



# Statutory residence test consultation

In his Budget speech in March, the Chancellor of the Exchequer, George Osborne announced that he would seek to introduce a statutory residence test for 6 April 2012. On 17 June 2011, HMRC released a consultation document setting out the planned changes in this area. The deadline for responding to the consultation is 9 September 2011 and we expect to see the first legislative draft before Christmas.

## Background

An individual's liability to UK tax is governed by three concepts: residence, ordinary residence and domicile. Individuals who are resident, ordinarily resident and domiciled in the UK are liable to tax on their worldwide income and gains. On the other hand, individuals who are resident and, either or both, not ordinarily resident or not domiciled in the UK may use the remittance basis to exclude certain elements of their overseas income and gains from UK taxation.

There is, currently, no statutory definition of any of the above three concepts in the UK and many of the prevailing practices have been developed from decisions in the Courts. There have been numerous tax cases over recent years that have resulted in a great deal of uncertainty as HMRC challenged what it perceived to be tax avoidance in this area. Added to this is the revision by HMRC of its own published guidance (now contained in HMRC 6) three times in the last couple of years. These decisions and the changes to HMRC guidance have led to a great deal of confusion for individuals who move to and from the UK. The need for a statutory framework that caters for the modern world is clear.

## What is in the statutory residence test consultation document?

Within the consultation document is a detailed framework for a statutory residence test. It contains a series of tests based on day-counting as well as taking into account connection factors with the UK. In some ways this is not too dissimilar to the current guidance contained within HMRC 6. However, the improvement is the intention to define clearly the connection factors and the weight given to each. Current guidance does not achieve this and this has resulted in uncertainty. In addition, guidance does not have the weight of law and the courts have not been bound to follow it. A statutory residence test will therefore give much more certainty in this area.

When applying the test, it is apparent that it is harder to cease to be a UK resident than to become one and this has been clearly stated to be the intention. Thus there are three parts to the test:

- ▶ Part A - Conclusive non residence
- ▶ Part B - Conclusive residence
- ▶ Part C - A combination of connection factors and day counts for those who cannot determine their residence status by A and B

If an individual meets the conditions in either Part A or Part B, there will be no need to consider Part C.

In addition, the legislation will also ensure most individuals will be able to split the tax year on arrival and departure. This is currently done by concession.

### Part A

If an individual meets any of the conditions in **Part A** they will automatically be treated as **not resident** in the UK for a tax year. The conditions are that they:

- ▶ Were not resident in the UK in all of the previous three tax years and they are present in the UK for fewer than 45 days in the current tax year; or
- ▶ Were resident in the UK in one or more of the previous three tax years and they are present in the UK for fewer than 10 days in the current tax year; or
- ▶ Leave the UK to carry out full-time work abroad, provided they are present in the UK for fewer than 90 days in the tax year and no more than 20 days are spent working in the UK in the tax year. A day spent working in the UK is one where more than 3 hours of work is done.

## **Part B**

Conversely, if an individual meets any of the conditions in **Part B** they will automatically be treated as resident in the UK. That is, if they:

- Are present in the UK for 183 days or more in a tax year; or
- Have only one home and that home is in the UK (or have two or more homes and all of these are in the UK); or
- Carry out full-time work in the UK.

## **Part C**

If parts A and B do not determine an individual's residence status then **Part C** applies. This looks at the number of connections an individual has with the UK and then assigns a number of days they can spend here without being regarded as resident, on a sliding scale. The less connection an individual has with the UK, the more time can be spent here before being treated as resident. An individual arriving in the UK can have more connections before being treated as resident than an individual who is leaving the UK. In addition, an individual who has been non-resident for the previous three tax years can spend more days in the UK than an individual who has been resident in one or more of those years.

The connection factors are family, accommodation, 'substantive work in the UK' (40 workdays or more each year on which the individual undertakes more than 3 hours of work), 'UK presence in previous year' and 'more time in the UK than in other countries'. Each of these is defined so, for example, the use of hotels whilst visiting the UK is not considered to be accommodation.

## **Investment income received while non resident**

In addition to the statutory residency test, the consultation proposes the introduction of anti-avoidance legislation to prevent individuals having a short period of non-residence during which they receive a large amount of income free of UK tax. In particular the consultation document mentions dividends paid by closely-controlled companies where the dividends reflect profits that have built up during a period of residence and which are taken out during a short period of non-residence. It is anticipated that a rule similar to the five year rule for CGT may be introduced.

## **Our view**

The proposed introduction of a statutory residence test is a very welcome development which will give individuals more certainty and enable them to plan their affairs. It is perhaps disappointing that the need was felt to make the test as complex as it is, so that there are still perhaps traps for the unwary - for example, it may not occur to an individual that selling their property overseas would impact on their UK residence position. Nevertheless, this represents a big improvement from the existing position and, as such, should be viewed positively.

## Further information

Ernst and Young will be heavily involved in the consultation process which ends on 9 September. If you would like to contribute to this process or are concerned about your own residence status, please speak to your usual EY contact, or one of the names below.

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