FORSTERS

NEWSLETTER
JUNE 2009

OFFSHORE UPDATE

RESIDENCE AND ORDINARY RESIDENCE

BACKGROUND

HM Revenue & Customs ("HMRC") introduced new guidance for determining whether or not an individual should be treated as resident and/or ordinarily resident in the UK in March. The guidance, called HMRC 6, took effect from 6 April 2009 and replaces HMRC's previous guidance on the same subject, IR20. IR20 has been used by practitioners since it was first published in the 1970s to establish whether an individual's visits to the UK are sufficient to make him or her resident or ordinarily resident for UK tax purposes. HMRC make it very clear that HMRC 6 (like its predecessor IR20) has "*no legal force, nor does it seek to set out regulation or practice*", it simply sets out HMRC's interpretation of the law. However, in the absence of any comprehensive statutory test for residence and ordinary residence, following the guidance is recommended to ensure that an individual maintains, so far as possible, his or her non-UK resident and/or not ordinarily resident status for UK tax purposes.

When an individual is resident in the UK, he or she will normally be taxed on his or her income and gains wherever they arise. Our previous newsletters have set out in more detail the new rules applicable to the 'remittance basis of taxation', including the £30,000 remittance basis charge and the pitfalls of remitting certain types of income and gains. This is a complex area but, very broadly, the remittance basis enables UK resident, not ordinarily resident and/or non-UK domiciled individuals to avoid UK tax on their foreign income and gains if such income and gains are kept outside of the UK.

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COMING TO THE UK – INDIVIDUALS WILL BECOME ORDINARILY RESIDENT A YEAR EARLIER

IR20 provided that an individual would be treated as ordinarily resident from the beginning of the tax year after the third anniversary of an individual's arrival in the UK if he did not originally intend to stay for at least three years, and he did not purchase accommodation or acquire a lease of three years or more. However, the guidance in HMRC 6 provides that an individual would be treated as ordinarily resident from the beginning of the tax year in which the third anniversary falls. This change of wording reduces the time in which an individual can spend in the UK before becoming ordinarily resident. For example, under IR20 an individual who came to the UK on 21 November 2005 without intending to stay for more than 3 years and who was still living in the UK on 6 April 2009, would be treated as ordinarily resident from 6 April 2009. Under HMRC 6, the same individual would be treated as ordinarily resident from 6 April 2008. This change in HMRC practice has been brought in without any transitional relief.

The new position reflects the decision of the Special Commissioners in the recent case of *Fabio Massimo Genovese v Revenue & Customs Commissioners*[1], which was heard in March 2009, around the same time that HMRC was finalising HMRC 6. One of the benefits of non-ordinary resident status for non-UK employees who have arrived in the UK is that it is possible for them legitimately to avoid UK taxation in respect of the part of their employment duties attributed to work carried on outside the UK. Rather than getting involved in split contract arrangements, which HMRC often consider to be artificial, the employee can submit a day count to HMRC with their tax return and they are only taxed on income attributable to days spent in the UK.

Mr Genovese, an Italian national, came to work in the UK in 1998 as an investment banker. On arrival he did not intend to stay in the UK for longer than two or three years but, in March 2002, he decided to purchase a property in the UK which was completed at the end of July 2002. HMRC argued that he was ordinarily resident by 5 April 2002, so that Mr Genovese's worldwide earnings from his employment should be subject to UK tax. HMRC said that Mr Genovese's intentions were clear from the contract to purchase the property, as well as other factors, such as putting his children on a waiting list for the local preparatory school.

The Special Commissioner held that it was not possible for him to follow IR20 in his judgment, where IR20 conflicted with case law. He specifically followed the case of *Barnett LBC v Shah*[2] (not a tax case but an appeal case in the House of Lords brought by several foreign students against the decision by various councils to refuse them educational grants under the Education Act 1962), which stated that to be regarded as ordinarily resident an individual's residence must be voluntarily adopted with a degree of settled purpose, stating that the settled purpose was to be determined by the individual's life pattern and lifestyle rather than the individual's intentions. In *Shah* the individuals in question were held to be ordinarily resident because they had been in the UK for three years.

The Special Commissioner held that Mr Genovese needed to be resident only for a part of the third tax year in order to be ordinarily resident for that tax year. The Special Commissioner said that the common law test laid down in *Shah* led him ***"to a conclusion at variance with booklet IR20"***. Therefore, HMRC may have amended their guidance to align it with the common law test. Encouragingly, the Special Commissioner did not consider that the offer on the house made in March 2002 should be taken into account in determining Mr Genovese's ordinary resident status and could only be used as an expression of his intentions.

1. (SPC 741)

2. [1983] 2 AC 309

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This contrasts with the position in HMRC 6 which makes it clear that the number of days spent in the UK will not be the determining factor in establishing whether an individual is resident, instead the day count will be "***an important consideration***" and the individual's intention and other factors will also be taken into account. Indeed, the Special Commissioner stated that a "***fundamental difference of approach***" between the HMRC guidance and the common law (or case law) produces a different outcome when establishing an individual's ordinary residence status.

The uncertainty arising from the different approaches taken in the Courts and the guidance is unhelpful. A statutory test for ordinary residence would assist individuals and the professional bodies are lobbying the government to introduce one.

LEAVING THE UK – END OF THE 91 DAY TEST?

In the absence of "tax avoidance", under IR20, when an individual decided to leave the UK, he or she was treated as not resident and not ordinarily resident from the day after departure, provided his or her absence covered at least the whole tax year and since leaving his or her visits to the UK totalled less than 183 days in any one tax year and averaged less than 91 days a tax year (taken over a period of four years). HMRC 6 provides that leaving the UK to go abroad does not mean that the individual will automatically become non-resident and/or not ordinarily resident.

The individual's visits after leaving are still important but HMRC 6 also labours the importance of the individual's reasons for leaving and the connections he or she retains in and with the UK, such as family members, property, business interests and social connections. Therefore, it is now clear that a complete break with the UK is required and HMRC may ask for additional evidence other than the fact of actually leaving to prove that an individual has become non-resident/ not ordinarily resident. This aligns the practice more closely to case law.

PROFESSIONAL FEES PAID OUTSIDE THE UK FROM FOREIGN INCOME OR GAINS

UK resident, non-domiciliaries or not ordinarily UK resident individuals ('RNDS') can directly pay professional fees for services provided (including commissions) in the UK from their foreign income or gains without making a remittance, provided that the professional advice relates only or mainly to property situated outside the UK. The fees must be paid to a bank account of the relevant adviser outside the UK. Therefore, it is important that RNDs ensure that any invoices received from UK professionals in relation to advice concerning their non-UK situs property are paid to a bank account of the adviser situated outside the UK.

This article offers general guidance only. It reflects the law as at June 2009. The circumstances of each case vary and this article should not be relied upon in place of specific legal advice.

For further information, please contact:
Carol Teale on 020 7863 8515 or cateale@forsters.co.uk

Forsters LLP | 31 Hill Street | Mayfair | London | W1J 5LS
T: 020 7863 8333 | F: 020 7863 8444
www.forsters.co.uk

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