



### Statutory Tax Residence Test Update (June 2012)

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Following the publication of responses to the Consultation Document, Private Client consultant Christopher Sly and Private Client associate Freddie Bjørn summarise the framework of the proposed statutory residence test for individuals to take effect from 6 April 2013

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In the summer of 2011 the UK Government published a consultation document ("the **Consultation Document**") containing proposals for the introduction of a new statutory residence test for individuals. The Government had planned to bring the new legislation into effect from 6 April 2012 but following the initial consultations it decided to defer the date to allow time for the proposals to be refined. In late June 2012 HM Treasury and HM Revenue & Customs published a further document ("the **Responses Document**") summarising the feedback from the 2011 consultation and containing revised draft legislation refining the original proposals on which further consultation will take place until 13 September 2012. The Government intends that the new legislation will take effect from 6 April 2013, and further drafts of the legislation will be issued later in the autumn of 2012 for further consultation on points of detail.

We commented on the 2011 proposals in our briefing note entitled "Government Issues Proposals for a Statutory Residence Test". This briefing note updates our original note to reflect the main changes in the Responses Document and accompanying draft legislation.

By way of general comment, the changes to the previous proposals are largely on points of detail, whilst the broad framework of the original proposals remains as before. Notably there is now a definite proposal to abolish altogether the status of "ordinary residence" in the interests of simplification of the system. In practice this will affect only a relatively small number of taxpayers.

Pending the introduction of the new statutory rules the existing law will continue to apply. It had been suggested by some that there might be merit in applying the new rules retrospectively, so as to provide clarity with regard to the status of individuals in the tax year 2012/13 and previous tax years. The Government has not agreed to this, except for the very limited purposes of a specific transitional rule.

### Proposed Framework for the Statutory Residence Test from 6 April 2013

As before, the Government's proposed test will be in three parts:

- Part A sets out the factors that would be sufficient in themselves to make an individual conclusively non-resident ("the automatic overseas test");
- Part B sets out the factors that would be sufficient in themselves to make an individual conclusively UK resident ("the automatic residence test"); and
- Part C contains other connection factors and day counting rules ("the sufficient ties test") to be considered and applied by an individual whose residence status is not conclusively determined by Part A or B.

The Responses Document includes draft legislation for comment. Whilst this does not, in terms, refer to Part A, B and C as in the Consultation Document and the Responses Document it is more convenient in this note to follow the structure and terminology of the Consultation Documents.

### ***Part A: the automatic overseas test***

Part A of the proposed test would conclusively determine that an individual is non-UK resident for a tax year if that individual:

- has been non-UK resident in all of the previous three tax years and is present in the UK for under 46 days in the current tax year; **or**
- was resident in the UK for one or more of the previous three tax years and is present in the UK for under 16 days in the current tax year; **or**
- left the UK to carry out full-time work (i.e. a 35 hour week) abroad, provided he is present in the UK for under 91 days in the tax year of which no more than 20 days are spent working (for over 3 hours).

The Government is currently consulting on whether to amend the scope of the full-time work abroad test by **either** increasing the number of working days allowed in the UK from 20 to 25 **or** increasing the number of hours which constitute a working day from 3 to 5.

The Government has provided some comfort to those who cease to be employed whilst relying on the full-time work abroad provisions by confirming that if an individual changes employment during a tax year, it will still be possible to qualify as working full-time abroad in that year provided the 35-hour or more weekly average was met over the full year. Where there is a gap between employments, a maximum of 15 days would be ignored for the purpose of calculating the weekly average, as long as no work was undertaken throughout the period between employments.

The new rules specifically exclude 'international transportation workers' (e.g. pilots) from the definition of full-time work abroad. Consequently the general residence test would need to be applied to those individuals using the tailored rules governing what would constitute a UK work day.

An individual who does not fall within Part A would not necessarily be resident in the UK, but would instead need to consider Parts B or C of the test.

### ***Part B: the automatic residence test***

There are a large number of people who are clearly tax resident in the UK because they spend almost all of their time in the UK, work exclusively or predominantly in the UK, or have their home in the UK and base their life and family in the UK. Part B is intended to give certainty to this group.

Provided Part A of the test does not apply, an individual would be automatically UK resident for the tax year under Part B if that individual:

- is present in the UK for over 182 days or more in a tax year; **or**
- has only one home and that home is in the UK (or has two or more homes and all of those are in the UK); **or**
- works full-time in the UK.

The Government has confirmed that a 'home' need not be a property an individual owns but could, for example, be a rented property. The Government has also confirmed that an individual would not fall under the 'only home' condition if his only home (or homes) is in the UK for a period of under 91 days (for example whilst a foreign property is being sold). However, if there is a continuous period of at least 91 days during which the individual's only home is in the UK and that period spans two separate tax years, he will be treated as having an "only home" in both tax years (although in some cases split year treatment may apply).

The rules on full-time work in the UK differ from the rules under Part A (which relate to full time work abroad). Broadly the Government is considering a definition which would class an individual as working full time in the UK if he is employed or self-employed in the UK over a continuous period of 12 months and no more than 25 per cent of his duties are carried on outside the UK during the period of full-time work.

An individual who does not meet any of the conditions in Part B will not necessarily be non-UK resident; instead he would need to consider Part C of the test.

In exceptional cases, an individual may satisfy the conditions of both Parts A and B. In such circumstances, it is proposed that non-UK resident status would prevail.

### ***Part C: the sufficient ties test***

Part C will only apply to those individuals whose residence status is not determined by Parts A or B and therefore whose circumstances are less straightforward. Residence is determined by considering how many ties or "connection factors" an individual has with the UK, together with the number of days he spends in the UK. This part of the proposed test reflects the principle that the more time someone spends in the UK, the fewer ties he can have with the UK if he wants to be non-UK resident. In consequence, it puts forward different rules for those arriving in the UK (who have been non-UK resident in all of the three tax years preceding the year under consideration) ("**Arrivers**") and those leaving the UK (who have been resident in one or more of the previous three tax years) ("**Leavers**") so that 'it is harder to become non-resident when leaving the UK after a period of residence than it is easy to become resident when arriving in the UK'.

The connection factors summarised below will be combined with days spent in the UK to form a "scale" as shown below to determine whether the individual is UK-resident or not:

- **family** - the individual has a spouse, civil partner or common law equivalent (provided they are not separated from the individual) or minor children resident in the UK;
- **accommodation** - the individual has accommodation available to them in the UK for a continuous period of at least 91 days in a tax year and spends at least one night in that place during the tax year [1];
- **substantive work in the UK** - the individual does substantive work in the UK (but does not carry out full-time work in the UK);

- **previous UK presence** - the individual spent more than 90 days in the UK in either of the previous two tax years;

and, for the purposes of Leavers only,

- **more time in the UK than in other countries** - the individual spends more days in the UK in the tax year than in any other single country.

[1] There will be an exception for accommodation held by relatives (other than the individual's spouse, partner or minor children). In theory such accommodation (e.g. the parental home) may be available continuously and therefore accommodation held by relatives will only count as a connection factor if the individual spends more than 15 nights there during the tax year.

**Days spent in the UK      Minimum number of connection factors needed to make an individual UK-resident in a tax year**

	<b>Arrivers</b>	<b>Leavers</b>
Under 16 days	Always non-UK resident	Always non-UK resident
16 - 45 days	Always non-UK resident	4
46 - 90 days	4	3
91 - 120 days	3	2
121 - 182 days	2	1
183 days or more	Always UK-resident	Always UK-resident

**Other Aspects of the Proposed test**

**Transitional Rules**

Where, under Part A, residence in prior years affects whether the relevant threshold for automatic non-residence is 15 days or 45 days and, under Part C, residence in prior years affects which of the day counting "ladders" should be used to assess residence status, the Government has announced transitional rules. These provide that where the individual needs to know what their residence status was in any of the three years prior to the introduction of the statutory residence test for the purpose of determining their residence in future years, he will be allowed 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. Use of these transitional rules will require a formal election.

**Day Counting in Exceptional Circumstances**

A new rule will be introduced so that days spent in the UK in 'exceptional circumstances' (i.e. where presence in the UK is beyond the individual's control) will be disregarded for day counting purposes (up to a maximum of 60 days in any tax year).

**Split years**

Currently, an individual is either resident in the UK for a full tax year or non-UK resident for a full tax year. However, by concession, it is possible to split a tax year so that an individual is treated as UK-resident for only part of a tax year.

The proposed test incorporates a split year test, but whereas the current test relies on the vague concept of a person becoming "permanently" resident in the UK or elsewhere, the new rules will treat a tax year as being split into periods of UK residence and non-UK residence if an individual:

- becomes resident by virtue of their only home being in the UK (arriving or returning);
- becomes resident by starting full-time employment in the UK (arriving or returning);
- 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 for more than 15 days (leaving); or
- loses UK residence by virtue of working full-time abroad (leaving).

A tax year will not be treated as split where the residence status of an individual changes due to changes in the number of connection factors under Part C, such as the arrival or departure of his family.

If an individual becomes non-UK resident by virtue of leaving the UK to work full-time abroad and is accompanied by his spouse, civil partner or common-law partner, split year treatment would also apply to him/her (subject to certain conditions).

The Government has confirmed that it will be possible for an individual to have split year treatment in consecutive tax years, provided that they meet the other relevant conditions. However, it will not be possible for the same tax year to be split more than once or for individuals to elect for split year treatment not to apply.

### ***Anti-avoidance provisions***

An individual will continue to be treated as being in the UK on any day where they are in the UK at midnight. However, the Government is concerned that this rule is open to manipulation and consequently it is considering a targeted supplementary rule which would apply only to those who are present in the UK on a large number of days without ever being in the UK at midnight on those days.

As proposed in the Consultation Document, a new income tax anti-avoidance rule will be introduced in relation to some forms of investment income. This is similar to the existing capital gains tax temporary non-UK residence provision, which broadly allows chargeable gains realised while an individual is non-UK resident for a period of less than five years to be taxed in the year of his return to the UK. This is to deter people from becoming non-UK resident for short periods of time to avoid UK tax liability on expected income.

### ***Abolition of Ordinary Residence***

Ordinary residence is a different concept to residence, but similarly has no statutory definition. Currently, individuals who are resident but not ordinarily (habitually) resident in the UK can use the remittance basis to shelter foreign income from UK tax. However, the concept of ordinary residence is uncertain and difficult to apply in practice, and consequently the Government has decided to abolish the concept altogether except in relation to "Overseas work days relief", which will be retained for not ordinarily resident employees and will be put on a statutory footing. This allows not ordinarily resident individuals to claim the remittance basis on employment duties carried on outside the UK, even if for a UK employer, although under the new rules it will cease to apply for UK domiciled employees.

Transitional rules will ensure that individuals who currently benefit from being not ordinarily resident do not lose out following abolition of ordinary residence. These will allow those who currently receive a particular tax treatment as a result of their ordinary residence status to continue to do so following the commencement of the new legislation, for as long as they would have continued to receive it under the existing rules, but with a maximum of two complete tax years following commencement.

## Conclusion

Neither overly complicated nor too subjective, the long-awaited statutory residence test, if adopted, is likely to provide a higher degree of certainty for individuals in determining their tax residence. However, the new test will not be able to provide clear answers for all taxpayers and the application of Part C, in particular, is unlikely to be straightforward. As a result, obtaining specialist advice well in advance of the introduction of the new rules in April 2013 is still to be recommended in the vast majority of cases.

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If you wish to discuss how this proposal could affect your tax situation please contact your usual contact in the Private Client department at Payne Hicks Beach, or the authors Christopher Sly ( [csly@phb.co.uk](mailto:csly@phb.co.uk)) or Freddie Bjorn ( [fbjorn@phb.co.uk](mailto:fbjorn@phb.co.uk)).

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