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SESSION 8

'SUPER STATUTORY RESIDENCE CASE STUDY: ACQUIRING AND RELINQUISHING UK RESIDENCE'

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A COMPREHENSIVE CASE STUDY

The following case study illustrates the effect of the Split Year Rules on an individual's Capital Gains Tax liability. I have included a detailed preliminary analysis to show how a failure to appreciate the intricacies of the rules for determining an individual's residence and whether, and under what case, a year is a split year in respect of the individual, can have very unfortunate Capital Gains Tax consequences.

THE FACTS

EXAMPLE

The Situation

Mr A was a widower who had lived all of his life in Shangri-La, up to and including the year 2013/14, and was domiciled in that country under English Law. He was not married, a member of a civil partnership or in an equivalent informal relationship.

Becoming absolutely entitled to settled property

He was the beneficiary of a trust established by his grandfather, now deceased, who was also domiciled in Shangri-La. In 2010/11 the trust had sold its only asset realising a gain of £2 million. This was the only gain which the trustees had made and no capital payments had been made within TCGA 1992 s.97(1). On 31st May 2014, the trust came to an end under its terms, and Mr A received 50% of the trust assets being £1 million.

This sum was paid to his bank account in Shangri-La. He transferred this amount to an investment management company ('MCo') which held its own accounts and those of its clients with UK banks except where it had been instructed that its client was UK resident but not UK domiciled. It held client moneys on bare trusts subject to discretionary investment management agreements. Under these agreements MCo could buy and sell listed investments at its discretion and the investments were to be held on bare trusts for the client.

The acquisition and redemption of loan notes issued by SLPlc

On 30th June 2014 Mr A sold some shares which he had acquired when they had an insubstantial value in exchange for loan notes issued by the acquiring Shangri-Layan company ('SLPlc'). The loan

notes were qualifying corporate bonds within TCGA 1992 s.117 and had a principal amount of £600,000.[1] This was an exchange within TCGA 1992 s.116(10). The loan notes were to be redeemed on 30th June 2015. He gave an instruction that on redemption the amount payable should be paid to MCo to be held by that company under the terms of his discretionary investment management agreement.

Mr A's Sojourn in the UK

Mr A was a computer consultant. Most of his work was performed remotely. He usually worked for 10 hours a day from Monday to Friday.

On 31st July 2014 his daughter married an Englishman and, after their honeymoon, they established a home in Somersetshire. His daughter invited him to make an extended stay and he flew to the UK on 1st February 2015 intending to stay for four months. During this period he intended to work for four days a week (Monday to Thursday) but to continue to work for 10 hours on each working day (accessing his clients' computers remotely) but he decided to take some breaks for sightseeing. He intended to stay partly with his daughter and partly in hotels.

He took a break from his work for sightseeing on the weeks beginning 2nd February, 9th February, 23rd March and 13th April 2015.

On 23rd April 2015 his daughter was involved in a car accident. Although her injuries were extensive and she broke many bones it was thought, at first, that her life was not threatened. Nonetheless Mr A decided to extend his stay until the end of June so as to visit her and help her convalesce.

[1] At this stage Mr A was not considering UK tax and so the exchange was not prevented from falling within TCGA 1992 s.116(1)(a) by TCGA 1992 s.137

On 25th June 2015, his daughter's condition suddenly worsened because of complications from the accident. In view of her condition, Mr A decided to stay on until he felt she was out of danger and his help was no longer needed.

On the 30th June 2015 the loan notes were redeemed in accordance with their terms and, as instructed, the amount payable on redemption was paid to MCo to be held to his order subject to the discretionary investment management agreement.

During the rest of June, July and August his daughter's condition was serious but in September she began to recover and on 30th September she was declared to be out of danger. She still faced a considerable period of convalescence, however, and he decided to stay on. He finally returned to Shangri-La on 24th January 2016.

In the week after his daughter's accident, from the 27th April 2015 onwards, he reverted to working 5 days a week in his practice. His only other break was after his daughter's discharge from hospital on 14th December 2015 until 1st January 2016 (inclusive). He did not work on the day he flew to the UK.

Throughout this time, Mr A had a Shangri-Layan home. He spent over 30 days in this home both in 2014/15 and 2015/16.

The sale of a commercial building

On the 15th March 2016, Mr A sold a commercial building which he owned in the UK making a loss of £500,000.

THE ANALYSIS

ANALYSIS

Residence

2014/15

In 2014/15 Mr A did not meet any of the Automatic Overseas Tests. He did not meet the First, Second[2] or Fourth UK Tests. Did he meet the Third Automatic UK Test?

Para. 9(1)(a)

Did he work sufficient hours in the UK as assessed over a period of 365 days? We shall consider the period from 2nd February 2015 – 1st February 2016.

Step 1

Identify any days in the period on which P does more than 3 hours' work overseas, including ones on which P also does work in the UK on the same day.

The days so identified are referred to as "disregarded days".

Mr A worked overseas on 6 days (24th January 2016 – 29th January 2016 inclusive and 1st February 2016). He therefore had 6 disregarded days.

Step 2

Add up (for all employments held and trades carried on by P) the total number of hours that P works in the UK during the period, but ignoring any hours that P works in the UK on disregarded days.

[2] This assumes that neither his daughter's home nor the hotels in which he stayed were Mr A's home at any time

The result is referred to as P's "net UK hours".

In this period Mr A did 2,120 hours of work in the UK.

Step 3

Subtract from 365 -

(a) the total number of disregarded days, and

(b) any days that are allowed to be subtracted, in accordance with the rules in paragraph 28 of this Schedule, to take account of periods of leave and gaps between employments.

The result is referred to as the "reference period".

Days in Period		365
Less:		
Disregarded Days	6	
Annual Leave[3]	43	
Parental Leave	0	
Sick Leave	0	
Embedded Days[4]	6	
		55
Reference Period		310

[3] Annual Leave for this purpose is a reference to 'reasonable amounts of time off from work for the same purposes as the purposes for which annual leave … is taken' (para. 146). Mr A did not work on the weeks beginning 2nd February, 9th February, 23rd March, 13th April, 14th December, 21st December and 28th December 2015. He also did not work on the Fridays of 20th & 27th February, 6th, 13th and 20th March and 3rd, 10th and 24th April 2015. It is assumed that this leave was taken for the same purposes as annual leave within para. 146 and was of a reasonable amount within para. 28. It will be noticed that although Mr A did no work in the UK between 23rd January 2016 and 1st February 2016 these were not days of annual leave. The 23rd & 24th and 30th & 31st January 2016 were weekends and 25th – 29th January 2016 were days on which he worked overseas. We have assumed that when Mr A changed from working 5 days a week to 4 days a week that the Fridays he took off were equivalent to annual leave rather than being days on which Mr A was 'not normally expected to work … according to [his] … usual pattern of work' (para. 28(6))

[4] The Embedded Days were 7th & 8th February 2015 and 19th & 20th, and 26th & 27th December 2015. Although Mr A did not work in the UK from 23rd January to 1st February 2016 none of these days met the conditions of para. 28(5) because the days when he did not work in the UK from 25th January – 29th January 2016 and 1st February were not annual leave

Step 4

Divide the reference period by 7. If the answer is more than 1 and is not a whole number, round down to the nearest whole number. If the answer is less than 1, round up to 1.

$$\frac{310}{7} = 44 \text{ (Rounded down)}$$

Step 5

Divide P's net UK hours by the number resulting from step 4. If the answer is 35 or more, P is considered to work "sufficient hours in the UK" as assessed over the 365-day period in question.

$$\frac{2120}{44} = 48.18$$

Mr A, therefore, worked sufficient hours in the UK over the 365-day period.

Para. 9(1)(b)

During this period there were no significant breaks from UK work because there was no period of 31 days or more on each day of which Mr A either did not work for 3 hours in the UK or would not have worked that amount of time were it not for the fact that he was on annual leave.

Para. 9(1)(c)

Part of the 365-day period fell within the fiscal year 2014/15.

Para. 9(1)(d)

More than 75% of the total number of days in the 365-day period on which Mr A did more than 3 hours work on the days on which he did more than 3 hours work in the UK. The calculation was:-

212 days working in the UK x 100 = 97.2%
218 days[5] working in total

Para. 9(1)(e)

At least one day which fell both in the 365-day period and in the fiscal year 2014/15 was a day on which Mr A did more than 3 hours work in the UK.

Mr A therefore met the Third Automatic UK Test for the fiscal year 2014/15 and was, therefore, resident in the UK in that year.

2015/16

Mr A did not meet any of the Automatic Overseas Tests in 2015/16. He spent 293 days in the UK subject to the Exceptional Circumstances Exception in the year. Did the Exceptional Circumstances Exception apply at all and, if so, during what period? Immediately after the accident, one might argue that Mr A was not prevented from leaving the UK by his daughter's accident. Although she was badly injured she was not in a critical condition and was not thought to be in danger. From 25th June to 30th September 2015 she was considered to be in danger. Thereafter she was not. Arguably the Exceptional Circumstances Exception only applied during the period when she was considered to be 'in danger'. If that is the case that was a period of 97 midnights. The Exceptional Circumstances Exception is restricted to 60 days in the year.[6] So it cannot reduce a period in the UK by more than that. For that reason, even if it applied, Mr A was still treated as having spent 233 (293 – 60) days in the UK in 2015/16 and therefore he met the First Automatic UK Test.

He also met the Third Automatic UK Test by reference to the same period as he met it in respect of 2014/15.

[5] 212 days plus 6 disregarded days

[6] So even if he satisfied the condition of being prevented from leaving the UK by Exceptional Circumstances for a longer period than just the period from 25th June 2015 to 30th September 2015 the number of days deducted under the exception would still have been only 60

The Split Year Rules

In 2014/15 Cases 1 – 3 did not apply to Mr A because he was not resident in the UK for 2013/14. He also did not meet the conditions of Case 4, Case 6, Case 7 and Case 8. Did his circumstances fall within Case 5?

Para. 48(2)

Mr A was not resident in 2013/14.

Para. 48(3)

We cannot consider whether the conditions of para. 48(3) are satisfied by reference to the same period which we used to consider the application of the Third Automatic UK Test to 2014/15 (and indeed to 2015/16 as well). That is because the first day of that period was not a day on which Mr A did more than 3 hours work in the UK. We must, therefore, look at the period starting on 16th February 2015 and ending on 15th February 2016.

In the part of the Relevant Year before this period began, did Mr A have sufficient UK Ties? In order to answer that question we have to apply the modifications in para. 48(5) to paras. 17 – 20 and Part 2 of the *SRT Schedule*. The numbers in the table in para. 19 are to be reduced by the appropriate number in each case. The appropriate number is found by multiplying the number of days in each case by:-

$$\frac{\text{The number of whole months in the part of the relevant year beginning with the day on which the 365-day period in question begins (that is 16th February 2015)}}{12}$$

$$\frac{1}{12}$$

The table in para. 19 therefore became:-

Days Spent by Mr A in the UK in 2014/15	Number of Ties that are Sufficient
More than 41 but not more than 82	All 4
More than 82 but not more than 110	At least 3
More than 110	At least 2

Mr A spent just 15 days in the UK in the part of the Relevant Year before the 365-day period so he could not have sufficient UK Ties in that period.

Did Mr A work sufficient hours in the UK as assessed over the period? The amount under Step 5 of para. 9(2) as modified by para. 48(4) was again 48.18 hours so Mr A worked sufficient hours in the UK in this period.

During this period there were no significant breaks from UK work. There would have been a significant break from UK work if at least 31 days went by and not one of those days was a day on which Mr A did more than 3 hours work in the UK or a day on which Mr A would have done more than 3 hours work in the UK but for being on annual leave, sick leave or parenting leave.

Mr A's longest break from work in the UK in the 365-day period was between 24th January 2016 and 15th February 2016. This was a period of less than 31 days.

At least 75% of the total number of days in the period on which Mr A did more than 3 hours work were days on which he did more than 3 hours in the UK calculated as follows:-

Working days in the UK
Total working days

212 x 100 = 93.0%
228

Mr A's circumstances therefore fell within Case 5 of the Split Year Rules. The overseas part of the year was the period from 6th April 2014 to 15th February 2015 (inclusive) and the UK part was the period from 16th February 2015 to 5th April 2015 (inclusive).

2015/16

In 2015/16 Cases 4 – 8 could not apply to Mr A because he was resident in the UK in 2014/15. In 2015/16 Mr A's circumstances did not fall within Cases 2 or 3 of the Split Year Rules. Did they fall within Case 1 of those rules?

Para. 44(2)

Mr A was resident in the UK for 2014/15.

Para. 44(3)

Mr A met the condition of para. 44(3) in respect of the period 25th January 2016 – 5th April 2016 (inclusive) because this was a period which began with a day that fell within the Relevant Year on which Mr A did more than 3 hours work overseas and ended with the last day of the Relevant Year and satisfied the overseas work criteria in this period.

Para. 44(4)

Mr A was not resident in the UK for the following fiscal year, 2016/17. He not only met the Third Automatic Overseas Test in that year but also the First Automatic Overseas Test. It is assumed that

this is sufficient to satisfy the condition that he was not resident in the UK for the next fiscal year because he met the Third Automatic Overseas Test for that year.

On this basis Mr A's circumstances fell within Case 1 of the Split Year Rules. The overseas part of the year was the period from 25th January 2016 to 5th April 2016 and the UK part of the year was the period from 6th April 2015 to 24th January 2016.

A Summary of Mr A's Residence and split year status

Mr A was, therefore, resident in the UK in both 2014/15 and 2015/16. Both years were split years in respect of Mr A. The overseas part of 2014/15 was the period from 6th April 2014 to 15th February 2015 (inclusive) and so the UK part was the period from 16th February 2015 to 5th April 2015 (inclusive). The UK part of 2015/16 was the period from 6th April 2015 to 24th January 2016 and the overseas part was the period from 25th January 2016 to 5th April 2016.

CGT Consequences

Becoming absolutely entitled to settled property

Mr A's grandfather's trust fell within TCGA 1992 s.87. The payment of the trust capital to Mr A on 31st May 2014 was a capital payment which was matched with one half of the unmatched trust gains of £2 million so he was deemed to realise a gain of £1 million. Under TCGA 1992 s.87(7) a portion of this gain is chargeable even though the capital payment was made in the overseas part of the year. The portion which is chargeable is the 'portion attributable to the UK part of the relevant fiscal year calculated on a time apportionment basis'. The following proportion is treated as chargeable:-

$$\frac{\text{Days in the UK part of the year}}{\text{Days in the year}} \times \text{£1m}$$

$$\frac{49}{365} \times \text{£1m} = \text{£134,247}$$

As a non-domiciliary, provided Mr A makes a claim, the Remittance Basis will apply to him. Section 87B applies a Remittance Basis to the capital payments charge. Under those provisions the moneys advanced to Mr A are treated as property deriving from the chargeable gains.[7] If this property was remitted to the UK, the chargeable gains will be treated as having been remitted to the UK. The property was remitted to the UK because it was transferred to MCo's UK bank account to be held on bare trusts for Mr A.

The acquisition & redemption of Mr A's loan notes issued by SLPlc

When Mr A disposed of his shares in exchange for loan notes on 30th June 2014 no gain arose because the exchange fell within TCGA 1992 s.116(10).[8]

The chargeable gain instead accrued on the redemption of the loan notes under TCGA 1992 s.116(10)(b) on 30th June 2015. Because that was in the UK part of the split year and the proceeds of the disposal were remitted on that day Mr A realised a chargeable gain of £600,000 in 2015/16.

The disposal of a commercial building

The disposal of a commercial building on 15th March 2016 gave rise to a loss but it was not an allowable loss as the disposal was made in the overseas part of the split year.

Mr A had therefore realised the following chargeable gains:-

2014/15	-	£134,247
2015/16	-	£600,000

7 TCGA 1992 s.87B(3)

8 There is no election for this treatment. Where the conditions of TCGA 1992 s.116(1) & (10) are satisfied the treatment is mandatory

He received no relief for the capital loss he realised in 2015/16.

His failure to appreciate the complexities of the interaction between the SRT, the Split Year Rules and CGT had been an expensive mistake.