

Statutory definition of tax residence

Proposed framework for a statutory residence test

Grant Thornton UK LLP (Grant Thornton) welcomes the opportunity to respond to the consultation document released on 17 June 2011 by HM Revenue & Customs (HMRC) in connection with the proposed introduction of a statutory test for UK residency. Our general comments in respect of the proposals are set out below, followed by our responses to the specific questions raised in the consultation document.

General comments

The question of an individual's residence status has been subject to much comment and deliberation over the years, giving rise to a number of high profile court cases. It is Grant Thornton's opinion that a statutory test for residency is long overdue and so welcomes these proposals that will hopefully do much to reduce to the uncertainty faced by many UK taxpayers each year.

We are encouraged by the commitment to provide greater certainty and are in agreement with the comments made at paragraph 1.7 of the consultation document that any measures introduced will need to be 'transparent, objective and easy to use'. We are pleased to state that we are in general agreement that the proposals largely meet this policy objective.

The proposed framework

It will be imperative that the process gives rise to a clear and unambiguous resolution. It will therefore be paramount that the parameters of any test are well defined. It would not be satisfactory if the test could not provide a considered and definite answer. It follows, that in order for the test to operate as a rigorous and out right deciding factor, any answer provided must be unequivocal and without scope for manipulation. We are satisfied that the proposed test goes a long way to being able to offer such a facility. In particular, we agree with the rationale behind the three parts to the test, and feel that this arrangement should provide a simple and quick answer for the most straightforward of cases.

It is unfortunately an inevitability that the introduction of such specific new terms and definitions will add a new layer of complication to the regime. However, we see this as an unavoidable consequence of introducing measures that will ultimately provide an overall simplification for the majority of taxpayers.

There are some points however, that will need addressing before the test may be finalised. These are predominantly covered in our answers to the questions raised in the consultation document. Our general comments follow.

- i. Paragraph 3.10 confirms that the test will not apply for National Insurance contribution (NIC) purposes. This admission could prove counterproductive, especially in light of the recent consultation regarding the harmonisation of the two taxes. We believe that the test should apply for NIC purposes to ensure a taxpayer does not have the added complication of separate NIC rules to consider. We are also concerned of the potential implications on the test if income tax and NICs subsequently merge.
- ii. Paragraph 3.10 continues by confirming that the new statutory definition will supersede the existing law and guidelines. This should undoubtedly be the case, however, we believe that it is essential that some transitional provisions are implemented following the introduction of the new rules. See our response to question 4 below.

- iii. We welcome the move to publish an interactive tool alongside the consultation document. The trial version has proven to be a useful instrument when interrogating the test. We are in full support of the implementation of this function as standard protocol in self-assessing one's residence status. One suggestion we would like to put forward regarding this tool would be in respect of the final 'results' page. An option to print the resulting qualification of their status would be a welcome addition to round off the exercise and provide the individual with a copy of the result for their own personal records.
- iv. Paragraph 3.44 states that the 'split year treatment' is available where an individual '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'. This implies that any return visit to the UK in the year, no matter how short, would preclude an application for the tax year to be split. We would welcome a review of a minimum days test instead for an individual to return for a short visit, perhaps to tie up their UK financial affairs, without automatically forfeiting a chance to split the tax year.
- v. Paragraph 3.46 confirms that an individual who wishes to accompany their spouse or civil partner who has undertaken to work full time abroad, will only be granted split year treatment if the 'sole or main home is outside the UK'. We would welcome a definition of what a 'main home' would be. Relying on a sole residence abroad would appear to be somewhat restrictive as the majority will prefer to retain their UK home in order to return there once the overseas employment contract has ceased.

Furthermore, while paragraph 3.43 confirms that the relevant extra statutory concessions A11, D2 and A78 are to be replaced by legislative rules, the consultation document appears only to refer to the adoption of these rules specifically in relation to the split year test. It is not explicitly clear as to whether the rules will continue to apply generally. We should welcome your clarification that the legislating of these rules will apply generally, not just in relation to those years that are 'split'.

- vi. When considering the 'family' connection factor in the Part C test, paragraph 3.30 brings into account the 'common law equivalent' of a spouse or civil partner. It is not clear, however, if the same treatment is extended for 'common law equivalent' individuals who choose to accompany their partner on full time employment abroad.
- vii. The anti-avoidance provisions would seem logical given the policy objective and we are in general agreement that the introduction of provisions that somewhat mirror those for the capital gains regime would seem appropriate. However, the proposed rules hold the potential to give rise to some unexpected results. We are therefore apprehensive regarding the possibility that income received in the years of non-residence could subsequently all become chargeable in one tax year, as implied by paragraph 3.51. This could result in income inadvertently becoming subject to the highest rates of tax. We would welcome the application of a more sympathetic approach in such circumstances.

Definitions

As we have stated above, we are in general agreement that the proposed framework is likely to achieve the policy objective. The respective definitions of terms and phrases used throughout the test will be fundamental in underpinning the strategy as a whole. It is vital, that these that these are clearly, concisely and categorically defined.

Our comments on the specific terms defined in the consultation document can be found below, in the answer section to question 5 posed in the consultation document. In particular, we feel that the consultation document falls some way short of providing a conclusive definition for the term 'only home' for these purposes.

Ordinary residence

Any amendments to the concept of ordinary residence will be significant to those individuals affected and, as such, require much more thorough scrutiny than appears to have been given in the consultation document. As simply removing the concept altogether has its complications, it would seem that legislating a new definition has been assumed a satisfactory alternative. This may not prove to be the case, especially considering the potential implications to those individuals who would subsequently be denied the benefits currently afforded to them.

The proposed statutory residence test appears to have adopted a sympathetic approach when considering its potential effects, seeking to avoid any unnecessarily adverse impacts on those affected individuals. It is surprising that the equivalent proposals for a statutory ordinary residence test appears to ignore such concerns.

Specific comments

We set out our comments on the specific questions raised in the consultation document below.

Residence Test

1. Do you think there are any other circumstances in which an individual should be conclusively non-resident? If so, what are those circumstances?

This part of the test should prove conclusive as it stands, dependant on the quality of any respective definitions.

2. Do you think there are any other circumstances in which an individual should be conclusively resident? If so, what are those circumstances?

This part of the test would appear to have potentially too wide a scope. This requires further consideration, with specific regards to the proposed 'home' factor. See our comments at question 5 below.

3(a). Do you think that these connection factors are appropriate and are there other connection factors that should be included?

We believe that the factors identified are largely satisfactory. However, the subtle change with respect to day counting is not a welcome measure as the inconsistency is likely to lead to unnecessary confusion. It would be logical to retain the well-established '91 day test', rather than introduce a new 'fewer than 90 days' classification.

See also our comments below.

3(b). Does this part of the test provide a fair outcome? If not, why not?

It could be construed as unfair to count an individual with a UK resident family and 'accessible accommodation' in the UK as having two connection factors for the purposes of Part C, as in the majority of cases these factors are likely to be concomitant.

It may also be argued that an individual's residence in previous years could be given less significance. However, the proposed factor does fall in line with the statement at paragraph 3.6 'that residence should have an adhesive nature'.

It is envisaged that the 'more time in the UK than other countries' factor could also give rise to anomalous results. It would not seem appropriate that a nomadic individual who just happens to spend more time in the UK than any one other country should be deemed a UK resident.

4. Would the lack of a transitional rule as described in paragraph 3.57 leave significant uncertainty?

As mentioned above, we are uncomfortable that a set of transitional rules have been omitted from the proposals. The consultation document is clear in its arguments for the introduction of a statutory test for residency. Indeed, chapter 2 of the document is devoted to highlighting the flaws to the current rules. We are in general agreement with the points raised. It would seem contradictory therefore for the consultation to attempt to justify that a transitional rule is not required.

The introduction of these measures is intended to solve the problems of uncertainty brought about by the current rules. This uncertainty has existed for a number of years so we would welcome the opportunity to allow the retrospective application of the rules, to at least some effect.

For example, the test considers the residence status of an individual in the years previous to that under review. In the absence of any transitional measures, this will mean that the new statutory test will rely directly on the old, ineffective guidelines. This is, in our opinion, not satisfactory as it would undermine the policy objective to provide a conclusive answer in all cases.

It would seem appropriate therefore, to allow an individual to elect to use the new rules when considering his or her residence status in the years prior to their introduction. This would also be relevant for situations where an individual is required to assess whether he or she will be 'deemed domiciled' under s 267 of the Inheritance Tax Act 1984.

Residence definitions

5(a). Do you think that the proposed definitions are appropriate?

Full-time work abroad

Defining 'full-time work' with reference to the number of hours undertaken is inherently problematic. Many individuals adopt very different working patterns from the normal '9 to 5' working week. A more objective test here would be appropriate.

Paragraph 4.2 would appear to imply that an individual who takes up an employment contract requiring him to work 20 hours per week and also carries on a self-employment business requiring a further 20 hours per week, would not be deemed to have taken 'full-time work abroad' for these purposes. It is hoped that this is not the case. We would welcome clarification on this matter.

Working day

Fundamental to any definition of a working day, will be a better understanding of what is deemed to be 'work' for these purposes. The consultation document proffers no explanations as to what will constitute work and what will not.

This lack of guidance further undermines the requirement, in paragraph 4.10, to provide evidence in support of the fact that a working day has not been completed. We should welcome some examples of the types of evidence you would expect to receive for these purposes.

Day of presence in the UK

It is logical that a consistent approach is adopted here. However, this is not to say that the current definition is without flaw itself. We have previously encountered problems regarding what activities are and what are not 'to a substantial extent unrelated to an individual's passage through the UK'.

Only home

The application of the 'home' factor, used in both Part B of the test and also when considering the new 'split year treatment' provisions, appears to be inherently flawed and would, as defined in the consultation document, give rise to some unintended results. The proposals would appear to deem that an individual will be UK resident if he or she happens to spend as little as six and a half weeks in the UK in a tax year where the only 'home' retained by that individual is in the UK.

We would welcome your further clarification as to the residence status of the individual in the following example:

Patrice is a French National. He has never been resident in the UK but owns a holiday home in Devon where he spends exactly 8 weeks of each year. During his stays in the UK he lets out his only other home in France.

Applying the test as it stands, Patrice would be deemed a UK resident. Paragraph 3.44 assures us that Patrice would be eligible to apply for split year treatment, however the resulting administrative burden that would arise in such innocent circumstances would be onerous.

This factor, and the accompanying definitions, requires further consideration. The test does not offer any guidance or explanation for instances where the factor applies for only a limited period, as in the example above. A similar point could presumably be raised if Patrice decided to sell his French property and failed to acquire a new one before contracts were exchanged?

Full time work in the UK

Again, not all individuals work to a standard, 35 hour, week. The definition would therefore appear somewhat inadequate.

Family

It would seem unfair that an individual who only spends time with his or her children outside of the UK, for example where that individual is separated from the other parent, would be deemed as having a connecting factor for the purposes of the residency test. This clause could be construed as having a detrimental influence on a parents ability to spend time with their children.

Accommodation

The definition of accessible accommodation requires some further consideration before it can be considered conclusive.

In particular, we should welcome your clarification as to what would constitute a 'short-term' stay in a hotel or with relatives. Furthermore, what relatives, specifically, may an individual lodge with in accordance with paragraph 4.22 of the consultation document? It would seem surprisingly illogical that an individual may be permitted to lodge with a distant, and unfamiliar blood relative under these proposals, but not a close and longstanding friend, who may indeed be thought of as a brother or sister.

Substantive employment (including self-employment)

See our comments above regarding the definition of a working day.

5(b). Would these definitions have an adverse impact for particular groups? If so, which groups and what would the impacts be?

As highlighted above, the definitions could adversely impact any individual who owns UK property and/or has any UK resident family members. The proposed new rules may also affect individuals accepting work abroad, either coming to the UK or going overseas.

Ordinary residence

6(a). Should ordinary residence be abolished for all tax purposes other than overseas workday relief?

This suggestion could prove contrary to the policy objective of introducing a simplified solution. We believe that retaining the concept in part would ultimately lead to further complication.

Many individuals do currently enjoy the benefits of being not ordinarily resident and, in particular, the option to take advantage of the remittance basis. Furthermore, as identified in paragraph 6.13 of the consultation document, claiming overseas workdays relief for people coming to the UK for short periods is a real incentive for those considering an offer to work in the UK.

It would certainly be preferable, therefore, to retain these benefits. The question remains however, as to how this may be achieved in the absence of a specific ordinary residence test. Introducing a new definition of ordinary residence would be one possible solution. The consultation document offers no real alternatives however. See our comments below.

6(b). If a new definition of ordinary residence was introduced, should it be restricted to non-domiciled individuals only?

This would be an unpopular and unnecessarily unfair resolution, as it would have a significant impact on those expatriate, UK domiciled individuals who currently rely on the benefits of their status as not ordinarily resident.

It is our opinion that this would more than likely discourage such individuals from accepting work assignments in the UK.

6(c). Is the proposed definition of ordinary residence appropriate? If not, are there alternatives that would not have a material Exchequer cost?

Further to our general comments above, any new definition of ordinary residence would need to be much more robust than the one used currently. We do not believe that the proposed definition offers the clarity required of a term that will apply across a number of situations and purposes. In particular, we would again refer you to our comments concerning the use of the term 'only home' in the application of the test. The proposals would mean that Patrice, from our example above, would also be deemed ordinarily resident.

Generally we find the proposals to be unnecessarily strict. For example, the proposals to qualify an individual as ordinarily resident if they have been UK resident in any of the previous five tax years are particularly restrictive.

Conclusions

Statutory Residence Test

The consultation document reports that the likely impact of these measures on the exchequer will be negligible. However, the potential implications for those affected individuals is likely to be significant. It is therefore paramount that the provisions are carefully considered in order to ensure that the test is as accurately targeted as possible.

In summary we feel that the proposals are certainly a step in the right direction. We are encouraged by the approach adopted and feel that the framework proposed will, ultimately, produce a capable statutory test. However, there remain a number of points that require addressing and, in particular a number of terms

and definitions that need to be made much more robust before their implementation into the UK tax regime.

Ordinary Residence Reform

In our opinion, we appear to be still some distance from reaching a satisfactory solution to the proposed reform.

If the concept of ordinary residence is to be repealed, then the term should be abolished in its entirety. It would not be satisfactory if a definition should linger on for certain, limited purposes (overseas workday relief, NICs). We believe that the consultation document is biased towards instead creating a statutory definition. However, it is our opinion that, before this approach is decided upon, it would be a worthwhile exercise to consider the alternatives in greater detail. In particular, the complete removal of the term for all purposes deserves a much more thorough review.

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