC	Her Majesty's Revenue and Customs
HMRC6	HMRC6: Residence, Domicile and the Remittance Basis
ICAEW	Institute of Chartered Accountants in England and Wales
ITA	Income Tax Act
IR20	IR20: Residents and Non-Residents - Liability to Tax in the UK
June 2011 ConDoc	Consultation Document "Statutory Definition of Tax Residence: a Consultation" published in June 2011
June 2012 ConDoc	Consultation Document "Statutory Definition of Tax Residence and Reform of Ordinary Residence: A Summary of Responses" published in June 2012
MTC	Model Taxation Convention
OR	Ordinary Residence
OECD	The Organisation for Economic Co-operation and Development.
Split Year Concession	The split year concessionary treatment adopted by HMRC for the tax years up to and

	including 2012/2013
Split Year Rules	The provisions allowing a tax year to be split under the SRT
SRT	Statutory Residence Test
STEP	The Society of Trust and Estate Practitioners
TCGA	Taxation of Capital Gains Act
TMA	Taxes Management Act

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"An individual's residence status is not simply a mathematical exercise but an assessment of a taxpayer's way of life."

Adrian Shipwright, the Special Commissioner in Barrett v HMRC2[1]

[1] (2007) SpC 639.

1. Introduction

Residence status is a key concept in determining the imposition of Income Tax, Capital Gains Tax and, in some respect, Inheritance Tax on individuals under both the UK domestic tax law and international tax law[2]. The 'resident of the contracting state'[3] plays a crucial role in determining the treaty's personal scope of application, qualification as a resident of a contracting state is the *sine qua non* of a claim to treaty benefits and the resolution of dual residence problems.[4]

Legislatures do not impose taxation on every item of income, or on every individual, in the world but only that income and those individuals which or who have connections with the country. These can be categorised as long-term connections, determined through the concept of domicile, and short-term connections determined through residence and, up to 5 April 2013, ordinary residence.

Normally, individuals who are not resident in the UK are assessable only on their UK source income[5] and on gains arising on disposals of UK assets[6] and those who are resident in the UK are taxed on their worldwide income and gains.[7] This general approach remains the same since Income Tax was introduced in 1799 to meet the cost of the Napoleonic Wars[8].

Over the years, many hoped to see the case law based rules for UK residence ('the old rules') consigned to history. After the Gaines-Copper case the need for residence to be defined in the legislation was indisputable. 40 years of the endless calls for residence to be defined in the legislation together with the Court's recognition of the need to give taxpayers due certainty when dealing with the complex issues of residence in the cross-border situations[9] resulted in the work on the new Statutory Residence Test ('SRT').

The new SRT received Royal Assent on 17 July 2013 and became law from 6 April 2013 after a long period of consultations between the Treasury and representatives from the profession. The fundamental framework of the SRT consists of three elements: an 'automatic

[2] See Sharon McKie, Income Tax – Residence, Domicile and the Remittance Basis; para.199-000.
[3] Art 4(1) of the OECD MTC.
[4] See Schwarz on Tax Treaties – Access to Treaty Benefits: Fiscal Domicile, Personality and Nationality; para.14-150.
[5] Colquhoun v Brooks (1889) 2 TC 490
[6] TCGA 1992, s.2 & s.10
[7] ITA 2007, s.829-832.
[8] See Schwarz on Tax Treaties – Access to Treaty Benefits: Fiscal Domicile, Personality and Nationality; para.199-002.
[9] See Gaines Copper, para.25.

residence' test, an 'automatic non residence' and 'sufficient ties' tests which can be seen to be the 'tie-breaker' rules when individuals do not satisfy neither of the automatic tests. The new rules incorporate anti-avoidance provisions to catch frequent day-trippers who left the UK in the last three years ('leavers') and who maintain close connections with to the UK determined through the 'sufficient ties' test.

The new rules regard individuals who fall within the automatic residence test as UK residents from the beginning of the tax year even if they arrive part way through the tax year. Although the new rules allow for the exclusion from UK tax liability of individuals who are coming ('arrivers') or leaving the UK part way through the tax year; under spilt year provisions. These are now rigid and very specific, and mostly apply to the employment related situations. Therefore, it can be argued that with lesser reliefs available for leavers and arrivers, individuals might seek the viable alternatives which can be offered under double tax agreements ('DTA'). The treaty "tie-breaker" rules, usually found in Art.4 of the DTA are based on the OECD Model Tax Convention (MTC), and solve the problem of double taxation of income and capital gains of dual residents by assigning taxing powers to only one country.

This paper considers the history of the concept of residence and discusses development of the case law in this area and, in that light, it is argued that the statutory definition of residence is simply a reflection of the old rules and that there has never been an intention to start with a blank page. It is also argued that two out of three main objectives of the SRT have been achieved, mainly transparency and certainty, however, the author argues that the rules are complex, and in some instances confusing.

2. Taxation of individuals in the UK

An individual's UK income tax and capital gains tax ('CGT') liability has been generally determined by their residence and, until recently, ordinary residence status. [10]

Individuals who are resident in the UK are taxed on their worldwide income and gains[11] but if they are not domiciled in the UK their non-UK income and gains will normally only be taxable if remitted to the UK although, for longer term residents, that privilege may only be accomplished at the price of paying the Remittance Basis Charge of £30,000 0r £50,000 per annum.[12] Those individuals who are not resident in the UK are assessable only on their UK source income[13] and on gains arising from disposals of UK assets[14]

Since its introduction in the 18th century, income tax was imposed on income arising from property in the UK regardless of whether the person whom the income arose was resident in the UK, and on the worldwide income of those who were resident in the UK; except income from foreign assets which was only taxable if it was remitted to the UK.[15] Until 1914, all foreign income was taxed on a remittance basis[16] and it now only applies to foreign domiciliaries.[17]

Under the old rules an individual would always be UK resident for a tax year if they were physically present in the UK for 183 days or more in that tax year and this has not changed. From 6 April 2008, any day where an individual was present in the UK at midnight was counted as a day of presence in the UK for the purpose of determining residence status providing the individual was not in transit. For these purposes transit included changing terminals or airports.

However, it was still possible to be treated as being UK resident, even where the 183 day test had not been breached. This was the case if an individual's visits to the UK amounted to an average of 91 days or more over four years. In this case an individual was

[10] See Sharon McKie, Income Tax – Residence, Domicile and the Remittance Basis; para.199-001.
[11] ITA 2007, s.829-832.
[12] ITA 2007, Pt 14, Ch. A1
[13] Colquhoun v Brooks (1889) 2 TC 490
[14] TCGA 1992, s.2 & s.10
[15] *The April 2003 Background Paper* at p. 6
[16] Income Tax Act 1842, s.100
[17] ITA 2007, s. 809B –809E

treated as UK resident from the beginning of the fifth tax year. If a person was resident in two countries, then the double tax treaty between those two countries would usually determine in which country he or she was to be treated as resident.[18]

[18] *HMRC6, para.215.*

3 The concept of residence in the UK prior to 6 April 2013

3.1 Residence test prior to 6 April 2013

The term "residence" has not previously been defined in the Taxes Acts; Section 334 of the Income and Corporation Taxes Act 1988, consequently replaced by section 829 of the Income Tax Act 2007 gave little, if any, assistance in determining one's residence status. [19] The test of residence was developed not by statute, but through case law. Cases which are still relevant to determining a person's tax residence in the UK were decided before the First World War (e.g. *Re Norris*[20]; *Cadwalader v Cooper CE*[21]), but for more than 80 years the leading authority on residence issues has been *Levene v Inland Revenue Comrs*[22] where it was held that to reside in the UK meant *"to dwell permanently or for a considerable time, to have one's settled or usual abode, to live in or at a particular place."*

Furthermore Viscount Sumner in *Levene v IRC* expressed his indignation at the unsatisfactory state of the law of residence together with his calls for a change, in the memorable passage:

> *"I wish, however, to point out the position in which Mr. Levene and others like him now find themselves. It is trite law that His Majesty's subjects are free, if they can, to make their own arrangements so that their cases may fall outside the scope of the taxing Acts. They incur no legal penalties and, strictly speaking, no moral censure, if, having considered the lines drawn by the Legislature for the imposition of taxes, they make it their business to walk outside them. It seems to follow from this and from other general considerations that the subject ought to be told, in statutory and plain terms, when he is chargeable and when he is not. The words "resident in the United Kingdom", "ordinarily" or otherwise, and the words "leaving the United Kingdom for the purpose only of occasional residence abroad", simple as they look, guide the subject remarkably little as to the limits within which he must pay and beyond which he is free. This is the more likely to be a subject of grievance and to provoke a sense of injustice when, as is now the case, the facility of communications, the fluid and restless character of social habits, and the pressure of taxation have made these intricate and doubtful questions of*

[19] See Gaines Cooper, para.16.
[20] (1888) 4 TLR 452
[21] (1904) 5 TC 101
[22] [1928] AC 217

residence important and urgent in a manner undreamt of by Mr. Pitt, Mr. Addington or even Sir Robert Peel. The Legislature has, however, left the language of the Acts substantially as it was in their days, nor can I confidently say that the decided cases have always illuminated matters. In substance persons are chargeable or exempt, as the case may be, according as they are deemed by this body of Commissioners or that to be resident or the reverse, whatever resident may mean in the particular circumstances of each case. The tribunal thus provided is neither bound by the findings of other similar tribunals in other cases nor is it open to review, so long as it commits no palpable error of law, and the Legislature practically transfers to it the function of imposing taxes on individuals, since it empowers them in terms so general that no one can be certainly advised in advance whether he must pay or can escape payment. The way of taxpayers is hard and the Legislature does not go out of its way to make it any easier. If it had been possible in this case to apply the principle that a taxing Statute must impose a charge in clear terms or fail, since it is to be construed contra proferentem, our duty would have been plain, but since the words are plain and it is only their application that is haphazard and beyond all forecast, Mr. Levene has no remedy in your Lordships' House. "[23]

What might he have said if he had known that the position would be even worse over 80 years later, when the *"facility of communications, the fluid and restless character of social habits, and the pressure of taxation have made these intricate and doubtful questions of residence important and urgent"*[24] to a degree beyond that which even he might have imagined.

Furthermore, in the same year, in *Lysaght v IRC*[25] it was held that one's residence is a question for the appeal commissioners to decide.

Malcolm Gunn in *Taxation* magazine, 1992, summarised the position that taxpayers were finding themselves in as "*tough luck and there is nothing anybody can do about it"* as cases

[23] See Levene v IRC, para.485&486.
[24] See Levene v IRC, para.502.
[25] [1928] 13 TC 511

were decided as *“they arose”* and *“without reference to any other previous decisions”* sometime even being in conflict with each other. [26]

From the end of the 1920’s until 2008 there were very few notable cases on residence, the only exception being *Reed (Inspector of Taxes) v Clark.*[27]

3.2 Governments’ view on residence issues

The Income Tax Codification Committee in 1936, found it *"remarkable"* that the Taxes Acts gave no more assistance than the rules, which could be found in a few sections in the Income Tax Act 2007[28], which have always been of limited application *"nor [were] the decisions of the Courts very helpful."*

The Committee concluded:

> *"The present state of affairs, under which an enquirer can only be told that the question whether he is resident or not is a question of fact for the Commissioners but that by the study of the effect of a large body of case law he may be able to make an intelligent forecast of their decision, is intolerable, and should not be allowed to continue. "*[29]

The issue was considered again by the Royal Commission on Income Tax[30] in 1955. They concluded that *"there ought to be certain principles laid down by Parliament as legal principles governing the question of residence"* and drew up a set of rules. The Royal Commission, however, did not recommend that there should be an exhaustive definition of residence and in fact, doubted whether it would be possible to formulate one.

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[26] See Gunn, M. (1992). *Taxation*, 3 December 1992, page 234.
[27] [1985] BTC 224
[28] See Income Tax Act 2007, s. 829– 832.
[29] Income Tax Codification Committee Report Cmd 5131 pp. 34–39.
[30] See The Royal Commission on Income Tax; Final Report, Cmd 9474, Chapter 14.

3.3 The need for reform

Although the need for reform was recognised in 1936 and again in 1955, no reform was undertaken despite the topic continuing to be a matter of public concern. In 1988 the Government published a consultative document entitled *"Residence in the United Kingdom – the Scope of UK Taxation for Individuals".* However, in light of the responses it received, the Government announced on 15 March 1989 that they did not intend pursuing their proposals.

13 years later, in his 2002 Budget Speech, Gordon Brown, the then Chancellor of the Exchequer announced that he was *"reviewing the complex rules of residence and domicile".* In April 2003 the Treasury published the *April 2003 Background Paper* but it contained no specific proposals, nor any timetable, for change. Various professional bodies submitted their comments on the paper to which there was little or no response. In October 2006, in response to an enquiry as to whether there were any changes to be made to the residence and domicile rules in the light of the 2003 Review, the Paymaster-General simply replied that the *"review [was] ongoing".*[31]

Finally, 13 years later, in the debates on the Finance Bill 2008 (22nd sitting on the afternoon of 17 June 2008) Jane Kennedy, the then Financial Secretary to the Treasury, said she *"was not unsympathetic to the case being made for a statutory residence test".*

3.4 Development of HMRC guidance

HMRC had set out its practice, only loosely based on the law, providing 'rules of thumb' which allowed individuals to predict whether HMRC would challenge their residence status. The guidance later found in *IR20*, first published in 1973, was based on guidance issued by HMRC before 1936. The Royal Commission considered this to be *"unsatisfactory"* and noted that the *"rules are regarded by the [Revenue] as either deduced from legal decisions or as representing what would be fair and in accordance with the spirit of the tax code."* The lack of a precise legal test of residence was unsatisfactory but individuals adapted pragmatically and applied the HMRC's guidance as if it were a code of law. HMRC

[31] See Sharon Mckie, Income Tax: Residence, Domicile and the Remittance basis, pp.190-004.

withdrew *IR20* with effect from 6 April 2009 and replaced it with a new statement of their view of the law of residence and domicile and of their practice in *HMRC6* which have been, yet again, criticised for their lack of assurances.

3.5 HMRC's change of practice

After a long period of silence, HMRC began to challenge the residence status and cases on residence began to reach the Courts in which, in the main, HMRC were the victors (e.g. *R (on the application of Davies & Anor) v R & C Commrs*; *R (on the application of Gaines-Cooper) v R & C Commrs*.[32]; *Grace v R & C Commrs.*[33]; *Hankinson v R & C Commrs.*[34]; *Farquhar*[35]; *Broome*[36] and *Kimber*[37]). Advisers had always been aware that HMRC's summary of their practice contained in *IR20*, was an over-generous view of the law but it was thought that it could be relied upon. In the view of many, in cases such as *Gaines-Cooper* and *Farquhar,* above, HMRC departed from their established practice.

The difficulty faced by the taxpayers concerned was that, even if that were the case, if they were resident in the UK under the law but not under HMRC's practice, the only way in which they could take advantage of the more generous practice was by establishing, in judicial review proceedings, that they had a legitimate expectation that HMRC would not apply the full rigour of the law. Mr Gaines-Cooper[38] attempted to do just that. Mr Gaines-Cooper, although living part of his time abroad and part of his time in the UK for over 20 years, had never left the UK, so the length of his visits were irrelevant. Mr Gaines-Cooper sought judicial review of HMRC's approach on the basis that *IR20,* HMRC guidance at the time of the case, gave him a legitimate expectation that if he limited his time in the UK to 90 days on average he would not be resident in the UK. To the general surprise of the tax profession, High Court, Court of Appeal and the Supreme Court all held that he did not meet the precise wording of *IR20* and thus could not rely on it.[39]

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[32] [2011] BTC 610
[33] [2009] BTC 704
[34] [2012] BTC 1
[35] [2010] TC 00532
[36] [2011] TC 01597
[37] [2012] TC 01803
[38] R (on the application of Davies & Another) v R & C Commrs; R (on the Application of Gaines-Cooper) v R & C Commrs. [2011] BTC 610
[39] [2009] EWHC 2617

4. The concept of ordinary residence in the UK

The UK Government adopted the concept of ordinary residence as a separate concept to residence. Its purpose was to bring individuals within the scope of Income Tax and Capital Gains Tax even when they were not present in the UK. According to HMRC ordinary residence was "*a more elusive concept than 'simple' residence". It was more adhesive, in that a person could remain ordinarily resident even though physically absent from the country throughout the year (and, accordingly, not resident).*[40]

An individual was considered to be ordinarily UK resident if they were habitually resident in the UK, i.e. *if he or she was resident in the UK year after year*[41] or as it was decided in *Reid* v *IRC*[42] an individual made regular returns to the UK and 'resided' in the UK for a part of every year. Rowlatt J went a step further in *Levene* v *IRC*[43] to define 'ordinary' as something "*habitual in the ordinary course of a man's life"*.

The concept of ordinary residence was revisited in *Reed v Clark*[44] where, Nicholls J held, citing the statement of Lord Scarman in *R v Barnet London Borough Council, Ex p Nilish Shah*[45] that 'ordinary residence' referred *"to a man's abode in a particular place or country which he has adopted voluntarily and for settled purposes as part of the regular order of his life or the time being, whether of short or of long duration"*.

As ordinary residence had no definition in the legislation the courts continued to interpret the concept[46] and it can be said that over the years three main features of voluntary adoption, settled purpose and the regular order of life, none of which was essential to acquisition of residence status, were established.

[40] Inland Revenue explanatory note relating to a proposed amendment to Finance Bill 1974, cl 18.
[41] See HMRC6; s.3.2,p.9.
[42] (1926) 10 TC 673.
[43] (1928) 13 TC 486.
[44] [1985] STC 323
[45] [1983] 2 AC 309, 343
[46] See *Miesegaes v IRC* (1957) 37 TC 493; *R v Barnet London Borough, ex p Shah* [1982] 1 All ER 698;

5. Income tax and capital gains tax implications of residence and ordinary residence

5.1 Income Tax implications of residence and ordinary residence

Generally a UK resident and ordinarily resident individual is liable to UK income tax on his or her UK and foreign income, whereas a non-UK resident individual was liable to UK income tax only on his or her income arising in the UK.

If an individual was resident but not ordinarily resident this was relevant when considering the UK tax treatment of foreign employment income and benefits; the effect of tax anti-avoidance legislation on transfers of assets abroad; and the income tax and inheritance tax (IHT) implications in respect of certain UK government securities.

5.2 Capital Gains Tax (CGT) implications of residence and ordinary residence

An individual who was either UK resident or UK ordinarily resident was liable to UK capital gains tax on disposals of assets wherever located. If the individual was non-UK domiciled and was a remittance basis user the disposal of a foreign asset was deemed only to occur when the disposal proceeds or asset gifted were received in the UK by certain categories of persons. If the individual was neither resident, nor ordinarily resident, he or she was not subject to UK capital gains tax on disposals of any assets, wherever located (including UK assets). The exception to this rule was that a capital gains tax charge would arise in respect of any disposal of assets used in a branch or agency undertaken in the UK, irrespective of the residence status of the owner.

Rules were in place to prevent an individual leaving the UK, disposing of assets whilst non-UK resident and then returning shortly thereafter in order to avoid paying UK capital gains tax. Where an individual became non-UK resident on or after 17 March 1998 but returned to the UK and became UK resident within 5 years following the year of departure, any capital gains made whilst abroad was taxed in the year of return. Similarly, any losses made whilst abroad were treated as allowable losses in the year of return.

However, this rule only applied to individuals who were UK resident or ordinarily resident in any 4 out of the 7 years proceeding the year of departure.

Assets that were acquired and disposed of whilst abroad were not taxable in the UK.

6 Splitting the tax year

A person who regularly visited the UK was UK resident and/or ordinarily resident for all or none of a given tax years, depending on the extent and purpose of the visits. Where individuals came to the UK on a longer-term basis, by concession, HMRC would allow for a tax year to be split for income tax and capital gains tax purposes if certain conditions were met. One such requirement was that the concession was not being used for tax avoidance.

6.1 Splitting the tax year: income tax

From an income tax perspective, HMRC would allow for the tax year to be split if an individual:

- came to the UK to live permanently or to stay for at least 2 years, providing he or she was not UK ordinarily resident prior to their arrival; or
- having come to the UK for at least 2 years left the UK to live abroad permanently and visits to the UK were kept under 183 days in a given tax year or under 91 days on average over a maximum of 4 years whilst abroad;
- left the UK on a full-time employment contract to work overseas for a period that covered a whole tax year and did not visit the UK for 183 days or more in a tax year or an average of 91 days or more over a maximum of 4 tax years whilst abroad (accompanying spouses were also treated as non-UK resident and non-ordinarily resident during the period abroad).

6.2 Splitting the tax year: CGT

HMRC allowed for the tax year to be split for CGT purposes, but under different conditions to income tax. If an individual left the UK, the tax year was split only if he or she was not UK resident or ordinarily resident in 4 of the 7 tax years immediately proceeding the year in which they left the UK. Where an individual came to the UK, the tax year was split if the individual was non-UK resident and not ordinarily resident throughout all the 5 tax years immediately proceeding the year of arrival.

7. The need for the statutory residence test

7.1 Calls for a statutory residence test[47]

In *R v Inland Revenue Comrs Exp MFK Underwriting Agents Ltd*[48] Bingham LJ stated that:

> *"Every ordinarily sophisticated taxpayer knows that the revenue is a tax-collecting agency, not a tax-imposing authority. The taxpayers' only legitimate expectation is, prima facie, that he will be taxed according to statute, not concession or a wrong view of the law… Such taxpayers would appreciate, if they could not so pithily express, the truth of the aphorism of "One should be taxed by law, and not be untaxed by concession".*[49]

Whilst the *Gaines-Cooper* cases proceeded, it became apparent that what was thought to be HMRC's practice could no longer be relied on. The case triggered a general concern that individuals were being deterred from coming to the UK and from bringing to it their capital, businesses and expertise or were deciding to leave it. At the time of the *"Residence and Domicile Review"* in 2007 (which introduced the Remittance Basis Charge) representatives of the various professional bodies called for a comprehensive statutory definition of residence and were promised one by the House of Lords Select Committee.[50]

4 years later, the Budget in March 2011 announced the proposed introduction of a statutory residence test for determining the tax residence status of individuals. Following a period of consultation, the Government confirmed the intention to implement the statutory residence test with effect from 6 April 2013, rather than 6 April 2012, as originally intended. The Government was considering changes to the rules for non-domiciled individuals, and business investment relief which proved simply too challenging to introduce all these changes at the same time. The Government wanted to ascertain that the new rules would be

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[47] Section 215 of the Finance Bill (No 2), Schedule 43.
[48] [1990] 1 WLR 1545, pp.1569.
[49] See *Vestey v Inland Revenue Comrs* [1979] Ch 177, 197 per Walton J.
[50] See Select Committee on Economic Affairs, 2nd Report of Session 2007-2008, the Finance Bill 2008.

transparent and objective before they were implemented but it appeared as if there were too many anomalies in the proposal to enact it.

After further consultation, the draft legislation on the proposals was published in June 2012 and a revised version was published in December 2012. The Finance Bill 2013 was issued on 28 March and included a third version of the legislation. As no changes were made before Royal Assent on 17 July 2013 this now represents the final version of the rules that apply from 6 April 2013 which can be found in Schedule 43&44, clause 215 of the Finance (No2) Bill 2013.

The overall framework of the statutory residence test has remained broadly the same since the original consultation, but there were several adjustments along the way to resolve as many irregularities as possible. The most significant changes in the current version relate to full-time work in the UK or abroad (now more appropriately referred to as 'sufficient hours') and the definition of a 'home'. Additionally, there were enhancements to the tests that apply on death and significant revisions to the split year rules.

7.2 The aims and objectives of the new SRT

The Exchequer Secretary to the Treasury, David Gauke MP, in his Foreword to the *June 2012 Consultation Document* said that they intended to introduce "*clear, objective and unambiguous"* rules that would not change residence status for the vast majority of people. He also addressed a desire to "*improve the predictability of this area of the UK tax system, making the UK a more attractive place for investors."*

He went on to say that the *June 2012 Draft Legislation*:

> *"... aims to be transparent, objective and simple to use* ... "and to" *bring greater clarity to individuals with more complex circumstances."*

Essentially he wanted individuals with complex circumstances to be able to predict the application of the draft legislation to their circumstances with a higher probability than they could under the old rules.

In the December 2012 Consultation Document the Exchequer Secretary, after amending the full time work provisions, stated that the new SRT *"will provide a greater* *degree of certainty and clarity to internationally mobile individuals and their employers. This is intended to increase the UK's reputation as a good place to invest in and do business, whilst continuing to ensure that those with close connections to the UK continue to pay their fair share of tax."*

The Government perceives these reforms as a significant step forward in clarity, predictability and simplicity in this area of the personal tax code.[51] This is, undoubtedly, a huge step toward 'certainty' as the rules are now enacted, but, on the other hand, one could argue, taking both Ireland and the United States as an example, that the rules could be simply based on an objective arithmetical measure of averaging days of presence in the UK as previously hoped by the profession.[52] The obvious answer is the Gaines-Copper case which greatly influenced the new rules. It can be argued that the 'sufficient ties' test is a reflection of this case, not only through the nature of the connecting factors included in the test but also the number of days of presence allowed in the UK whilst still retaining these connections.

The main criticism of the new SRT is its complexity, not only does it still includes a few subjective tests but also the endless tests, definitions, subsidiary tests and subsidiary definitions which need to be considered in conjunction with the number of days of presence, both in the UK and overseas, to determine whether one's circumstances would make him resident in the UK. Please see Appendix 1 for the trade-off between UK ties and days of presence in the UK.

Additionally, in the era of self-assessment, unfortunately, there is no hope for internationally mobile individuals to deal with their residence issues unaided, even with a kind offer of help from HMRC in a way of an online 'tax residence indicator' as, in the light of the Gaines-Copper case, one could, easily, argue that reliance on anything produced by HMRC can only create problems as opposed to resolving them.

[51] See Foreword to the *June 2012 Consultation Document.*
[52] See letter from the CIOT to HMRC headed "Residence for Tax Purposes: Comments of the Chartered Institute of Taxation" dated 14 November 2007.

8. The mechanics of the statutory residence test

8.1 Introduction

The statutory residence test contains three main elements. The first two parts look at more straightforward circumstances where an individual will be treated as either automatically non-resident or automatically UK resident. The third part then covers the situation where neither of these tests are satisfied and a wider range of factors need to be considered. In such cases, an individual's residence status will be governed by a combination of their links to the UK ('UK ties') and the number of days spent in the UK. Different limits are applied to 'arrivers' who have not been resident in the previous three years and 'leavers' who have been resident within that period. Generally 'arrivers' can spend more time in the UK than 'leavers' in a given tax year, without being treated as UK tax resident.

One could argue, that a separate set of rules for 'leavers' and 'arrivers' is just an unnecessary complication, and as Nicholls J pointed out in *Reed v Clark*[53] the same principles should apply to individuals whether they leave or arrive to the UK as long they can demonstrate that they *"altered their life's pattern"*[54] and moved to the UK or left the UK with *"a view or intent of establishing their residence"*[55] here or overseas.

The 'sufficient ties' test is designed to capture a requirement for a 'distinct break' from family and social ties in the UK which have always been "*main factors*" in determining whether one should be regarded as UK resident or non-resident.[56]

[53] See Reed v Clarke in Gaines-Cooper, para.22.
[54] See Gaines-Cooper, para.65.
[55] See Reed v Clarke, p16H.
[56] See Gaines Copper, para.93.

8.2 The basic rule

The basic rule is that a person is resident in the UK for a tax year if the automatic residence or the sufficient ties tests are met for that year[57] and if neither of those tests is met for that year, an individual is not resident in the UK for that year.[58] The three-part design of the SRT is, certainly, helpful as it gives safe harbours within which an individual is or is not conclusively resident.

It should be noted that HMRC guidance on the Statutory Residence Test published on 27 May 2013(updated in August 2013) refers to the automatic non-residence test as a starting point before moving on to the automatic residence test. This paper will follow the order in the legislation hence the discussion will start with the automatic residence test.

8.3 The automatic residence test

"The automatic residence test is met for year X if P (individual) meets—

(a) at least one of the automatic UK tests, and

(b) none of the automatic overseas tests."[59]

8.3.1 The automatic UK tests

There are 4 automatic UK tests:

8.3.1.1 <u>The first automatic UK test: 183 days in the UK</u>

If an individual spends at least 183 days in the UK in a tax year he will be automatically resident here. This approach remains unchanged and it is in line with the

[57] Section 215 of the Finance Bill (No 2), Schedule 43, para.3.
[58] Section 215 of the Finance Bill (No 2), Schedule 43, para.4.
[59] Section 215 of the Finance Bill (No 2), Schedule 43, para.5.

approach taken by most of the countries in the world. However, a simple exercise of counting days of presence can turn into an arithmetical nightmare for specific taxpayers.

8.3.1.1.1 Days of presence

Days of presence are still counted in accordance with the midnight under the new SRT. Therefore, if an individual is in the UK at midnight it is treated as a day of presence in the UK. The transit exception still applies and as long as nothing productive is being done whilst in transit it is ignored for this purpose.

8.3.1.1.2 The exceptional circumstances

The main changes were introduced to the exceptional circumstances section and the deeming rule has been introduced.

Under the old rules there was no limit as to how many days could be excluded from the day count due to the exceptional circumstances but under the new rules, these are capped to 60 days in a tax year. The old rules did not provide the definition of the exceptional circumstances and, unfortunately, the new rules do not provide it neither. Generally, if the exceptional circumstances beyond one's control prevent him from leaving the country they will be allowed for this purpose, for example:

- national or local emergencies e.g. war, civil unrest or natural disasters
- sudden or life threatening illness or injuries.

The new rules refer also to the individual's close relatives (a spouse or a child), hence if one's child was to be injured he would be allowed to accompany them at the hospital and these days would not count as days of presence in the UK for any of the other tests. However, neither the new rules nor the HMRC guidance mention parents, hence if one happened to be in the UK whilst his elderly parent became ill, the days spent looking after the parent could count towards his days of presence. This indicates further inconsistency in the legislation as the definition of 'close relatives' for the exceptional circumstances purpose varies from the one in the accommodation tie which includes both parents and siblings. Although there is no definition of the exceptional circumstances in the legislation, the new rules explicitly exclude life events such as birth, marriage, divorce and death; as not routinely regarded as exceptional circumstances.

8.3.1.1.3 The anti-day tripper rule

The new SRT introduced anti-avoidance measures which apply to 'leavers' with more than 30 departure days and three or more UK ties called the deeming rule. It appears that the deeming rule is relevant to the first automatic non residence test, so it does count towards the 16 days test as well as the first automatic residence test, the 183 days test. It also applies to the split year treatment under Case 3 and the sufficient ties test excluding only the '91 day tie' test.

One could argue that this was designed to counter the circumstances similar to the Gaines-Cooper case as the rule makes reference to three ties explicitly. It prevents individuals from leaving the UK before midnight in order to be treated as non-resident but quite rightly does not apply to the 'full-time work' test as it could bring individuals working overseas into the UK tax jurisdiction if they were coming to the UK for a short meeting with clients. If they were here for more than three hours they would be subject to the UK work day rules anyway.

In the author's view this rule brings more complexity to the 'days of presence' test as individuals could find themselves unknowingly breaching the threshold of, for example, 16 days of presence in the UK by having days of presence where they left before midnight which they had not considered originally.

8.3.1.2 The second automatic UK test: the UK home

8.3.1.2.1 Definition of 'home'

The guidance applies a reasonable person test asking whether "*a reasonable onlooker with knowledge of the material facts would regard as that person's home"*[60]. To determine whether an individual has a 'home' in the UK he might need to refer to the old *Godwin v*

[60] See Statutory Residence Test Guidance, Annex A, para.A4, pp.81.

Curtis case[61] to see whether there is a sufficient degree of permanence or stability for it to count as a 'home'. [62] The key point to note is that an individual does not need to be a legal owner of the property for it to pass the test but it must be capable of being used as a home, even if it is temporarily unavailable it still could fall within the test.[63]

The second automatic UK test is that if the individual has a 'home' in the UK for all or part of the tax year available to him for at least one period of 91 consecutive days; spends a sufficient amount of time there in that year (i.e. present there for at least 30 days in the year) and either has no overseas home or has one or more overseas homes but spends there fewer than 30 days in the tax year concerned.[64] Although the overseas home test is very similar to the UK home test it does not include the availability aspect. If all of these tests are satisfied an individual would be regarded as having the only home in the UK.

This is, yet again, a reflection of the Gaines-Cooper case where it was said in paragraph 43 that:

> *"He was then warned however that, if he continued to have "property" in the UK for his use, his reason for doing so must have been consistent with his stated aim of living abroad permanently or for at least three years. The suggestion was therefore that it might be permissible for him to maintain in the UK not a "home" but "property… for [his] use" but that, if he did so, he would fail to secure non-resident status unless his reason for doing so survived the test of consistency with his stated aim.*[65]
>
> .....
>
> *any "property" retained by him in the UK for his use was required to be used for the purpose only of visits rather than as a place of residence."*[66]

[61] (1988) STC 475
[62] Section 215 of the Finance Bill (No 2), Schedule 43, para.25.
[63] See Statutory Residence Test Guidance, Annex A, para.A16, pp.84.
[64] Section 215 of the Finance Bill (No 2), Schedule 43, para.8(1).
[65] See Gaines Copper, para.43.
[66] See Gaines Copper, para.45(e).

The test is broad and very confusing as it refers to the definition of a ‘home’ in cases where the new rules explicitly exclude it from applying, for example, a ‘holiday *home*’. The test could be possibly simplified by looking at the number of days spent in there to determine whether it is one’s main residence. If an individual resides there for less than 30 days a year then it is most likely to be a holiday home and it should be excluded. As the availability test is very important in determining whether one has the only home in the UK, if a property was available for less than 91 days, it would be most unlikely to be treated as a main residence in the UK and should be excluded without scrutinising one’s circumstances any further.

Not surprisingly, this test has been mostly criticised after the draft legislation was published for the consultation as originally it did not provide a definition of a ‘home’ at all. It only confirmed that a ‘holiday home’ would not constitute a ‘home’ which, yet again, was confusing because a ‘holiday home’ can actually constitute a ‘home’ under certain circumstances. The revised legislation gives some definition but still rather subjective and hardly satisfactory. One could (either through optimism or sheer naivety) consider his home to be overseas and obtain a favourable outcome from the indicator tool only to find out several years down the line that HMRC take a different view of the facts.

In the author’s view the Government has taken a rather indolent approach to this problem by taking a definition under the old rules, adding a timeline to it, and hoping for this to work. The concept of a ‘home’ requires further attention and should not be overlooked as it affects many other provisions of the new rules.

8.3.1.3 The third automatic UK test: working sufficient hours

The third automatic UK test goes a bit further than the old rules where *“if an individual had full time employment abroad, it was not necessary to look at the wider factors.”*[67]

Individuals will be treated as working sufficient hours in the UK if they work 35 hours per week in the UK. This is assessed over a continuous period of 365 days during

[67] See Gaines Copper, para.56.

which there are no significant breaks in UK work. A workday is a day on which more than three hours' work is performed, but overseas work days will be disregarded if more than three hours are worked in the UK on the same day. A significant break is a continuous period of 31 days where there have been no actual work days or days that would have been work days were it not for annual leave, sick leave or parental leave. [68]

8.3.1.3.1 The incidental or substantive duties

The incidental or substantive duties rules do not apply as these do not exist anymore. Previously one could have work days which were considered to be incidental to his duties, for example, coming to the UK/going abroad for a training course or a conference which would bear no consequences on his residence status but under the new rules these would be a work day if more than 3 hours were spent on doing something productive. Therefore, if one does a bit of work whilst waiting for a plane at the airport this could count toward a work day and bring him into the UK tax jurisdiction. As the exceptional circumstances are not defined what would happen if a plane is delayed?

The annual leave, parenting leave, sick leave, weekends are deducted for the purpose of calculating the relevant period but not public holidays. This is fair if considering a usual working week in the UK but some countries have lots of public holidays so one would need to average his working hours after a bank holiday to 35 hours to ascertain that his residence position.

Travel time under the new rules is also a necessary evil. Time spends travelling would be treated as work time if the cost of the journey would be taxed deductable by the employee. For example, if one was to travel on Sunday for more than 3 hours before his Monday meeting and he was required to cover the cost of the journey personally he could have unknowingly done a day of work on Sunday under the new rules. At least, once an individual boards a plane his work in the UK ends.

In the author's view the 'full time work' test is a bit more rigid when compared with the old rules. Previously, when determining whether an individual worked full time or not it was possible to take into account the specifics of the job, compare it to the local conditions to

[68] Section 215 of the Finance Bill (No 2), Schedule 43, para.(9)(2)(a)-(9)(2)(e).

ascertain that the test was met but the new rules are very specific on this point which could produce undesirable results.

8.3.1.4 The fourth automatic UK test

The fourth automatic UK test is that the individual dies in the tax year when either his home was in the UK or, if he had more than one home; at least one was in the UK, he met the automatic residence test in each of the previous three tax years and the previous tax year was not a split year, even assuming he were treated as non-resident in the tax year of death.

Equally, if an individual dies in the tax year and were resident for each of the previous three tax years under the automatic residence test and had a home in the UK at the time of death he or she will be treated as a resident in the UK in the year of death.

8.3.1.5 Summary of the test

Individuals will be treated as automatically UK resident in a tax year if:

- they are present for 183 days or more in a tax year; or
- there is at least one period of 91 consecutive days where they only have one home, and that home is in the UK (or two or more homes and all of these are in the UK); or
- they work sufficient hours in the UK; or
- they die in the tax year and were resident for each of the previous three tax years under the automatic residence test and had a home in the UK at the time of death.

8.4 The automatic overseas test

As most of the definitions contained in this test have been discussed in the automatic UK residence section, no further explanation will be given to avoid duplication.

There are 5 automatic overseas tests under which individuals will be treated as automatically non-resident in a tax year if one of the following tests is satisfied:

8.4.1 The first automatic overseas test

An individual was resident in one or more of the previous three tax years and present in the UK for fewer than 16 days in the current tax year; or

8.4.2 The second automatic overseas test

An individual was not resident in any of the previous three tax years and present for fewer than 46 days in the current tax year, or

8.4.3 The third automatic overseas test

The third automatic overseas test is satisfied if one works full-time abroad (now defined in terms of 'sufficient hours' abroad) for a complete tax year without any 'significant breaks' (a continuous period of 31 days where there have been no actual workdays). Additionally, they must spend fewer than 31 days working in the UK in the year and fewer than 91 days in the UK overall. A workday in this context is one where more than three hours work is performed in the UK. 'Work' includes training time, incidental duties and business travel. [69]

It was clear from decisions like *Combe*[70] that, if a taxpayer left the UK in order to pursue employment abroad which was full-time, it was likely not only that he would cease to be a UK resident but also that he would escape being deemed still to be a UK resident under

[69] See Section 215 of the Finance Bill (No 2), Schedule 43, para.14(1).
[70] [1951] 1 All ER 767

the statutory provision. For, from the fact that the employment was full-time, it was likely to follow that he had made a distinct break in the pattern of his life in the UK.[71] However, the new rules bring much more detailed provisions and a few complex definitions.

8.4.4 The fourth automatic overseas test

The fourth automatic overseas test is satisfied if the individual dies in the tax year and either was not resident in the UK in either of the preceding two tax years and spent less than 46 days in the UK in the year of death or was not resident in the immediately preceding tax year where the year before that was a split year by virtue of Cases 1, 2 or 3 (discussed later) and spent less than 46 days in the UK in the year of death.

8.4.5 The fifth automatic overseas test

The fifth automatic overseas test is satisfied if one dies in the tax year, having met the 'sufficient hours' automatic overseas test in the previous two tax years and having worked sufficient hours in the part-year leading up to death. This treatment is extended to those who were non-resident under the sufficient hours test in the previous year and who qualified for split year treatment under Case 1 (see below) in the year before that.

[71] See Gaines Cooper, para.21.

8.5 The sufficient ties test

The 'sufficient ties' test is in a way a reflection of the old rules as it concerns having the connecting ties with the UK which were discussed in much detail in the Gaines-Copper case where it was held that one needs to establish the necessary distinct break with family and social ties in the United Kingdom to become non resident and the appellants failed to do just that. In particular:

> "*they continued to have a substantial house here, in which their spouses lived when not visiting them in Belgium and where they lived when in the United Kingdom; and they retained employment and business links in the United Kingdom, as well as other links such as with Swansea Football Club and the Area Health Authority*."[72]

There are 5 connecting factors to consider in the case of 'leavers' and 4 in the case of 'arrivers' as it is generally accepted that people coming to the UK would have less connections with the UK, hence are allowed to spend more days in here before they become UK tax resident. In principle, the more time someone spends in the UK, the fewer ties they can have with the UK if they want to be treated as non-resident.

8.5.1 Family tie

A 'family tie' exists where one has a 'relevant relationship' at any time during the tax year with a person who is UK resident in a tax year under consideration. For this purpose the new rules consider a spouse/ civil partner or minor children (unless an individual spends fewer than 61 days in the tax year in the UK with his children and they do not spend more than 20 days in the UK outside term time).

Generally, if one spends time with his family in the UK because they reside here he will have a connection to the UK, however one's children can continue their education without making their parents resident in the UK as long as the children spend their time

[72] See Gaines Copper, para.79.

during the term time and holidays outside of the UK. This is a significant improvement and most definitely gives taxpayers more certainty when compared with the old rules.

8.5.2 Accommodation tie

An 'accommodation tie' exists where an individual has a place to live in the UK that is available to him for a continuous period of at least 91 days in the tax year and he spends at least one night there during the tax year. A 'place to live' is home, holiday home, temporary retreat or accommodation that is otherwise available to the individual to live when he is in the UK.

The accommodation test is much wider than the 'home' test discussed earlier in this paper as any place where one can stay for a continuous period of at least 91 days is treated as an available accommodation for this purpose. In addition, there is no permanence requirement and if the accommodation is the home of a close relative and the individual spends at least 16 nights there during the tax year he establishes an accommodation tie. It should be also noted that if the individual visits his spouse/civil partner and stays there only for one day, he will be regarded as having an accommodation tie. The only time when there is no accommodation is when the occupation test is not breached, it means that even if the accommodation is available for the relevant period but individual does not actually stays there, it is disregarded and individual does not have the accommodation tie to the UK.

This area is rather subjective, as it is not really clear how HMRC is going to determine whether someone's home is available to an individual, for example, sibling's house. At the same time this is very significant area as only one day of presence there could mean that one needs to reduce his visits to avoid becoming a UK resident under the 'sufficient ties' test.

8.5.3 Work tie

A 'work tie' exists where an individual works in the UK for at least 40 days in the tax year (days are counted where the individual does more than three hours' work in the UK on a particular day). There are special rules for individuals who have a 'relevant job' aboard a vehicle, aircraft or ship.

8.5.4 90-day tie

A ‘90-day tie’ exists for a tax year where the individual has spent more than 90 days in the UK in either or both of the preceding tax year and the one before that.

8.5.5 Country tie (only relevant for leavers)

The individual spends more days in the UK in the tax year than in any other single country. Days of presence in the relevant countries will be determined by the individual’s location at midnight.

8.5.6 Leavers and Arrivers

As previously mentioned, arrivers are generally allowed to spend more time in the UK than leavers. Arrivers are allowed to spend 90 days in a tax year if they have all 4 connecting factors to the UK before they become UK resident. This could, in some respect, be difficult to achieve because one would need to move his family here, have an accommodation, substantive work and spend more than 91 days in the previous 2 tax years in the UK and seems rather generous to individuals.

According to the old rules individuals were non resident if they spent less than 91 days in the UK each year but it was uncertain how HMRC might look at other circumstances. The new rules give more certainty in this area as individuals can determine how many days they are allowed to spend in the UK, having certain connections to the UK, before they become resident or non-resident in the UK. Even if there are certain grey area around the definitions, if taken the old rules approach the individual could find himself in a position when he unknowingly becomes the UK resident. This time he can take a prudent approach as he knows what will happen if he suddenly brings his family over to the UK as by assessing his circumstances he can see whether this would trigger his UK residence.

The arriver versus leaver approach is reflecting the old rules, making it harder for the individuals leaving the UK to shed their UK residence. Leavers are allowed to spend less time in the UK as they are more likely to have more connections to the UK than the person arriving to the UK.

Even if the individual works in the UK for less than 40 days in a tax year to avoid having a connecting factor it does not mean that he will not be subject to the UK tax on his earnings. He might be subject to the income tax whether he is resident or non-resident depending on the double tax treaty or the type of work he does in the UK whilst here.

8.5.7 Conclusion

Historically, the accommodation and the family were the most important factors when determining taxpayer's residence status. Individuals were in some respect forced to change their life style completely, taking family away, selling/renting out their house but now their family can remain in the UK and as long as the days of presence do not exceed the permitted limit still be treated as non-resident here.

On the other hand, individuals who will be pushing their days spend in the UK to the maximum could find themselves in a risky position if HMRC tries to argue that their ties to the UK should bring them back into the UK tax jurisdiction.

8.6 Split year treatment

Although residence status is generally determined on a full tax year basis, it is possible for the tax year to be split into UK and overseas constituent parts in some circumstances. Under the previous rules, this was done on a concessionary basis[73] however; the Government has now put it on a statutory footing but making them more strict and specific. The existence of special charging rules for cases involving split years is not intended to affect any question as to whether an individual would fail to be regarded under double taxation arrangements as a resident of the UK.[74]

8.6.1 The basic rule

The starting position is that if an individual is resident under the SRT he is resident for the whole of that tax year in which he becomes resident. Where a year is split an individual will have a period of UK residence where you are taxed as resident and an overseas part where you are taxed for most purposes as a non-resident. Split year treatment '*... in not intended to affect any question as to whether an individual would fall to be regarded under a DTA as resident in the UK'*. These are the domestic rules and these have no connection with whether you an individual would be regarded UK resident under the DTA.

It can be necessary to establish the individual's particular circumstances when he comes to the UK part way through the tax year to see whether a split year treatment can be applied. There are now 5 cases as such but the guidance refers to 8 cases of the split year treatment. Most of the cases involve working full time either in the UK or overseas. Case 5 is a new one as it appeared in the recent legislation and is considered to be quite helpful to high net worth individuals.

The eight cases where split year treatment is intended to apply; the first three apply in the year of departure and the remaining five apply in the year of arrival. If the individual meets the conditions for more than one case for arrival or departure, the case that produces the longest UK part will apply (i.e. he or she will be treated as UK resident for the longest period possible).

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[73] ESC 11A.

[74] See Finance Bill 2013, Part 3, para.42

Case 4 has two parts

4(a) coming to the UK to live,

4(b) coming to the UK to work

Case 5 people coming to the UK to live here but cannot get the treatment under case 4 potentially due to the tax year after they arrived they are not going to meet that automatic UK residence test. This might be helpful in that regard.

Most people will have a house before they get here, they might have a house for a several years in the UK so they need to go through all the home tests to see whether the existing property, e.g. a holiday home turns into a home. Not everyone will get it but there is a scope for individuals who come to the UK to live and not to work to get it.

Split year treatment was highly debated at the consultation stage as under the proposal it was restricted to individuals leaving or coming to the UK in order to undertake a full-time employment. It meant that wealthy individuals, entrepreneurs, business people coming to the UK to live not to work would struggle to get a split year treatment. This indicated that individuals will need to look more at the DTAs in order to get effectively a split year treatment as it will not be available under the domestic law.

It originates from the 'only home' test but many individuals will have more than one property/home and they will never work in the traditional sort of way. This aspect needed improving as it was difficult to judge whether someone would get a split year treatment or would be denied one. Presently the difficulties encountered stem from individuals coming and leaving the UK frequently. The difficulty here is the date when they become the UK resident for the split year treatment is uncertain.

It has to be assumed that people coming to the UK would become UK resident form 6 April in the tax year of their arrival. If the individual would be regarded as treaty resident in their home country under the relevant tax treaty in place before the date they arrive to the UK, then you would be the UK treaty resident after the arrival so it means that en individual can get some sort of split year treatment but people coming to the UK from the middle east where there are no DTAs with the UK would receive no tax relief.

Some people have no residence in any particular country but want to come to the UK. Previously, individuals would be advised to; say, that when they arrive to the UK they have to spend an example of six weeks here before their departure and to ensure make sure that the pattern is different when they return here again. So if they were non resident when they left already, the treaty would not apply help them. The treaty is there to resolve the problem of dual residence and not to try to make someone resident in this particular jurisdiction. The rules on a split year treatment might be difficult and confusing.

The Case 5 individual ceases to have any home in the UK and from then on has no home in the UK for the rest of the year and from that date has less than 16 days of presence in the UK. This is really confusing as these 16 days are not prorated so if you live in May you got 16 days of presence in the UK if you live in March you still have 16 days of presence and you need to meet a ‘sufficient link’ test, hence within 6 months of ceasing to have any home in the UK the individual must have a ‘sufficient link’ with a country overseas, i.e. be resident there for tax purposes, have been present there at the end of each day in the 6 month period (no holidays allowed) or have only home/all homes in that country which aids the split year treatment.

In the author’s view this has been influenced by the Gaines-Cooper case so if you want to get the split year treatment you effectively need to not have a UK home any more. What might work for people who genuinely want to retire abroad may not for people who want to leave temporarily.

8.7 Anti-avoidance provisions

8.7.1 The day-tripper rules

These rules have been discussed in detail above and are listed here for the reference only.

8.7.2 Temporary non residence

Since 1998, rules have existed to prevent the avoidance of tax by individuals making disposals of assets during periods of non-residence that are only temporary. The main thrust of the rules has been to ensure that individuals who leave the UK for periods of residence abroad of less than five complete tax years will remain chargeable to capital gains tax on gains made on disposals of assets that were held at the date of departure.

In consequence of the proposed Finance Bill 2013 draft legislation that places the definition of residence and split year treatment on a statutory footing (and abolishes the concept of ordinary residence), a new definition of 'temporarily non-resident' is introduced, together with definitions of the 'year of departure' and the 'period of return' and consequential amendments are made to TCGA 1992, s.10A (temporary non residents).

The Finance Bill provisions include additional temporary non-residence rules for income tax purposes, and existing rules are revised. The changes will affect individuals leaving the UK after 5 April 2013 who have historically been UK resident and who receive distributions from close companies (or foreign companies that would be close if they were in the UK), lump sum pension distributions from certain pension schemes, or make chargeable event gains on life assurance policies whilst non-resident. The distributions would become taxable if the individual returns to the UK within five years of becoming non-resident.

An individual is "Treaty non-resident" at any time if at the time the individual falls to be regarded as resident in a country outside the UK for the purposes of double taxation arrangements having effect at the time.[75]

[75] See Finance Bill 2013, Schedule.43, para.110, sub-para.3

8.7.2.1 Temporary non-residence rules post 6 April 2013

In order for an individual to be ‘temporarily non-resident’, four conditions must be met:

(1) The individual has ‘sole UK residence’ for a ‘residence period’ (which may be either a tax year or the overseas or UK part of a split year) – this period is known as ‘period A’.

(2) Immediately following period A, there are one or more residence periods for which the individual does not have sole UK residence.

(3) In at least four of the seven tax years immediately proceeding the year which consists of or includes period A (the ‘year of departure’), the taxpayer had sole UK residence or, if the year was a split year, the individual had sole UK residence for part of it.

(4) The period between the end of period A and the start of the first subsequent residence period (the ‘period of return’) for which the individual has sole UK residence is 5 years or less.

An individual has ‘sole UK residence’ if UK resident for a tax year and not treaty non-resident (regarded as resident in a country outside the UK under double taxation arrangements then in force) or, in the case of a split year, if UK resident and not treaty non-resident in the UK part of the year.

8.7.2.1.1 Capital gains tax consequences

The basic rule is that the individual is chargeable to capital gains tax as if gains and losses had accrued to the taxpayer in the period of return, subject to the exceptions below.

There are special rules applicable to gains and losses realised by non-resident close companies in which the individual is a participator and gains treated as accruing to the settler of a non-resident settlement under section 86 of TCGA 1992.

Chargeable gains are not treated as accruing to the individual in the period of return if the individual is otherwise chargeable to capital gains tax in respect of the gain. If the remittance basis applies for the year of return, any foreign chargeable gains remitted at any time in the period of temporary non-residence are treated as remitted in the period of return.

However, generally speaking the above rule does not apply to a gain or loss accruing on the disposal of an asset acquired during the period of non-residence, which will not therefore be treated as accruing in the period of return. There are exceptions:

- where the asset was acquired via a no gain, no loss transaction (e.g. transfers between spouses or civil partners);
- where the asset is an interest created by or arising under a settlement;
- where the amount or value of the consideration for the acquisition falls to be reduced in consequence of a rollover relief claim on the disposal of an asset acquired when UK resident (and not treaty non-resident); or
- where the disposal of the asset acquired whilst non resident would trigger a gain held over on the disposal of an asset that was not acquired during the non-residence period (or that falls within one of the above three exceptions) – for example, a 'frozen gain' that crystallises on disposal of a QCB under section 116(10) of TCGA 1992.

The basic rule that gains and losses will be charged on the individual in the period of return cannot be overridden by any double tax relief arrangements, and irrespective of any other time limits for assessments, an assessment to capital gains tax for the year of departure may be made at any time before the end of the second anniversary of the 31 January next following the year of return.

8.8 Transitional rules

A number of the above tests refer to residence status in the preceding three tax years. For the first three years of the statutory residence test, residence status in years where the statutory residence test did not exist may therefore be relevant. Where residence status in those years is relevant, the taxpayer may make an election for those years to be treated as though the statutory residence test had existed. This election should provide more certainty to individuals who would clearly have been non-resident had the new rules existed at the time but whose position is not clear cut under the original rules. The election will be irrevocable.

8.9 Problems not addressed

The statutory residence test does not alter one particular factor that makes the tax position of mobile workers complex: the UK's tax year of 6 April to 5 April. No other country in the world has these dates, with most countries using the calendar year. Although these rules aim to provide increased certainty as to the UK tax position, they will not remove the complexity caused by an internationally mobile worker having to determine tax residence in different countries according to deferring tax year ends. Whilst the attempt to clarify concepts such as 'full time work' and 'working day' are laudable, there will inevitably be many cases where the definitions of these terms and the 'connecting factors' do not cover the position of a particular taxpayer. On a particular note, taxpayers will be required to self-assess their residence status but HMRC have provided an online tool to assist with this, which is a welcome development.[76]

[76] See Miller and Oats, Principle of International Taxation; pp.323.

9. The interaction between Art 4 of the OECD MTC and the connecting factors under the new rules

Double tax agreements ('DTA') shift tax revenue from source countries to residence countries, because under the generally accepted rules, the source country is allowed to impose the first tax on any revenue deriving from sources within it. In the absence of a DTA, source countries can tax both active and passive income within the country. [77]

Article 4 of the OECD Model Tax Convention ('MTC') does not define residence but refers it back to the domestic law of the contracting states. Therefore, the domestic law will decide whether an individual is a resident of that contracting state and, consequently, is within the scope of the treaty.[78]

9.1 Treaty non-residence

An individual is Treaty non-resident if he falls to be regarded as resident in a country outside the UK for the purposes of double taxation agreements having effect at the time.

9.2 Dual Residence

It is possible for an individual to be resident in both or neither of two contracting states under the relevant domestic laws. The Art 4 of the OECD MTC determines individual's residence for the purpose of the Convention, it affects neither the domestic definition of residence nor the domestic law status of that individual.[79] If an individual is resident in two contracting states in the same tax year, if there is a DTA in place, the relevant provisions under this agreement would determine which country has taxing rights over any income or gains an individual may have. [80]

A split year treatment is put on a statutory basis under the new SRT. The new rules deem individuals who are resident for any particular year to be resident "at all times" in that

[77] See AVi-Yonah (2007). *Double Tax Treaties: Introduction*, pp.4.
[78] See Baker (2001). *Double Taxation Conventions: a manual on the OECD model tax convention on income and on capital*; pp.4B-01.
[79] See Baker, pp. 4B-02.
[80] See HMRC Guidance, *Double Taxation Agreements – an introduction*.

year for the purposes of income tax, capital gains tax etc. The effect of this is of course modified by the split year rules, but the way in which this modification occurs is not straightforward, especially where tax treaties are concerned.

9.3 The tie-breaker rules

As mentioned above, it is possible for an individual to be resident in both contracting states and paragraph 2 and 3 of most modern DTAs include the 'tie-breaker' rules for determining in which of the two countries an individual should be treated as resident for the purposes of the DTA.

The new SRT provides that where an individual is a resident of another state for the purpose of a DTA he will be regarded as non-resident in the UK. A fundamental principle of the OECD MTC is to eliminate double taxation; therefore, dual residents will be always allocated to only one contracting state which is achieved through the application the tie-breakers rules.

As mentioned previously, the new SRT also includes a series of tie-breaker rules defined in the 'sufficient ties' test. International case law seems to confirm that an individual must be linked to a contracting state by a connecting factor which is generally recognised in international law as a justification for the worldwide taxation basis.[81]

9.3.1 Permanent home

The HMRC Guidance on SRT refers to the concept of a 'home' under SRT to be completely different to the definition of a permanent home under the Art.4(2) of the OECD MTC. It goes on to say that the DTAs "*have an additional qualifiers that are not included as part of the SRT and so the two terms do not have the same meaning*".[82]

[81] See Baker, pp.4B-07, R v Forest Crown Industries Ltd (1995) 95 DCT 5389.
[82] HMRC Guidance on Statutory Residence Test (SRT).

Art 4(2) provides:

> *"Where by reason of the provisions of paragraph 1 an individual is a resident of both Contracting States, then his status shall be determined as follows:*
>
> *a) he shall be deemed to be a resident only of the State in which he has a permanent home available to him";*

The paragraph 12 of the Commentary to the Art.4 considers that *"the residence is that place where the individual owns or possesses a home".*[83] Further, this home (any form of home) must be permanent, meaning that, the individual must have arranged and retained it for his permanent use as opposed to staying at a particular place under such conditions that it is evident that the stay is intended to be of short duration (travel for pleasure, business travel, educational travel, attending a course at a school, etc.).[84]

It appears that the new SRT does differ from what the Commentary describes as a permanent home. The 'only home' test under the automatic UK residence test does not require a home to be owed by an individual. It still contains the permanence and stability tests for it to count as an individual's home but he does not need to be a legal owner of the property. This could mean that HMRC may lose each battle over individuals who they regard to be UK resident under the second automatic UK residence test because they have a home in the UK for a continues period of more than 91 days here. The second automatic UK residence test would disregard a home overseas which is used for less than 30 days and treat an individual as automatically UK resident but one could argue that his home is overseas under the treaty provisions under the principles established in the French Conseil d'Etat[85]. per the

Furthermore, paragraph 15 of the Commentary on the Art.4 confirms that "*if a person who has a home in one State sets up a second in the other State while retaining the first, the fact that he retains the first in the environment where he has always lived, where he has*

[83] OECD Commentary on Art.4.para.12.
[84] OECD Commentary on Art.4.para.13.
[85] See Decision No. 69852 of January 26, 1990, (1990) 23-24, Droit Fiscal, 800, discussed in 1990 E.T. 300.

worked, and where he has his family and possessions, can, together with other elements, go to demonstrate that he has retained his centre of vital interests in the first State."[86]

It can be also argued that setting the availability test as low as 91 days under the 'only home' UK residence test sits rather strangely with the 183 days test. Under the old rules[87] visits totalling less than 183 days in the tax year would be regarded as temporary visits exemption. It appears as, the 183 days test has now been halved for individuals with an overseas property, and not all will be able to use a double tax treaty tie-breaker test to establish non-residence.[88]

9.3.2 Centre of vital interest

If the individual has a permanent home in both Contracting States, Art.4(2)(b) gives preference to the State with which the personal and economic relations of the individual are closer. The paragraph 15 of the Commentary gives an exhaustive list of factors which may provide a confirmation of the centre of vital interests being established in another country:

> *"Regard will be had to his family and social relations, his occupations, his political, cultural or other activities, his place of business, the place from which he administers his property, etc"*[89]

This is a very similar approach the one under the old rules where an individual was required to sever all his ties with the UK and establish the above connections in another contracting state to be regarded as non-resident. The new rules do not require severing the ties with the UK or another contracting state depending on whether coming or leaving the UK but simply loosening his connections. This is in line with the judgment in the Gaines-Cooper case delivered by Lord Walker where it was held that "severance" of family and social ties was to strange word.[90]

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[86] See OECD Commentary on Art.4, para.15.
[87] See s.831 of ITA 2007
[88] See Deloitte Commentary on the Draft Legislation.
[89] See OECD Commentary on Art.4, para.15.
[90] See Gaines-Cooper case, para.20.

9.3.3 Habitual abode

Art.4(b) establishes a secondary criterion for two quite distinct and different situations:

a) the case where the individual has a permanent home available to him in both Contracting States and it is not possible to determine in which one he has his centre of vital interests;

b) the case where the individual has a permanent home available to him in neither Contracting State.

In the first situation, the centre of vital interests is to be considered the state where an individual stays more frequently. For this purpose visits to both the permanent home in the state in question and any other place in the same State will be taken into account.[91]

The second situation is the case of an individual who has a permanent home available to him in neither Contracting State, as for example, a person going from one hotel to another. In this case also all stays made in a State must be considered without it being necessary to ascertain the reasons for them.[92] However, it is not clear what a sufficient length of time is for it to determine which contracting state should retain taxing rights under the treaty.[93]

9.3.4 Nationality and Mutual Agreement

Where, the individual has a habitual abode in both Contracting States or in neither, preference is given to the State of which he is a national.[94] If, in these cases still, the individual is a national of both Contracting States or of neither of them, and the taxing rights will be assign through mutual agreement according to the procedure established in Article 25.[95]

[91] OECD Commentary on Art.4, para.17.
[92] OECD Commentary on Art.4, para.18.
[93] OECD Commentary on Art.4, para.19.
[94] See Art.4(2)(c) of the OECD MTC.
[95] OECD Commentary on Art.4, para.20.

10. Conclusion

After the Supreme Court’s decision in the Gaines-Cooper case in 2011 on the application of the HMRC Guidance, the world of the UK taxation stood still for a moment. All that was believed to be the well established HMRC practice which could be relied on have been dismissed. Advisers had to warn their clients that what they had always used to advise them on their residence status could produce unsatisfactory results.

The case triggered a debate around the concept of residence in the UK and pushed the Treasury together with HMRC to revisit their work on a statutory residence definition. Residence had previously not been defined in the legislation apart from a few ‘meaningless’ provision in the Income Tax Acts and has always been based on the case law which have been developed over the years. Some of the cases were 130 years old and referred to dated concepts which did not fit with current world of international travel. As the HMRC Guidance did not assist any further the profession demanded the rules to be put in the statutory footing and some certainty was due to taxpayers.

A long period of consultation between the Treasury and representatives from the profession resulted in the Statutory Residence Test being enacted and becoming the law from 6 April 2013. The Government promised “transparent, objective and simple” rules with the main purpose to give taxpayers greater certainty in an area that had become fraught with difficulties in recent years, and anything that helps to give certainty should be warmly encouraged.

The new rules consist of three elements of which two are designed to conclusively determine whether an individual should be treated as resident or non-resident in the UK in a tax year. There is a series of the ‘sufficient ties’ test which the author cannot avoid calling the ‘tie-breaker’ rules as these are referred to only if the two previous tests are incapable of deciding the residence status of the individual.

The new rules are mainly a reflection of the old rules established by the case law over years. Various alterations were made to the well-established definitions, some provisions were removed and a few of the new ones were introduced. The biggest change was the removal of the ordinary residence concept as it was perceived, by many, as an unnecessary complication; the introduction of different rules for ‘arrivers’ and ‘leavers’ under a general view than arrivers should be allowed to spend more days in the UK as they inherently have less connections with the UK. In the current spirit of tackling ant-avoidance, some new rules were introduced to stop individuals from making frequent visits to the UK without triggering the UK residence.

From international law perspective, the biggest changes have been made to a split year treatment as it appears that fewer individuals will be able to benefit from this relief than under the old rules. First of all, the spilt year has been defined in the legislation as previously it was dealt with on concessionary basis. The main winners are people in the full-time employment, as most of the cases apply to individuals who leave or come to the UK to work. It can be argued that rigid and very selective rules could stop wealthy individuals from coming to the UK to do business and consequently their money and expertise. On the other hand, this could make advisers and individuals to look for the alternatives which can be offered by the treaty provisions.

In summary, the statutory residence test should be welcomed by all in the profession and taxpayers themselves. It definitely brings a greater certainty when dealing with the complex situations of internationally mobile individuals than the old rules. Although there are certain areas which are still subjective and need more work, the author of this paper shares the view of the CIOT express in their response to the draft legislation that the rules should be revisited in two years time to see how the rules are being implemented by the profession.

The only criticism of the new rules would be its undesired complexity as the legislation is a maze of the tests combined with their subsidiary tests and the definitions which are either confusing or illogical at times. Nevertheless, this is a huge step forward.

Appendix 1

The trade-off between UK ties and days of presence

Days in UK	Minimum number of UK ties which make individuals **coming** to the UK resident (i.e. not UK resident in the previous three tax years)	Minimum number of UK ties which make individuals **leaving** the UK resident
< 16 days	Always non-resident	Always non-resident
16 - 45 days	Always non-resident	4
46 – 90 days	4	3
91 – 120 days	3	2
121 – 182 days	2	1
> 182 days	Always resident	Always resident

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