

Becoming non-resident: staying overseas for a while will not suffice!

HMRC has announced that it is rewriting the guidance booklet which sets out its normal practices in relation to what constitutes residence in the UK for tax purposes. The booklet is IR20 and has long been generally accepted as setting out a workable summary of the relevant legal principles, coupled with useful HMRC practices and concessions. Interested parties have been invited to make representations to the Revenue as to how the wording of the booklet can be improved and updated. This, therefore, is a good opportunity to have some influence over the content of the booklet, and it is known that many practitioners are taking advantage of that.

The fundamental point is that the booklet was written many years ago and the world has moved on since. For example it is now possible for UK taxpayers to relocate to France and commute to the UK on an almost daily basis. Under what was understood to be the Revenue's practice as set out in the booklet IR20, someone could commute into the country via the Channel tunnel early on Monday morning and leave late on Thursday, working at home in France on Friday and he or she would not be regarded as resident in the UK for the tax year. This is because days of arrival in and departure from the UK were, under historic Revenue practice, disregarded and so only Tuesday and Wednesday each week would count as days in the UK; if one operated on this basis for 44 weeks in the year, that would be 88 days in the UK, which is under one of the thresholds for UK residence. There would be eight weeks remaining in the tax year, most of which would be annual and bank holidays.

In order to deal with this situation, and the general mobility of taxpayers in today's environment, the Finance Act 2008 has introduced a statutory rule to the effect that any day on which the taxpayer is in the UK on midnight will count as a day of presence in the UK. So the commuter mentioned above will now have three days per week in the UK instead of two. That would cut his available weeks in the UK to 29 or 30 and, so the Revenue hopes, would make the practice uneconomic.

This, however, is not the only aspect of the residence rules which is undergoing changes. It was previously thought that, by carefully limiting days within the UK to less than 90 per annum (averaged over four years), HMRC would accept that the taxpayer becomes non-resident. It is now clear that the Revenue will not accept this (or more correctly is now ceasing to accept this) and will first look to establish whether there is a "distinct break" with the UK before even considering whether non-residence can apply.

What constitutes a "distinct break" is not defined, and it is a point which is left to be decided on a case-by-case basis. That is hardly helpful to the taxpayer and, of course, it is no use asking the Revenue for further advice on the issue since they will simply say it depends on the facts of each particular case. In recent years, no fewer than four taxpayers have appealed against Revenue rulings that they have remained resident in the UK despite establishing themselves overseas, and only one was successful; three failed, each of them as a result of applying the "distinct break" test. Anyone who wishes to escape UK income tax liability by

acquiring non-resident status will therefore need to pay close attention to this matter.

It will certainly not do if the taxpayer's family remain in the UK and he or she stays with them on return visits. Even if the taxpayer is willing to stay out of the UK for one complete fiscal year, not making any visits at all, this might still not be sufficient. If he or she is abroad on full-time employment, the Revenue practice is fairly clear in that situation, and it allows non-residence to apply; however, it was held in a very early tax case that a mariner who was abroad for a complete tax year, while his family remained in the UK, remained resident here for that tax year and this is likely to be the situation for most of those who go abroad for one tax year otherwise than under a foreign employment.

It will be seen, therefore, that satisfying the "distinct break" test is by no means a straightforward matter, but fortunately, there are some guidelines which can be found by careful research of the recent appeals on residence. Those who succeed in acquiring non-resident status enter a very favourable tax position in relation to many sources of UK income. In particular, distribution from UK companies (including family companies) may then effectively tax free to the shareholder, whereas a 25% tax liability might otherwise arise if the shareholder were UK resident. The same does not necessarily apply in relation to capital gains, as five continuous years of non residence are required to escape the clutches of capital gains tax; thus a non resident individual may find that income has better UK tax treatment than capital gains.

So substantial UK tax advantages can still be obtained by becoming non-resident, but the methods of achieving that status are now more stringent than hitherto.

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