

Statutory residence test

The final draft

November 2012

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Part 1—Introduction

Current residence rules

The extent to which an individual is subject to UK tax depends on whether they are resident, ordinarily resident or domiciled in the UK. The concept of residence is used to measure the strength of an individual's links with the UK. The underlying principle is that those with the strongest links to the UK should pay more tax than those whose connections are weaker.

Neither residence nor ordinary residence is defined in legislation. Although guidance published by HM Revenue & Customs ("HMRC") is important, in the absence of a clear statutory test the courts have had to decide what residence and ordinary residence mean and there is now a large body of relevant case law.

The need for reform

For many taxpayers their resident status is clear under the present system, but considerable uncertainty exists for other taxpayers. The extent to which an individual can make and retain connections with the UK and still be considered to be a non-UK resident is particularly uncertain. This affects UK visitors who gradually build up connections with the UK such as employment, business, accommodation etc. No clarity exists as to the point at which these connections with the UK are strong enough to cause the individual to become UK resident.

For a number of years taxpayers relied on the guidelines in HMRC publication IR20 and its successor HMRC6 to determine resident status. HMRC have subsequently argued against their own published guidance and, on 19 October 2011, the Supreme Court confirmed in the Gains – Cooper case that taxpayers do not have a legitimate expectation, based either on HMRC published guidance, or any previous practice by HMRC, to be treated as non-UK resident for tax purposes. This and subsequent court decisions have made the determination of UK tax resident status more uncertain and the need for reform greater than ever before.

Proposal for a statutory test of residence

The Government announced in the 2011 Budget its intention to introduce a statutory test of tax residence for individuals. Its objective is to replace the current uncertain and complicated residence rules with a clear statutory residence test that is simple for taxpayers to use.

HMRC has issued draft legislation and undertaken a consultation process on the proposed statutory residence test. A summary of responses to the consultation was issued by the Government and HMRC in June 2012. The Government has confirmed that, following the consultation, the draft legislation is "close to a final draft" although a further consultation is being carried out on a number of points. This briefing paper summarises the proposed statutory test of residence following the consultation. This is subject to final amendments by the Government.

A final version of the draft legislation is expected to be published shortly after Budget 2013 and will be subject to normal Parliamentary scrutiny before it is enacted in the Finance Act 2013 to take effect from 5 April 2013.

Part 2 - The statutory tests of residence

The three tests:

- Automatic Overseas Test which defines conclusive non residence.
- Automatic Residence Test which defines conclusive residence.
- UK Ties and Day Counting Test which applies to everyone else.

If an individual meets the Automatic Overseas Test they are conclusively not UK resident. If an individual does not meet the Automatic Overseas Test but meets the Automatic Residence Test they are conclusively UK resident. If they meet neither of these two tests then their resident status will be determined by the UK Ties and Day Counting Test.

Key concepts are highlighted below and defined in Part 3. There is also described in Part 3 the method of day counting employed in all three tests of residence.

Automatic Overseas Test – conclusive non-residence

An individual is treated as not resident in the UK for a tax year if they satisfy any one of the following three Automatic Overseas Tests:

- they are not resident in the UK for all of the previous three UK tax years and they are **present** in the UK for fewer than 46 days in the current tax year;
- they are resident in the UK in one or more of the

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- previous three UK tax years and they are **present** in the UK for fewer than 16 days in the current UK tax year; or
- c. they leave the UK to carry out **full-time work abroad**.

Automatic Residence Test - conclusive residence

Where none of the Automatic Overseas Tests apply, the individual will be treated as resident in the UK for a tax year if they meet any one or more of the following automatic UK tests:

- they are **present** in the UK for at least 183 days in the tax year;
- their only **home** is in the UK (or they have two or more homes and all of them are in the UK) and they are present for a period of at least 91 days, in or straddling the tax year;
- they carry out **full-time work in the UK**; or
- they die in the tax year and, for the preceding three tax years, they have been an automatic UK resident and at the time of their death their normal home was in the UK (even if they were living in the UK temporarily at the time).

UK Ties and Day Counting Test

Where an individual meets none of the Automatic Residence Tests and none of the Automatic Overseas Tests they need to consider whether they have sufficient UK ties to be treated as UK resident. What counts as a UK tie depends on whether an individual was resident in the UK for one or more of three preceding tax years.

a. Arrivers

Where an individual was not resident in the UK in all of the previous three UK tax years ("an Arriver") each of the following four ties counts as a UK tie:

- a **family tie** - the individual has a UK resident family;
- an **accommodation tie** - the individual has accessible accommodation in the UK;
- a **work tie** - the individual has a substantive UK employment (including self-employment); and
- a **90-day tie** - the individual spent 90 days or more in the UK in either of the previous two tax years.

The table below shows how many UK ties are sufficient for an Arriver to be treated as UK resident.

Days spent in UK	Number of ties that are sufficient
Fewer than 46 days	Automatically non-resident
46 – 90 days	Resident if individual has all 4 ties
91 – 120 days	Resident if individual has at least 3 ties
121 – 182 days	Resident if individual has at least 2 ties
183 days or more	Automatically resident

b. Leavers

Where an individual was resident in the UK for one or more of the previous three UK tax years ("a Leaver") each of the following five ties counts as a UK tie:

- a **family tie** - the individual has a UK-resident family;
- an **accommodation tie** - the individual has accessible accommodation in the UK;
- a **work tie** - the individual has a substantive UK employment (including self-employment);
- a **90-day tie** - the individual has spent 90 days or more in the UK in either of the previous two UK tax years; and
- a **country tie** - the individual spends more days in the UK in a tax year than in any other single country.

The table below shows how many UK ties are sufficient for a Leaver to be treated as UK resident:

Days spent in UK	Number of ties that are sufficient
Fewer than 16 days	Automatically non-resident
16 – 45 days	Resident if individual has at least 4 ties
46 - 90 days	Resident if individual has at least 3 ties
91 – 120 days	Resident if individual has at least 2 ties
121 – 182 days	Resident if individual has at least 1 tie
183 days or more	Automatically resident

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Part 3 - Key concepts

Some of the key concepts used in the proposed statutory residence test are defined as follows:

Present

All three tests require day counting. A day of presence in the UK follows the current residence test, being when:

- an individual is present at midnight at the end of that day;
- except where:
 - the individual is in transit (i.e. travelling through the UK as a passenger is ignored when the individual leaves the UK within a day of arrival, and does not engage in activities substantially related to their passage through the UK); or
 - exceptional circumstances beyond the individual's control prevent departure (e.g. national or local emergencies or sudden or life threatening illness or injury). Only 60 days may be ignored by reason of exceptional circumstances.

The Government has confirmed that it will consider whether there is a risk of manipulation of the midnight rule and may introduce a targeted supplementary rule which would apply to those present in the UK on a large number of days but not at midnight.

Home

"Home" may be any place, including a vehicle or a vessel. A place may be an individual's home whether or not they own or rent it. A holiday or weekend home would not count as a "home".

Work

"Work" includes undertaking the duties of an office or carrying on any self-employed profession or vocation. Training and reporting duties would be included in the definition of work. Travelling would also be included (but not commuting). Unpaid voluntary work will not be included.

Full time work abroad

The qualifying period for full time work abroad ("FTWA") is to work abroad for a complete UK tax year (i.e. 6 April to 5 April).

A limit of fewer than 91 days presence in the UK and less than 21 working days in the UK in a UK tax year is permitted under the FTWA test. These limits will be pro-rated where an individual leaves the UK part way through the tax year, and is treated as not resident for part of the year under the split year rule.

"Full time work" consists of one or more contracts of employment where the combined total working hours carried out abroad are at least 35 hours per week. In determining whether the test is met the length of the period may be reduced to take account of "reasonable" amounts of leave and absences due to illness or injury (but no reduction is allowed for weekends or bank holidays).

Full time work in the UK

Full time work in the UK ("FTWUK") is defined as work in the UK for a period of 276 days (9 months) in or straddling the tax year and there are no significant breaks from work during that period (i.e. more than 75% of the days of work (i.e. three hours or more) are days of work in the UK).

The definition of "full time work" for FTWUK is the same as for FTWA.

The Government has confirmed that it will consider increasing the qualifying period from 9 months to 12 months and is seeking views on this.

The UK ties

a. Accommodation tie

An individual has an accommodation tie if:

- they have a "place to live" in the UK;
- that place is available to them during the tax year for a continuous period of at least 91 days; and
- they spend at least one night at that place in the tax year.

An individual has a "place to live" if they have a home, holiday home, weekend home, temporary retreat or something similar in the UK or accommodation is otherwise available to them where they can live while in the UK.

Accommodation may be available to an individual whether they own or rent it and even if they have no legal right to occupy it.

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If the accommodation belongs to a close relative (parent, grandparent, sister, brother etc) an individual needs to spend at least 16 nights there to have an accommodation tie.

b. Country tie

An individual has a UK country tie for the tax year if the country in which they spend the greatest number of days in that tax year is the UK.

The country tie applies only to Leavers. It does not apply to Arrivers.

c. Family tie

An individual has a family tie in the UK where:

- the individual has a UK resident spouse, civil partner or common law equivalent and child under the age of 18 in that tax year or any part of that tax year. Child includes natural and adopted children but not step-children (unless adopted). A person who is separated from the individual under a court order or separation agreement or where the separation is likely to be permanent is excluded from this tie.
- the individual sees his child in the UK for more than 60 days (or part days).

A child who is in full time education will not be treated as resident in the UK if he spends less than 21 days in the UK outside term-time.

d. Work tie

An individual has a work tie if:

- they work in the UK for at least 40 days in any tax year; and
- a working day is any day during which more than three hours of work is undertaken. This can include any day where the individual is not in the UK at the end of that day.

If less than three hours work is carried out in a day, the individual should maintain sufficient records to be able to demonstrate that less than three hours work was carried out on that day.

The Government has confirmed that it will consider increasing the limit for a working day from three to five hours and is seeking views on this.

e. 90 day tie

An individual has a 90-day tie for the tax year if they have spent more than 90 days in the UK in the tax year or the year preceding the tax year.

Part 4 - Other concepts

Split year treatment

It is proposed that the split year treatment concession will become a statutory right which will be linked to the statutory residence test. The principle of the relief is as follows:

- an Arriver is treated as a resident in the UK from the date of arrival, and not resident for the part of the year prior to arrival in the UK; and
- a Leaver is treated as a resident in the UK before the date of their departure, and not resident for the part of the year following their departure from the UK.

Split year treatment applies to split a tax year into periods of residence and non-residence where an individual:

- becomes resident by virtue of their only home being in the UK (Arrivers and Leavers);
- becomes resident by starting full time employment in the UK (Arrivers and Leavers);
- establishes their only home in a country outside the UK and becomes tax resident in that country and does not come back to the UK in that tax year (Leavers);
- loses UK residence by virtue of working full-time abroad (Leavers); or
- returns to the UK following a period of working full time abroad and, in addition, satisfies one of the other tests for split year treatment.

In addition to these situations split year treatment will be available to spouses and partners of individuals who work full time abroad, subject to certain conditions.

The Government considers the draft legislation relating to split year treatment to be "work in progress" which will require refinement before it is finalised.

Death in year

The statutory residence test will cater for situations where an individual dies part way through the tax year. It is proposed that:

- the Automatic Overseas Test for individuals who have been resident in the UK in one or more of the previous three years and have spent fewer than 16 days in the UK cannot apply;

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- in the UK Ties and Day Counting Test the number of days that need to be taken into account will be reduced on a pro-rata basis, based on the proportion of whole months left in the tax year following the month of death; and
- where an individual has been resident in the UK for the previous three years on the basis of satisfying one of the conditions in the Automatic Overseas Test and, in the year of death, their normal home was in the UK, they will remain UK resident for that year, regardless of circumstances.

Anti avoidance

New anti-avoidance rules are proposed to counteract the risk of individuals creating artificial, short periods of non-residence to receive income free of tax when it accrues during a period of residence and which would otherwise be liable to UK tax. This would be similar to the existing rule which applies to capital gains (Section 10 TCGA 1992) which treats gains arising in a temporary period of non-residence as accruing to the taxpayer in the year of return.

It is proposed that the new rules will be modelled on the existing capital gains rules and will apply where an individual:

- has been resident in four or more of the seven tax years prior to the tax year in which they become non-resident; and
- becomes resident again within five years of leaving.

Where these conditions are met, certain types of income that arise during the years of non-residence will be treated as arising instead in the year in which the individual becomes resident again.

The rule will cover the following types of income:

- distributions from close companies;
- lump sum benefits from employer-financed retirement benefit schemes; and
- chargeable event gains from life assurance contracts.

This will be in addition to the types of income and gains covered by the existing rules for temporary non-residents i.e. certain income withdrawals from pension schemes, remittances and chargeable gains. However, the Government has confirmed that it will not apply to ordinary earnings from employment or self employment or to regular types of investment income such as bank interest or dividends from non-close companies.

Ordinary residence

Following the consultation the Government proposes to abolish the concept of ordinary residence for all tax purposes (other than overseas work day relief which will be put on a statutory footing).

Part 5 -Transitional rules

The Government proposes a limited transitional rule for prior years.

The transitional rule will apply only for those parts of the test where the individual needs to know what their residence status was in one or more of the three years prior to the introduction of the test for the purpose of determining their residence in future years. It will allow individuals to apply the new rules to those preceding years for this specific purpose only. The existing rules will continue to apply for determining actual residence status and tax liability in the earlier years. An individual will need to make a formal election to use this transitional rule.

The transitional rule will only be applicable to the following parts of the new residence test:

- Automatic Overseas Test – where residence in prior years affects whether the relevant threshold for automatic non-residence is 15 days or 45 days; and
- UK Ties and Day Counting Test – where residence in prior years affects which of the day counting "ladders" should be used to assess residence status (see Part 2 above).

The transitional rule will not apply for other tax purposes such as the "17 out of 20 year" deemed domicile rule for inheritance tax or the residence period which determines liability to pay the remittance basis charge.

Part 6

Conclusion

A statutory residence test is welcome because it provides far greater clarity about resident status than has previously existed.

The draft legislation summarised in this briefing paper may change following further consultation on a number of points although in general the Government considers the draft legislation to be "close to a final draft". Final

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legislation is due to be published and implemented by 5 April 2013.

The Government proposes to maintain an on-line assessment tool to assist individuals with self-assessing their resident status although the Government has confirmed that the ruling provided by this on-line facility will not be binding on HM Revenue & Customs. Therefore advice may be needed, particularly for individuals who do not comply with the Automatic Overseas Test or the Automatic Residence Test .

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