

Comment

The proposed statutory residence test: a missed opportunity?

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2010/11 may well turn out to be a watershed year for the law of residence of individuals. Pressure for reform has been building following a decade of concerted effort by HMRC in their campaign to close the tax gap by pursuing individuals claiming not to be UK resident.

If the proposals outlined in the HM treasury and HMRC consultation document are enacted, it will be the first time since the first introduction of income tax that a thorough review

of the most important connecting factor in the tax system, determining whether an individual's worldwide income and gains are to be taxed in the UK has been comprehensively addressed.

It may however be a missed opportunity. The consultation fails to ask the basic question whether the proposed rules (or the broad effect of the existing rules if they are thought to be the same) are fit for purpose.

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Historically, the ease with which individuals only modestly connected to the UK may be resident has had an important safety valve. The remittance basis for non-domiciled or not ordinarily resident individuals has meant that individuals who are resident as a result of such connections may effectively be taxed on UK source income and gains only without resorting to complex arrangements to deal with the mismatches that inevitably arise between tax systems. Access to the remittance basis was significantly curtailed by Finance Act 2008 and, in its present form, the remittance basis is effectively unmanageable, except for the most well off and well advised. The widening of the tax net with these changes has caused the UK system to become unbalanced compared with countries that, in principle, tax worldwide income but have a much higher and easily identifiable threshold to establish residence. The present proposals do nothing to address that. Choosing the right test involves judgements about the economy and society both existing and desired. While some policy aspects are mentioned, this consultation makes no attempt at the suitability for the 21st Century of what is, in essence, a codification of HMRC's present view of (or perhaps wishes for) old principles developed in a bygone era.

Although the proposals have been generally welcomed as providing legal certainty, a close examination shows that much of the detail resolves ambiguity in favour of HMRC and introduces new rules that are harsher than both the existing law and HMRC's previously published statements. In this sense, the proposals cannot be said to reflect existing law or practice.

Six easy fixes

I offer a few simple changes to fix some of the rough edges of the proposed test:

1. Treat individuals who are resident in another contracting state under a tax treaty tie-breaker as non-UK resident for all purposes in the same way that companies are so treated under CTA 2009 s 18. This would bring coherence and consistency to the UK tax system and help to reduce some of the harsh and surprising results of the current legislative proposals.
2. Average periods of presence over relevant years, or, give the presence in most recent years a higher value than that in earlier years, rather than a fixed time in each tax year. This will allow ordinary people to cope with the vicissitudes of life.
3. Except UK presence for circumstances beyond a person's control. It is a matter of common decency.
4. Include a combination of employment and self-employment for the purpose of full-time work in and out of the UK. This is modern reality.
5. Make a working day for the purpose of days spent working in the UK, any day in which three hours and a half or more of work is carried out, only if an individual is present in the UK at the end of the day. The present proposal is small minded, impractical and un-administrable.
6. Offer a transitional rule that would test residence from 2012/13 onwards where residence in past years is relevant by reference to the SRT. The absence of such a rule means in effect that the current legal position and the manner in which it is administered will continue in practical terms, with the result that the statutory regime will only be fully in effect from 2015/16.

The end of tax advice?

The drafters of the proposal assert that the framework outlined in the consultative document will allow individuals to assess their residence status simply and without the need to resort to specialist advice. The acid test whether this objective can be achieved will be the passage of legislation without the need for any HM Treasury explanatory notes nor any guidance published by HMRC thereafter. If there is confidence by the proposers that the legislation stands on its own without explanation, the prospect that taxpayers may be able to simply read the rules and apply them without taking specialist advice may be at hand.

HMRC are considering an interactive online tool to allow individuals to self-assess their residence status by answering a small number of simple questions. Few people live their lives according to a spreadsheet and this laudable objective is more likely to be illusory given the definitions proposed or a trap for the unwary.

The consultation paper 'Statutory definition of residence' and the prototype of the interactive online tool are available via www.lexisurl.com/PZLSG. The consultation closes on 9 September.

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