Opportunity missed

Simon McKie gives an in-depth assessment of the final draft legislation

On 11 December 2012, the Government published amended draft legislation (December draft) to enact the statutory residence test (SRT) and a paper (December response) summarising the responses which had been made to the June 2012 Consultation Document on the SRT (June condoc) and giving responses to them.

In 2007, the CIOT called urgently for the introduction of a statutory residence test. The profession's hope was that it would be simple, objective, and based on days of presence in the UK, probably following the US model.

Aims and objectives of the new SRT

The Exchequer Secretary to the Treasury, David Gauke MP, has said:

> '... the rules for determining whether an individual is tax resident in the UK should be clear, objective and unambiguous ... [the draft legislation] ... aims to be transparent, objective and simple to use.'

KEY POINTS

- The final draft legislation has not addressed some of the major issues raised in previous consultation responses
- The statutory test will be an improvement on the present state of the law
- However, the legislation misses the opportunity to create a simple and unambiguous test

This article examines three key areas of the legislation to see whether the new test is an improvement on the current position and whether it achieves its aims. All references in this article are to the draft Schedule published by the Government on 11 December 2012 entitled: Schedule 1 statutory residence test.

Definition of a home

Whether and where an individual has a home or homes is fundamental to the SRT forming a key element of the second automatic UK test (para 8), the accommodation tie (para 32) and cases 3, 4 and 5 of the split year rules (paras 43 to 45).

The CIOT, STEP and ICAEW all strongly criticised the use of the concept of a home in the SRT in their submissions in response to the June condoc. As the CIOT said:

> ' ... "home" means different things to different people. To some people it means a building. To others a place (town/city), to others the country from which they come. Indeed there are ten different definitions in the OED.' (*Statutory definition of tax residence and reform of ordinary residence: response by the Chartered Institute of Taxation* (CIOT 2012 response, para 3.3.)

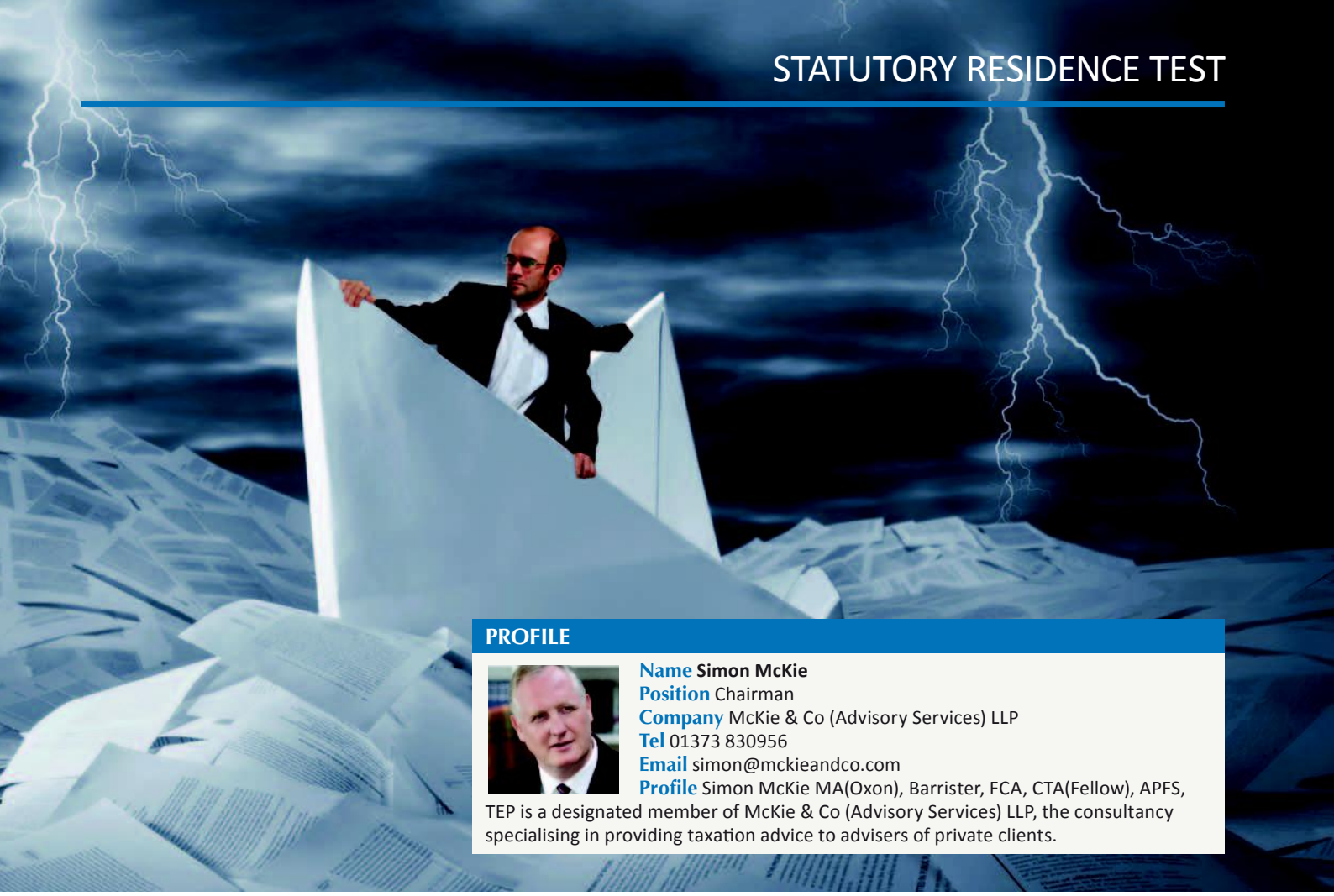
In the December response the Government said that it has:

> '... considered whether it would be possible to define in legislation what constitutes a home more precisely. It has concluded that it would be very difficult to set out every single scenario in legislation. ... the Government continues to believe ... that the vast majority of taxpayers will know whether and where they have a home.' (para 33 of the December response.)

So the application of the SRT is by reference to a concept which the Government acknowledges is incapable of precise definition and yet it thinks that taxpayers will be able to identify what that concept means even though the Government, is unable to define it. To provide a statutory definition of a home the Government would not be required 'to set out every single scenario in legislation'. What is required is a definition that taxpayers can apply to their circumstances to determine their residence status. If that cannot be done, it is clear that the word 'home' is not a suitable concept for use in the SRT, the aim of which is to provide a 'clear, objective and unambiguous test of residence'.

Legislation – para 24

The draft legislation published in June (June draft) had included at para 14



PROFILE

Name Simon McKie
Position Chairman
Company McKie & Co (Advisory Services) LLP
Tel 01373 830956
Email simon@mckieandco.com
Profile Simon McKie MA(Oxon), Barrister, FCA, CTA(Fellow), APFS, TEP is a designated member of McKie & Co (Advisory Services) LLP, the consultancy specialising in providing taxation advice to advisers of private clients.

some provisions regarding the meaning of 'home' which were of only the most limited help. An expanded version now appears as para 24:

'(1) A person's home could be a building or part of a building or, for example, a vehicle, vessel or structure of any kind.
(2) Whether, for a given building, vehicle, vessel, structure or the like, there is a sufficient degree of permanence or stability about P's arrangements there for the place to count as P's home (or one of P's homes) will depend on all the circumstances of the case.
(3) But somewhere that P uses periodically as nothing more than a holiday home or temporary retreat (or something similar) does not count as a home of P's.
(4) A place may count as a home of P's whether or not P holds any estate or interest in it (and references to 'having' a home are to be read accordingly).
(5) Somewhere that was P's home does not continue to count as such merely because P continues to hold an estate or interest in it after P has moved out (for example, if P is in the process of selling it or has let or sub-let it, having set up home elsewhere).'

Inadequacy of para 24

It will be seen that these sub-sections are either truisms (sub-paras (4) and (5)), or they neither exclude anything from, nor significantly include anything within, the meaning of the term (sub-para (1)), or they assume an element of the definition without actually stating it (sub-para (2)) or they introduce further undefined concepts of equally imprecise meaning as 'home' (sub-para (3)).

Sub-para (1)

The December response says at para 3.35:

> 'The Draft Legislation now makes it clear that a home will generally be a structure or a building as opposed to a place such as a town or a country.'

Para 24 does nothing of the sort. Sub-para (1) does not tell us that a person's home will generally be a building etc but that it could be such an object.

Sub-para (2)

The December response says at para 3.35:

> 'The Legislation also indicates that a home will have a degree of stability or permanence for the individual …'

If it does do that, it does so only obliquely. Sub-para (2) assumes that, for a place 'to count as P's home', 'P's arrangements there' (note, not the home) must have 'a sufficient degree of permanence or stability'. But that is an assumption. It does not provide that a home is a place which has a sufficient degree of permanence or stability.

Sub-para (3)

Sub-para (3) does exclude something, not from the definition of a 'home', but from things that 'count as a home'. No indication of what the sub-para means by a 'holiday home' or 'temporary retreat (or something similar)' is given by the legislation. So we have four uncertain concepts instead of one. Moreover, the sub-para is implicit in the possibility of a temporary retreat, or something similar, that might be a home, which is merely 'counted' by sub-para (3) as if it were not. This suggests that the word 'home' is to be given the widest possible meaning. So although sub-para (3) excludes some undefined things counting as a home, it actually widens the ambit of the term in a wholly unpredictable way.

Perhaps the most disappointing paragraph in the December response is 3.39.

> 'HMRC will publish detailed guidance setting out how they will interpret the legislative provisions and provide examples of different scenarios to show when a particular property would constitute a home and when it would not.'

The draft guidance, in outlining the characteristics of a 'home', does little more than repeat paras 24(1)–(3) (at para A9). It gives examples, at paras A9 to A20, of things which HMRC does and does not accept are 'homes'; but the examples are lacking in detail and fail to give the reasoning used to arrive at the conclusions as to whether the individuals in the various examples have a home and, if so, where it is. The draft guidance could hardly do so for if, as the Government considers, a 'home' is indefinable, it cannot relate the facts in the examples to principles by which what is a home can be distinguished from what is not.

The SRT was intended as a solution to a situation in which HMRC had attempted to repair the uncertainties of the existing law by setting out detailed guidance on their practice, a practice which was only loosely related to the law. Under the SRT, the taxpayer will again be in the position of relying on examples in guidance which have only a loose relationship to the law which it purports to apply.

> **"Someone in the UK at the time of the Arab Spring might have been prevented from going back to their home in Libya. But there would be nothing to stop them taking a ferry to France**

Accommodation tie

A person who satisfies the sufficient ties test in respect of a year will be resident for that year. One of the ties by reference to which the test may be satisfied is the accommodation tie, which follows:

'(1) P has an accommodation tie for year X if–
  (a) P has a place to live in the UK,
  (b) that place is available to P during year X for a continuous period of at least 91 days, and
  (c) P spends at least one night at that place in that year.
(2) If there is a gap of fewer than 16 days between periods in year X when a particular place is available to P, that place is to be treated as continuing to be available to P during the gap.
(3) P is considered to have a "place to live" in the UK if–
  (a) P's home or at least one of P's homes (if P has more than one) is in the UK, or
  (b) P has a holiday home or temporary retreat (or something similar) in the UK, or
  (c) accommodation is otherwise available to P where P can live when P is in the UK.
(4) Accommodation may be "available" to P even if P holds no estate or interest in it and even has no legal right to occupy it.
(5) If the accommodation is the home of a close relative of P's, sub-paragraph (1)(c) has effect as if for "at least one night" there were substituted "a total of at least 16 nights".
(6) A "close relative" is–
  (a) a parent or grandparent,
  (b) a brother or sister,
  (c) a child aged 18 or over, or
  (d) a grandchild aged 18 or over,
  in each case, whether by blood or half-blood or by marriage or civil partnership.' (para 32)

A confused structure

The structure of the accommodation tie is confused. It can be seen in sub-para (1) that three conditions must be satisfied for there to be such a tie. The first is that the individual must have a place to live in the UK; the second is that the place must be available to the individual for a minimum period. What, then, is a place to live? It is defined in sub-para (3), which is a three-part definition. The third part is accommodation which 'is otherwise available to' the individual. If we insert this definition into the three-part test of sub-para (1) that accommodation is available is both part of the definition of a place to live under para 32(1)(a) and an additional requirement in respect of the place to live under para 32(1)(b).

When we look at the definition of a place to live in para 32(3), either (3)(c) would, with appropriate adjustment, have been sufficient on its own or (a) and (b) will cover situations not covered by (3)(c). But (3)(c) covers all situations where accommodation is available to the individual so one might think that the homes covered by (3)(a) and the 'holiday home, temporary retreat (or something similar)' covered by (3)(b) must extend to homes etc which are not available to the individual for him to live in – a strange sort of home, holiday home or retreat indeed and a very strange element of the definition of the phrase a 'place to live'!

Uncertain scope of available accommodation

In what circumstances accommodation is available is uncertain. The use of this concept in IR20 caused considerable difficulties. STEP, in its response to the June condoc, commented on its broad meaning. The CIOT pointed out (para 8.1) that a person could have an accommodation tie by reason of a friend being willing to put him up at any time and his spending just one night in the year at the friend's house.

The Government has persisted with the use of this concept in the accommodation tie in spite of this criticism.

Regular bookings and sub-para 32(2)

Difficulty exists where a room is regularly booked at the same hotel less than 16 days. That is often the case where regular business trips are made to report back to a UK group or divisional head office. Because a gap of fewer than 16 days between periods in which a particular place is available is ignored, a person who books the same hotel room for one night per fortnight for eight fortnights will find that he has an accommodation tie.

In the December response it said at para 3.58:

> 'It is right that … very frequent and regular stays at the same hotel over a long period should be capable of being an accommodation tie.'

That does not explain why spending eight nights at the same hotel over a period of a little less than four months should result in one having an accommodation tie.

Close relative relaxation

It will be seen that the conditions of the accommodation tie are relaxed in respect of accommodation made available by close relatives (para 32(5)). There seems no particular reason why one should have an accommodation tie when one stays for a night with one's closest friend and yet not have a tie when one stays with one's half-brother or sister.

Under the June draft it was necessary for the accommodation to belong to the close relative; an arbitrary and imprecise requirement. The Government has changed this, now requiring the accommodation to be the home of the close relative. The policy behind the change is opaque. It is not clear why the relaxation should be available when I stay with my brother in his home, but not when I stay with him in the flat which he uses on occasional visits to town. The Government has exchanged one arbitrary restriction for another.

Sub-para 32(4) – what does it mean?

Sub-para 32(4) is puzzling. It provides that accommodation may be 'available to the taxpayer even if the taxpayer holds no

estate or interest in it and even has no legal right to occupy it'. If a friend tells me that I can stay at his flat, he gives me a non-exclusive licence to occupy it. That is a legal right. Is there any class of person who occupies a property without a legal right to do so other than trespassers?

Exceptional circumstances

Determining the number of days spent by an individual in the UK is relevant to the first automatic UK test (para 7), the four automatic overseas tests (paras 12 to 15) and the sufficient UK ties test (paras 16,17 and 30 to 35). The general rule is that if an individual is present in the UK at the end of a day, that day counts as one spent by the individual in the UK. This is subject to two exceptions, one of which covers exceptional circumstances as follows:

> '(4) The [exceptional circumstances exception] is where–
>
> (a) P would not be present in the UK at the end of that day but for exceptional circumstances beyond P's control that prevent P from leaving the UK; and
>
> (b) P intends to leave the UK as soon as those circumstances permit.
>
> (5) Examples of circumstances that may be "exceptional" are–
>
> (a) national or local emergencies such as war, civil unrest or natural disasters; and
>
> (b) a sudden or life-threatening illness or injury.
>
> (6) For a tax year–
>
> (a) the maximum number of days to which sub-paragraph (2) may apply in reliance on sub-paragraph (4) is limited to 60; and
>
> (b) accordingly, once the number of days within sub-paragraph (4) reaches 60 (counting forward from the start of the tax year), any subsequent days within that sub-paragraph, whether involving the same or different exceptional circumstances, will count as days spent by P in the UK.'

The exception ought to provide that it is satisfied if the individual is prevented from reaching his country of destination rather than if he is prevented from leaving the UK. As the CIOT pointed out:

> 'Someone in the UK at the time of the Arab Spring might have been prevented from going back to their home in Libya. But there would be nothing to stop them taking a ferry to France.'

Of course, it may be that the court, may correct this fault by applying a radically purposive interpretation and it may be that, in practice, HMRC will not take the point (the draft guidance does not seem to do so – see the examples in para B15). Again, the SRT's purpose of providing rules which are 'clear, objective and unambiguous' is not achieved.

Sub-para 21(5)

It could be argued that sub-para (5), which provides a restrictive list of examples of exceptional circumstances, restricts the extent of the exception and certainly makes its scope less easily determined. That is because it might be the case that the meaning of exceptional circumstances is to be restricted to items which are *ejusdem generis* to the examples given in sub-para (5). That might suggest that an injury which was neither sudden nor life-threatening but which was sufficient to prevent one's travelling, such as the development of severe back pain, would not be an exceptional circumstance. Similarly, it might be argued that emergencies which were not of the same degree of extremity as those listed in sub-para (5)(a), such as transport strikes, are not 'exceptional' for this purpose. It is notable that all of the examples given in the draft guidance are in respect of extreme circumstances (paras B7–B16).

Wrong concept

More fundamentally, it is not clear that 'exceptional' is the appropriate concept to be used in this relaxation. It may be that it would have been better to define its scope by reference to unforeseen circumstances. Frequent travellers will not consider a French transport strike exceptional but a particular strike may well be unforeseen.

The Government's response

The December response does not note any of these difficulties of the legislation and proposes no changes in respect of them. This is particularly unfortunate in respect of the limitation of the exception to 60 days. After all, the most likely circumstance in which a person will be prevented from leaving the UK for a period of more than two months is where he is subject to a long-term incapacitating injury or illness. Indeed, the examples given in the draft guidance of the operation of this restriction includes one of an individual who is injured in a car crash, suffers multiple injuries and returns to France as soon as he is discharged (para B11). It is difficult to imagine the policy reasons which justify subjecting an individual's worldwide income and gains to taxation because he has been unfortunate enough to suffer multiple injuries in a car crash while making a short-term visit to the UK.

The December response promises at para 3.66 that:

> 'Guidance will be available to explain how HMRC will apply these provisions. The guidance will also cover some of the concerns which were raised in consultation.'

Again it needs to be said that poorly drafted legislation cannot be corrected by any amount of 'guidance'.

Conclusion

It is clear that the SRT has almost reached its final form and any significant changes before enactment are unlikely.

Significant improvement

The incoming SRT will be a significant improvement on the current law; individuals will be able to determine their residence status with greater probability than they can do now.

Wasted opportunity

Ultimately, the incoming SRT is a wasted opportunity. Considering the early hopes for a simple, objective test based on days of presence in the UK and looking at the bloated December draft of 55 pages, not including the draft legislation abolishing ordinary residence status, one wonders how we got to this position. That is a tale which, unfortunately, cannot be told in its entirety because most of the key discussions took place under Chatham House Rules; that is, on conditions of confidentiality.

Although the test is an improvement, once enacted, it is unlikely to be significantly recast for many years. Indeed, the Government could have made a major and cost-free simplification of a key element of the tax code; instead, it has chosen to make a half-baked reform resulting in a grossly complex test containing significant areas of uncertainty which will provide occupation for the courts, the Revenue Bar and tax advisers for years to come.