

# Fifty shades of grey

**SHARON MCKIE** examines the proposed statutory residence test.

If one were considering what books to pack for summer holiday reading, one attractive option might be the government's response to the June 2011 consultation on the statutory definition of tax residence and reform of ordinary residence together with proposed draft legislation. The published legislation in relation to the statutory residence test is said to be 'close to a final draft, subject to any changes that may be considered as a result of [the] consultation'. The legislation is split into four parts:

- Part I – the main rules of the test;
- Part II – key concepts and definitions;
- Part III – split year treatment;
- Part IV – anti-avoidance provisions.

This article concentrates purely on parts I and II relating to the statutory residence test. All statutory references in this article are to schedule 1 of the draft legislation.

The paper states that the aim of the statutory residence test is to be 'transparent, objective and simple to use'. To what extent does the draft legislation achieve this?

The statutory residence test found in schedule 1 determines whether an individual is resident or not in the UK, as opposed to England, Wales, Scotland or Northern Ireland. The rules apply in relation to 'relevant taxes' which are defined as income tax, capital gains tax and, so far as the residence status of an individual is relevant to them, inheritance tax and corporation tax.

## The test

In the original consultation it was proposed that the test would consist of three parts: conclusive non-residence, conclusive residence, and other connection factors and day counting.

The draft legislation does not adopt this structure although it achieves the same result by a different route. Under para 3 an individual is resident in the UK for a relevant tax year if he satisfies either of two tests for that year:

### KEY POINTS

- Automatic residence.
- The midnight rule.
- No definition of 'home'.
- What are sufficient ties?
- Test is complex.



- the automatic residence test; or
- the sufficient ties test.

A flow diagram showing how these tests work in practice can be found on the website version of this article.

If neither test is met in the relevant year then the individual is not resident in the UK. This seems relatively straightforward or is it?

When is a person not resident in the UK? The legislation provides that if neither of the two tests mentioned above are satisfied, then an individual is not resident in the UK. However, the automatic residence test is not satisfied if any of the automatic overseas tests are met. Para 5 sets out the automatic overseas tests; an individual is not resident in the UK:

- where he was resident in the UK for one or more of the three tax years preceding the relevant year and has spent less than 16 days in the UK in the relevant year (this has been increased from 11 days despite representations from the professional bodies which wanted the threshold increased to 31 days);
- where he was not resident in the UK for one or more of the three tax years preceding the relevant year and has spent less than 46 days in the UK in the relevant year;
- where he leaves the UK to carry out full-time work abroad for at least one year, present in the UK for less than 91 days in the relevant year and has spent fewer than 21 days working in the UK in that year. A working day is defined as any day on which three hours or more of work is carried

on. In response to representations, the government is consulting on whether the 21 days should be increased to 26 or the number of hours required to constitute a working day be increased to five hours.

Special rules apply for international transportation workers.

## Automatic residence test

The automatic residence test is met for a relevant year if an individual satisfies at least one of the UK tests and none of the overseas tests (para 5(1)).

There are four automatic UK tests.

### Day count

The day count test is satisfied if an individual spends at least 183 days in the UK (para 5(3)). As is currently the case, if an individual is present in the UK at the end of the day (midnight) that day is considered as a day spent in the UK, with two exceptions (para 12).

The first is where the individual arrives in the UK as a passenger on one day and leaves the UK the following day and between arrival and departure he does not engage in any activities that are to a substantial extent unrelated to his passage through the UK.

The second case is where the individual would not be in the UK at the end of that day but for exceptional circumstances beyond the individual's control that prevent him from leaving the UK and he intends to leave the UK as soon as those circumstances permit. Para 12(5) then provides that:

'Examples of circumstances that may be "exceptional" are national or local emergencies such as war, civil unrest or natural disasters and a sudden or life-threatening illness or injury.'

It is not clear what effect this provision has. It makes clear that war, civil unrest etc may constitute exceptional circumstances but that surely did not need saying. Will the courts construe exceptional circumstances as only being those circumstances which are analogous to the specific circumstances listed? One cannot say with certainty.

The legislation also introduces a statutory limit of 60 days that can be regarded as not spent in the UK as a result of such exceptional circumstances. It is irrelevant whether the same or different exceptional circumstances exist (para 12(6)). This limit is particularly harsh because if someone is in the UK for more than 60 days because of exceptional circumstances beyond their control it will be because something is seriously wrong, for example a serious medical condition.

The government has expressed concern about the manipulation of the midnight rule by some people who depart from the UK before midnight on a regular basis. They are considering introducing a rule which will only apply to people who are present in the UK on a large number of days without being in the UK at midnight.

Such a provision is not likely to be necessary as it seems unlikely that very many people will be travelling in and out of

the UK for most days of the year simply to manipulate their residence status.

## Home in the UK

The UK home test in para 5(4) is satisfied if an individual's only home is in the UK or if he has more than one home, all of which are in the UK. It must be the individual's home for at least 91 days, all or part of which fall within the relevant tax year; or if there are two or more separate periods within that year the periods must together add up to at least 91 days.

A home is not defined but para 14 states that it may be 'any place (including a vehicle or vessel)'. There is no requirement that an individual needs to hold any estate or interest in the home. In an entirely redundant provision, para 14(3) states that a place which was once an individual's home does not continue to be so merely because the individual continues to hold an estate or interest in it after he has moved out. It is difficult to ascribe any purpose to this provision unless it is intended to prevent an individual being resident only because he still owns a house in which he no longer lives, because he rents it out.

The government has said that it does 'not consider that a holiday home, weekend home or temporary retreat should count as a home for the purposes of this condition (para 3.89).

Defining a 'home' was always going to be a major problem. Both the Society of Trust and Estate Practitioners (STEP) and the Chartered Institute of Taxation (CIOT) in their representations emphasised the importance of getting the definition right so as to avoid uncertainty for taxpayers. The

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## UK TIES DAY COUNT

Days spent in the UK in the relevant tax year	Number of ties that are sufficient where an individual has been UK resident in the three years preceding the relevant year	Number of ties that are sufficient where an individual has not been UK resident in the three years preceding the relevant year
More than 15 but fewer than 46	At least four	
More than 45 but fewer than 91	At least three	All four
More than 90 but fewer than 121	At least two	At least three
More than 120	At least one	At least two

government has 'concluded that it would be extremely difficult to provide a precise definition given the wide variety of living patterns adopted by individuals and their families' and so it has simply failed to do so. The paper says, however, that the government is 'confident ... that the vast majority of people will know where their home is and whether that home is in the UK or overseas'.

As we have seen, a home may be 'any place'. Unfortunately, no statutory definition of a place is given. The *Shorter Oxford English Dictionary* defines 'place' as 'a particular part or portion of space ... whether occupied or not ...' but it also gives a narrower definition: 'a residence, a dwelling, a house, a person's home..' The latter gives a circular definition so in the context of para 14 it must be the wider definition which is relevant. The failure to provide a definition of a home places a major uncertainty at the heart of the new statutory residence test.

### Full-time work in the UK

The full-time work in the UK test is satisfied if an individual works full-time in the UK for a period of 276 days (nine months, although the government is consulting on extending this to 12 months) during which he has no significant breaks from work, all or part of that period falls within the relevant tax year and more than 75% of the total number of days in the relevant year when he does more than three hours work a day are days when he does that work in the UK (para 5(5)).

Following representations from the professional bodies, 'working' includes both employed and self-employed work. The legislation provides that a significant break from work is a period of 31 days or more where there is no day on which the individual does more than three hours' work in the UK and the reason for his absence is not because he was on annual leave or sick leave (para 5(6)).

Full-time work is defined in para 17 as 35 hours or more a week on average over the period. This may be reduced to take account of reasonable amounts of leave taken during the period and periods of sick leave when an individual cannot be reasonably expected to work as a result of injury or illness.

Under para 15 an individual is considered to be working at any time when he is doing something in the performance of his duties of his employment or in the course of a trade carried on by him. This definition is extremely wide so as to encompass everything to do with work, but it would seem to exclude gossiping, day dreaming and making coffee. Time spent travelling will count as time spent working if the cost can be deducted from earnings or profits, or the individual does something else during the journey which would itself count as work, for example making telephone calls or emailing people.

Unhelpfully, the legislation provides that 'Work is done where it is actually done' except where work is done in the course of travelling (para 16(1)). Work done in the course of travel by sea, air or the Channel Tunnel from overseas to the UK or from the UK to overseas is assumed to be done overseas (para 16(2)). Travel starts at the 'embarkation point'. It is not clear whether that is when an individual reaches the airport or when they board their plane.

### Death during the year

This test is satisfied if an individual dies in the relevant year, had for each of the previous three tax years been resident in the UK because he had satisfied the automatic residence test, and when he died his normal home was in the UK and the preceding tax year would not be a split year for the individual even on the assumption that he was not resident in the UK in the relevant tax year. This does seem a rather cruel test.

### Sufficient UK ties test

The sufficient ties test is met for a relevant year where the individual meets none of the automatic UK tests nor any of the automatic overseas tests but has sufficient UK ties for that year (para 7). Whether or not an individual has sufficient UK ties in a relevant tax year will depend upon whether the person was resident in the UK for any of the previous three tax years and the number of days the individual has spent in the UK in the relevant tax year (para 7(3)). See **UK ties day count**. Special rules apply if the individual dies during the relevant year.

Despite representations from STEP and the CIOT that the separate family and accommodation ties in practice represent double counting, the government has retained these with some amendment. The legislation differentiates between what is a UK tie on the basis of whether or not an individual was resident in the UK in one or more of the three tax years preceding the relevant year. If so, the following are UK ties:

- family tie;
- accommodation tie;
- work tie;
- 90-day tie; and
- country tie.

If that is not the case the country tie is omitted and so only the following count as UK ties:

- family tie;
- accommodation tie;

- work tie; and
- 90-day tie.

## Family tie

Paragraph 20 provides that an individual has a family tie if in the relevant year there is a 'relevant relationship at any time between the individual and another person' who is resident in the UK in the relevant tax year. A relevant relationship is defined as one which existed at any time between an individual and another person if:

- at the time the individual has a husband or wife or civil partner and they are not separated;
- the individual and another person are living together as husband and wife or if they are of the same sex as civil partners; or
- the individual is a parent of a child under the age of 18. In response to representations, this rule will not apply where the individual sees the child in the UK on fewer than 61 days in total in the relevant year. A day counts when the individual sees the child in person for all or part of that day (para 20(4)).

Read literally, it is not a requirement of the first condition that the individual and the other person are married or in a civil partnership. As currently drafted that means that this condition is satisfied by any person who is married or in a civil partnership if there is any person in existence who is resident in the UK at the time concerned. This drafting error needs to be corrected.

For the purposes of the third condition, para 21(3) provides that where an individual's child is in full-time education in the UK and the child spends less than 21 days in the UK outside term time the child is treated as not being UK resident.

As pointed out by the professional bodies, there was a possibility that the residence of spouses would be interdependent on one another but para 21(2) resolves this circularity stating it can be disregarded.

## Accommodation tie

An individual has an accommodation tie in a relevant year if he has a place to live in the UK which is available to him for a continuous period of at least 91 days during that year and he spends at least one night at that place in that year (para 22).

An individual is considered to have a place to live in the UK if he has a home, holiday home, weekend home, temporary retreat or something similar in the UK, or accommodation is otherwise available to him where he can live when he is in the UK (para 22(3)).

It is not necessary for the individual to hold an estate or interest in the accommodation or have any legal right to occupy it. Where there are fewer than 16 days between the periods in which a particular place is available to the individual, that place is treated as being available to the individual for that period.

Paragraph 22 will, in most cases, mean that short stays in hotels and guesthouses will not count unless an individual books a room for at least 91 days or the 16-day rule above applies. In the latter case the individual should stay at another hotel to avoid the 16-day rule applying.

If the accommodation belongs to a close relative of the individual then the requirement to spend one night there is increased to a total of at least 16 nights at that place in that year (para 22(5)). A close relative is defined as a parent, grandparent, brother, sister, and a child or grandchild aged 18 or over. It would have been more sensible for the 16-night increase to apply when no consideration is given for the accommodation.

As it stands, if a good friend will always be willing to put up the individual the accommodation tie will be satisfied if he spends one night at his friend's house.

## Work tie

An individual has a work tie if he works in the UK for at least 40 days in the relevant tax year. He is considered to work for a day if he does more than three hours' work in the UK on that day.

As mentioned above, the government is consulting on increasing the number of hours worked per day to five hours.

## Ninety-day tie

An individual has a 90-day tie for the relevant tax year if he has spent more than 90 days in the UK in either the tax year preceding the relevant year, the tax year preceding that year or each of those tax years (para 24).

## Country tie

An individual has a country tie for a relevant year if the country in which he spends the greatest number of days in that year is in the UK. In the event that he spends the same number of days in two or more countries in a year and that number is the greatest number of days spent by him in any country, he will have a country tie if one of those countries is the UK. This test has remained despite criticism from the professional bodies.

## Far from perfect

There is no doubt that a logical, well-structured and concisely drafted statutory residence test would provide certainty to many taxpayers. There was an opportunity here for the government to produce such a test. Most commentators from the tax profession take the view that a simple weighted average day count test, similar to the one used in the US, would be the best solution.

The proposed test is better than the chronic uncertainty of the current situation but by how much? It is highly complex, involves concepts which are by nature subjective and which have not been, or have been inadequately, defined. The draft legislation runs to some 60 pages and will, no doubt, expand further.

When Dawn Primarolo started the review process in 2002 cynics predicted that whatever emerged would be far from transparent, objective and simple to use and they have been proved right. Determining whether an individual is resident in the UK under the statutory residence test will still be a painful process lost in 50 shades of grey. ■

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