

# The proposed statutory residence test law european essay

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## **Introduction**

As part of the Finance Bill 2013, the Government is seeking to introduce a statutory definition of residency for tax purposes. The objective of defining residency for tax purposes, through a statutory residence test, is to provide a system of assessing residency that " is transparent, objective, and simple to use".[1]Furthermore, the proposed statutory residence test has been designed " to ensure that those with close connections to the UK pay their fair share of tax and that the rules do not give rise to unfair outcomes or opportunities for tax avoidance."[2]Whether the introduction of a statutory residence test improves the state of the law relating to residence of individuals for tax purposes is subjective and open to critique. However, this essay will seek to outline the criticisms and flaws of the current regime and assess whether the introduction of the proposed statutory residence test satisfactorily addresses those criticisms and flaws.

## **The current position**

The concept of residency for tax purposes is not statutorily defined under the existing tax regime. Rather, the term residency is understood according to its plain and ordinary meaning as elucidated by Viscount Cave in *Levene v IRC* [1928] AC 217 at 222; " My Lords, the word " reside" is a familiar English word and is defined in the Oxford English Dictionary as meaning " to dwell permanently or for a considerable time, to have ones settled or usual abode, to live in a particular place. No doubt this definition must for present purposes be taken, subject to any modification which may result from the terms of the Income Tax Act and schedules, but, subject to that observation,

it may be accepted as an accurate indication of the meaning of the word "reside".<sup>[3]</sup> However, a result of residency for tax purposes taking its ordinary meaning is that "residence is not a term of invariable elements, all of which must be satisfied in each instance. It is quite impossible to give it a precise and inclusive definition. It is highly flexible and its many shades of meaning vary not only in the contexts of different matters but also in different aspects of the same matter"<sup>[4]</sup> The difficulty of such an approach is that the courts must consider each case on its facts and no single factor is determinative.<sup>[5]</sup> Examples of factors that may be taken into account, but are not determinative, include presence<sup>[6]</sup>, place of usual abode<sup>[7]</sup> and intention or desire.<sup>[8]</sup> The Income Tax Act 2007 does impose some restrictions on case law by providing that an individual will be liable for income tax where that individual is physically present in the UK at midnight<sup>[9]</sup> for 183 days or more during a tax year.<sup>[10]</sup> However, for individuals falling below that 183 day threshold, case law must be considered when determining residency. This reliance on case law for determining residency has been strongly criticised on the basis that case law does not provide clear principles.<sup>[11]</sup> Additionally, the facts on which many tax residency cases were decided are very different from the factual scenarios arising in a modern and globalised world.<sup>[12]</sup> On this basis, the current residency rules have been described as "vague, complicated and perceived to be subjective."<sup>[13]</sup> The expression ordinarily resident highlights the difficulty of elucidating a certain and reliable definition from the courts. Case law states that ordinarily resident is "broadly equivalent to habitually resident"<sup>[14]</sup> while the HMRC guidance suggests that "[t]he word ordinary

indicates that your residence in the UK is typical for you and not casual." [15]Tiley provides a more comprehensive definition, combining the position in case law and HMRC guidance such that; "[p]eople are ordinarily resident in the UK if they have habitually and normally resided lawfully in the UK from choice and for a settled purpose throughout the relevant period apart from temporary or occasional absences". [16]Despite these attempts at explaining ' ordinarily resident', a clear and unequivocal definition remains elusive and for certain individuals with complex living and working arrangements, the position remains uncertain. In an attempt to provide advice on the issue of tax residency, Her Majesty's Revenue and Customs (HMRC) has regularly released guides, with the latest titled " Residence, domicile and the remittance basis." [17]However, even the certainty and reliability of this guidance has been questioned, with academics pointing out that it is based ostensibly on case law that favour HMRC and ignores decisions favouring the taxpayer. [18]Furthermore, HMRC guidance is not binding law and only presents HMRC's interpretation of tax law. As such, individuals must avoid over-reliance on this material in assessing their tax residency.

## **The proposed Statutory Residence Test**

Under the proposed legislation, an individual will be held to be a UK resident in a tax year if the automatic residence test is met for that year or the sufficient ties test is met for that year. [19]Should an individual met neither of those tests, they will not be a UK resident for that tax year. The automatic residence test requires satisfaction of at least one of the automatic UK tests and satisfaction of none of the automatic overseas tests. As such, if an

individual satisfies both an automatic UK test and automatic overseas test they will not be a UK resident for tax purposes. Professional bodies[20] have broadly summarised the proposed legislation into three main parts; the conclusive non-residence test, the conclusive residence test and the other connecting factors and day counting factors which only need to be considered by those individuals whose residence status is not determined by either of the first two tests. The automatic UK tests and the automatic overseas tests, which correspond to the conclusive residence test and the conclusive non-residence test as summarised by professional bodies, are based on the number of days either spent in the UK, having a home in the UK or working in the UK. Critics point out that there remains the potential for disputes to arise over what is meant by the terms ‘ only home’,[21] ‘ work’[22] and even ‘ physical presence’,[23] but largely the automatic UK tests and the automatic overseas tests are quantitative tests. The sufficient ties test operates to deem an individual, who has sufficient UK ties but does not satisfy the automatic residence test, as a UK resident for tax purposes. The expression ‘ UK tie’ is defined in the legislation as exhaustively including; a family tie, an accommodation tie, a work tie, a 90-day tie and a country tie.[24] Substantial further definitions are provided for each ‘ UK tie’. The number of ties that are required by an individual to be considered ‘ sufficient’ depends on the number of days that the individual spends in the UK in that tax year and whether the individual was a resident in the UK for any of the previous 3 tax years. Therefore the sufficient ties test is a combination of quantitative and qualitative tests.

## **Advantages of the proposed Statutory Residence Test**

Practitioners<sup>[25]</sup> and academics<sup>[26]</sup> have generally praised the certainty provided under the proposed statutory residence test. This certainty is provided through the use of a quantitative approach to assessing residency. Under the proposed legislation, the automatic UK tests and the automatic overseas tests are assessed through days, while the sufficient ties test quantifies the amount of ties and corresponding days required to prove residency or non-residency. This substantial reliance on the number of days spent in the UK as an assessor of residency is a significant departure from the current residency test which only utilises days spent in the UK as an assessor of residency where an individual has spent greater than 183 days in the UK.<sup>[27]</sup> Under this current system, individuals falling under the 183 day cut-off point are required to consider a range of factors presented by case law in respect of their residency status and potentially there is no limit on the number of factors that must be considered by individuals. This creates uncertainty for individuals who cannot be entirely certain that they have considered all factors. Under the proposed legislation, those individuals assessing their residency under the sufficient ties test will only be required to consider a set number of factors dependent on the number of days spent in the UK. Another aspect of certainty provided under the proposed statutory residence test is the absence of the expression 'ordinarily resident'. As discussed, this expression has been criticised as unclear and undefined and its removal has generally been welcomed as providing greater clarity.

<sup>[28]</sup> The proposed legislation will abolish the expression 'ordinarily resident' for determining tax residency for individuals but will retain the concept of

domicile for the purposes of certain provisions such as the general remittance basis and the overseas workday relief. A significant criticism of the current system of residency for taxation purposes regards concerns that individuals are able to avoid taxation through manipulation of their residency status. In the report "Tackling Abuses – Tackling Unemployment", Rt Hon Gordon Brown MP, then Shadow Chancellor for the Exchequer commented that "[i]n Britain, it is easy for a few, even if they live or work here to avoid substantial amounts of tax through claiming to be non-resident or non-domiciled".[29]Brown provided an example of how such avoidance might be achieved under the then legislation; "Today it is possible for an individual to fly into Britain every day of the year and not be treated as resident if he is absent for a few hours of each day"[30]. The 'present at midnight' qualification partly closed this apparent loophole although individuals could potentially still manipulate their residency status by avoiding presence in the UK at midnight for each relevant day. In response to this criticism, the new legislation aimed "has been designed so that it is harder to become non-resident when leaving the UK after a period of residence than it is to become resident when an individual comes to the UK."[31]This design is reflected in the sufficient ties test where those individuals who were resident in the prior three years are required to show that they possess less ties to the UK than those individuals who were not resident in the previous three years.

[32]Although the potential for manipulation has not been closed it will make the task considerably more onerous for those with UK ties to avoid taxation through simply flying in and out of the UK.

## **Criticisms of the proposed Statutory Residence Test**

In the introduction to the Consultation paper for the proposed statutory residence test, it was stated that "[t]he Government is therefore committed to introducing a statutory test that is transparent, objective, and simple to use. This will enable taxpayers to assess their residence status in a straightforward way."<sup>[33]</sup> While the proposed legislation may have increased certainty through greater employment of quantitative methods of assessing residency, there has been strong criticism<sup>[34]</sup> that the proposed statutory residence test is not 'simple to use'. The basis of this criticism is that there remains many undefined or ambiguous terms and expressions in the proposed legislation.<sup>[35]</sup> A specific example of this ambiguity, pointed out by respondents to the consultation report document, is the failure of the proposed legislation to define the expression 'only home'.<sup>[36]</sup> The government's response to this criticism has been to concede that "it would be extremely difficult to provide a precise definition given the wide variety of living patterns adopted by individuals and their families."<sup>[37]</sup> The Government further argued that "[a]ny detailed definition would run the risk of inadvertently including or excluding certain individuals from the test because of the way in which they chose to live their lives."<sup>[38]</sup> While this lack of clear definition will allow the courts to retain some flexibility and discretion concerning tax residency laws, the result for individuals with complex living and working arrangements is that they will still most likely be required to seek professional assistance when determining their tax residency. In this respect, the proposed legislation is not an improvement on the current residency regime and the Government's aim of developing a



system that is 'will enable taxpayers to assess their residence status in a straightforward way' has clearly failed. The proposed legislation has also been criticised for being too strict in certain circumstances. Schwarz warns that "[i]f the proposals do reflect current residence rules, then it is a reflection based on all ambiguity resolved in favour of the Revenue and an inflexibility that runs contrary to human experience in relation to how ordinary lives are lived".[39] Respondees to the Government consultation paper criticised in particular the 45 day and 10 day (changed to 15 days as a result of the consultation process) limit required to prove non-residency under the conclusive non-residency test.[40] An argument against this criticism, however, is that the proposed legislation has included certain exception clauses to avoid unnecessary strictness. For example, clause 12 provides that where an individual "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", that day will not be considered a "day spent" in the UK.[41] Furthermore, clause 12(5) provides examples of circumstances that may be exceptional. The use of the word "may" indicates that this list is not exhaustive and allows the HMRC and courts to retain some discretion, although the extent of the discretion has been questioned, [42] in applying the proposed legislation. Nonetheless, these criticisms reveal that, to an extent, inflexibility is a trade-off for certainty, a point later conceded by Schwarz, "[w]ell drafted legislation will of course bring more certainty than the existing case law as administered by the HMRC." [43]

## **Conclusion**

By attempting to statutorily define a term as capricious and variable as "residence" for tax purposes, it was inevitable that the proposed statutory residence test would become subject to extensive analysis and evaluation. Nonetheless, academics and practitioners have broadly been favourable of the proposed statutory residence test for achieving a balance of certainty and flexibility that is palpably an improvement on the current system. One area in which improvement is debatable however, has been in developing a system that is "simple to use". As has been seen, there remain significant ambiguities in the proposed legislation and individuals with complex living and working arrangements would most likely be required to seek professional advice to assess their tax residency, a position no better than that under the current tax residency regime. Despite this criticism, the fact remains that the proposed statutory residence test has achieved its overall objective of statutorily defining the expression 'residence' for tax purposes and, furthermore, the certainty and flexibility inherent in this definition suggests that, at the very least, the proposed statutory residence test is a satisfactory improvement in the state of the law relating to residency for tax purposes. Bibliography

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