

Paradise lost

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Paradise lost

High-net-worth individuals seeking solace from the *Gaines-Cooper* ruling will be tempted to look at the forthcoming new statutory residence test, but even that will impose strict conditions on tax exiles, say **David Anderson** and **Andinee Pillay Jagambrun**

The Supreme Court's ruling in the *Gaines-Cooper* case last week will come as a blow to individuals who left the UK some time ago and sought to claim non-resident status by relying on what was considered to be a firm practice of HMRC.

Rejecting Mr Gaines-Cooper's challenge to HMRC's application of its residency guidance 'IR20', the Supreme Court, by a majority of 4-1, found that HMRC had correctly applied IR20 and there was insufficient evidence to suggest HMRC had an established practice departing from IR20.

Gaines-Cooper claimed to have left the UK in 1976 for the Seychelles. He maintained various links to the UK and returned here on occasion, although the time he spent in the country did not exceed 91 days per year on average – a factor set out in paragraph 2.9 of IR20. As there is no double-tax treaty (DTT) between the Seychelles and UK, the question of residency had to be determined only in accordance with UK law.

The Supreme Court held that IR20 should be read as a whole, and, on the proper construction of the document in its entirety, it could not accept that HMRC had intended the individual circumstances in separate parts of IR20 to be freestanding. The court agreed that IR20 could have been much clearer, but, as a whole, the sophisticated taxpayer would have known from the guidance that he had to leave the UK permanently or indefinitely making a distinct break from his pattern of life in the UK or for full-time employment. Therefore, simply keeping your days in the UK below 91 each year would not be conclusive as to non-residency under the old practice of HMRC.

Developing approach

As there is no statutory definition of UK residency, individuals have often sought to rely on case law and tax legislation to determine whether or not they are

considered resident in the UK. HMRC published IR20 as guidance on residence and ordinary residence in the UK.

In IR20, HMRC stated that the ordinary meanings of 'resident' and 'ordinarily resident' should be used. It also set out circumstances where it would consider an individual to not be resident or ordinarily resident in the UK. For instance, an individual who has left the UK to take up full-time employment abroad, has left the UK permanently or for at least three years, or went abroad for a settled purpose and remained abroad for at least a whole tax year, will be considered to not be resident in the UK. Individuals who visit the UK for short periods of time in any one year and averaged less than 91 days each year.

Partly as a result of the number of residency disputes, including the *Gaines-Cooper* case, HMRC replaced IR20 in April 2009 with a new guidance, *HMRC6 – Residence, Domicile and the Remittance Basis*. This document makes it clearer to an individual that "it is not simply a

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question of the number of days you are physically present in the UK during a tax year, although this is an important consideration". It provides a list of other relevant factors that will be considered together to determine the individual's residency status. It goes further to state in part 8 of the guidance that "the act of leaving the UK does not necessarily make you not resident and not ordinarily resident. You must also make a definite break from the UK and any remaining ties

you have with the UK must be consistent with not being resident here."

While this guidance provided some clarity, there are still elements of uncertainty and unpredictability, which has prompted the government to hold a consultation on a new statutory test (see box).

Tipping point

While IR20 has been repealed, the *Gaines-Cooper* case will still be important and closely scrutinised by individuals who have moved to non-DTT countries as HMRC may seek to review other claims to non-residency from those periods in light of the decision. However, whether these individuals will be able to construct a successful defence against HMRC seems unlikely, particularly as many would have planned their residency status based on a similar interpretation of IR20 to that of *Gaines-Cooper*.

IR20 was supposed to have provided individuals certainty over their residency status. Clearly, it did not. HMRC suggested in its guidance that 'residency' should be given its ordinary meaning. However, in light of this decision, an individual who has moved to a country and established a home there, spends most of their time there, has family there and conducts business there could still be considered UK resident if he returns here on occasion and maintains interests in the country. If you asked an objective onlooker whether this person was resident in the UK or elsewhere, what answer would you expect to receive?

It has often been repeated that individuals must be able to show that they have left permanently/indefinitely and that there has been a definite break from the UK. However, what is considered a definite break remains precarious. Moreover, how one goes about demonstrating this break is even more troubling for the reasons mentioned above. *Gaines-Cooper* had left the UK with the intention of leaving indefinitely. He had an established business

in the Seychelles in which he actively participated. Yet the court considered him resident in the UK.

Could it have been because he had sent his son to a private school in the UK that he was considered resident in the UK? Or perhaps because he still had his collection of motorcars kept at his London home? Both these factors together with many others were subject to interpretation and consideration for the court when assessing Gaines-Cooper's residency status. The 'tipping point' must be blurred in these circumstances – at what point do connections to the UK become too many connections to be considered non-resident?

It is not unusual for wealthy individuals to send their children to the UK for private schooling. Equally, it is not unusual for wealthy individuals to own properties around the globe. So it is likely that even with these so-called ties to the UK an objective onlooker would have concluded that Gaines-Cooper had broken his life pattern in the UK.

Hidden perils

Although IR20 no longer applies, this case demonstrates the perils potentially facing individuals who are planning to move to non-DTT countries, such as Monaco, as the current practice of HMRC remains impractical for lack of certainty. It is unacceptable that individuals cannot be certain in respect of their residency status, especially in today's economic climate. High-net-worth individuals should feel confident to invest and be reassured that their investments or business interests in the UK will not inadvertently result in a UK residency status, bringing their worldwide income within the UK tax net.

The fact that the government has recognised this by seeking to introduce a statutory test is encouraging. The statutory test will aim to provide the necessary reliability and will simplify matters for individuals, as they will no longer need to consider various case laws and practice guidance to determine their status.

The test is by no means a generous one because, in certain circumstances, it only permits leavers to visit the UK less than ten days in the year. However, it will reassure individuals of their residency status. Currently, an individual may spend ten days or less in the UK and still be considered UK resident on the interpretation of the current HMRC

NEW STATUTORY RESIDENCE TEST

A statutory definition of tax residence, the government believes, will give individuals and businesses confidence to invest in the UK without worrying that they could unwittingly become resident or ordinarily resident in the UK as a result.

A consultation on a new statutory residence test recently ended and draft legislation could be available ahead of the Budget 2012, possibly coming into force for the 2012-13 tax year.

The statutory residence test (SRT) will take into account the amount of time the individual spends in the UK and the other connections they have with the UK. It will have three parts.

Part A: conclusive non-residence factors

Individuals will not be resident in the UK for the tax year if they:

- were not resident in the UK in all of the previous three tax years and are present in the UK for less than 45 days in the current tax year; or
- were resident in the UK in one or more of the previous three tax years and are present in the UK for less than ten days in the current tax year; or
- leave the UK to carry out full-time work abroad, provided they are present in the UK for less than 90 days in the tax year and no more than 20 days are spent working in the UK in the tax year.

Part B: conclusive residence factors

Individuals will be resident in the tax year if they:

- are present in the UK for 183 days or

more in a tax year; or

- have only one home and that home is in the UK (or have two or more homes and all of these are in the UK); or
- carry out full-time work in the UK.

Part C: other connecting factors and day counting

Part C would apply only to those individuals whose residence status is not determined by part A or part B and, therefore, whose circumstances are less straightforward.

Factors include: family; accommodation; work in the UK; UK presence in the previous year; and more time in the UK than in other countries.

Depending on the number of factors that apply to you, you will be allowed a maximum number of days in the UK while remaining non-resident. The more factors that apply, the fewer days you can spend in the UK and remain non-resident.

The proposals distinguish between 'arrivers' to the UK and 'leavers'. Arrivers are individuals who have been non-UK resident in all of the past three years, whereas everyone else counts as a leaver. Arrivers will have a slightly easier time in proving they are non-resident as they will be conclusively non-resident if they spend less than 45 days in the UK. Leavers will be conclusively non-resident if they spend less than ten days.

guidance and this case, whereas leavers under the statutory residency test will be considered non-UK resident conclusively if they are present in the UK for less than ten days in the current tax year.

On the face of the proposals set out in the consultation, the test does indeed appear to be "transparent, objective, and simple to use". Whether or not the actual draft legislation will reflect what has been proposed remains to be seen.

Until the statutory residency test comes into force, it appears that individuals seeking to discard their UK resident status with certainty have two options: either they cut any ties with the UK, be it a property, a family connection or any business interest, or they keep these ties but do not set foot in the UK. Anything in between will be subject to interpretation and therefore be uncertain.

Remember that, even where the legislation defining residency comes into force, an individual may still need to refer to any existing double-tax treaties and

possibly to the domestic legislation of the country that they are leaving or moving to in order to determine their residency status. There are several advantages to moving to a country which has a double-tax treaty with the UK, one of which is an increased level of certainty over the individual's residency status. If the individual is still minded to relocate to a non-treaty country such as the Seychelles, it may be possible to obtain non-UK residency via a DTT country and then move to the non-treaty country from there; i.e. move from the UK to France for a period then to the Seychelles.



David Anderson is a solicitor and chartered tax adviser at Sykes Anderson LLP. He is grateful to Andine Pillay Jagambrun, trainee, for her assistance with this article. Contact: www.sykesanderson.com