U.K. TAX RESIDENCY RULES FOR INDIVIDUALS AND COMPANIES[1]

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Tags
Statutory Residence Test
Tax Residency
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INDIVIDUALS – RESIDENT OR NOT? THREE YEARS INTO THE STATUTORY RESIDENCE TEST

Background

If an individual becomes resident in the U.K. for tax purposes, *prima facie* liability arises regarding U.K. tax on worldwide income and gains. In normal circumstances, therefore, an individual will endeavor to avoid U.K. tax residency, particularly as the taxation of nonresidents is confined to certain U.K.-source income, such as rent, and capital gains tax is generally confined to U.K. residential property and assets used in the individual's branch or agency in the U.K.

The U.K. statutory residence test has applied since April 6, 2013, and has brought a considerable degree of clarity to previously confused rules. Prior to April 2013, statutory law was virtually nonexistent. Instead, extensive case law and published guidance from H.M. Revenue and Customs ("H.M.R.C.") governed the establishment or relinquishment of residence.

In many cases, this guidance extended far beyond the principles set out in the law. For example, individuals looking to leave the U.K. apparently needed to made a "clean break" and sever most, if not all, connections with the U.K. in order to achieve nonresident status for U.K. tax purposes. Individuals who kept poor records of visits to and from the U.K. were particularly vulnerable, as physical presence was the main residency criterion prior to April 2013.

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Statutory Residence Test – Main Principles

The statutory residence test ("S.R.T.") brings clarity for most individuals, although, there are some areas of uncertainty, particularly with regard to definitions of "only home" and "full time work." Nonetheless, the tests to determine whether an individual is tax resident are applied in a straightforward manner. Consequently, tax planners may plan for an individual to be nonresident prior to the disposal of a business or receipt of a significant amount of income, provided appropriate client cooperation exists.

S.R.T. – Part A

This test will "conclusively" determine that an individual is *not* resident in the U.K. for a given tax year if *any* of the following conditions are applicable:

- The individual was resident in the U.K. for one or more of the preceding three

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tax years and is present in the U.K. for fewer than 16 days in the current tax year.

- The individual was not resident in the U.K. in all of the previous three tax years and is present in the U.K. for fewer than 46 days in the current tax year.
- The individual works full time abroad, provided that presence in the U.K. is limited to fewer than 91 days, not more than 30 days are spent working in the U.K. in the current tax year, and the individual is does not work in international transportation.

S.R.T. – Part B

Provided Part A of the test, above, does *not* apply, an individual will be resident conclusively for the tax year under Part B if *any* of the following conditions are met:

- The individual is present in the U.K. for 183 days or more in a tax year.
- The individual has only one home and that home is in the U.K. If the individual has two or more homes, all are in the U.K.
- The individual carries out full-time work, as defined, for a sufficient number of hours in the U.K. in the year and does not work in international transportation.

S.R.T. – Application to Other Cases

If Part A and Part B are inapplicable, or an individual is neither *conclusively* nonresident nor conclusively resident for a tax year, the determination is made by reference to the "ties" that exist with the U.K. and physical presence in the U.K. Here, the analysis can be complex, as it requires the advisor to probe quite deeply into the individual's affairs in order to provide correct advice in support of the residency position claimed on the tax return.

For these cases, the determination is based on the number of ties to the U.K. and days spent in the U.K., applying an inverse relationship. As the ties increases in number, residence will exist with fewer days of presence in the U.K. The ties to consider are as follows:

- Family – This tie supports resident tax status if the individual's spouse, civil partner, or common law equivalent is resident in the U.K., provided the individual is not separated from that person. Also, this tie includes the residence status of minor children, although exclusions are provided for minor children undertaking full-time education in the U.K.
- Accommodation – This tie supports resident tax status if the individual has available accommodation in the U.K. and makes use of it during the tax year. There are exclusions for some types of accommodation. The accommodation may be owned, rented, or otherwise provide free of charge, as when the premises are owned by a family member.
- Substantive Work in the U.K. – A tie may exist if the individual performs "substantive" work in the U.K. but does not work in the U.K. full time. Specifically, there will be a tie if the individual does more than three hours of work per day in the U.K. on at least 40 days in that year (whether continuously or

intermittently). Special rules apply to individuals who are involved in international transportation.

- Time Spent in the U.K. v. Other Countries – In this case, one must scrutinize the number of days spent in the U.K. and in other countries, as a tie will exist if more time is spent in the U.K. than in any other country. However, this tie is considered only when the individual was resident in the U.K. in one or more of the three previous tax years.
- Time Spent in the U.K in Prior Years – The last tie will apply if the individual spent more than 90 days in the U.K. in either of the two preceding years. Consequently, it will be possible to return to the U.K. to a greater extent, without having a tie exist, once two years of nonresidence have been achieved.

The following chart sets forth the relationship of days, ties to the U.K., and residence in prior years that lead to tax residence in the U.K. for the current year.

Impact of U.K. Ties on Residency Status		
Days Spent in the U.K.	**Individuals *Resident* in ≥ 1 of the Previous 3 Tax Years**	**Individuals *Not Resident* in Previous 3 Tax Years**
< 16	Always Nonresident	Always Nonresident
16 – 45	Resident if individual has 4 factors	Always Nonresident
46 – 90	Resident if individual has ≥ 3 factors	Resident if individual has 4 factors
91 – 120	Resident if individual has ≥ 2 factors	Resident if individual has ≥ 3 factors
121 – 182	Resident if individual has ≥ 1 factor	Resident if individual has ≥ 2 factors
≥ 183	Always Resident	Always Resident

Claiming Nonresident Status

An individual who is nonresident, or an individual who is a dual resident in the U.K. and another country, claims nonresident status based on the above factors in a U.K. tax return, whether issued by H.M.R.C. or otherwise required because, for example, of chargeable U.K.-source income was derived. There is a specific "residence, remittance basis, etc." section on a U.K. tax return where an individual must report nonresident status and answer 22 or more questions regarding U.K. ties, physical presence, and other relevant criteria. The 22 questions may seek information that goes beyond what is needed to determine residence status, and there are points that might then be checked with the relevant overseas tax authority or used to gather information about a taxpayer, such as residence status in another country.

Days on which the individual is in the U.K. at midnight count for residence determination purpose. Also counted are days spent working for more than three hours in the U.K. and any days attributable to exceptional circumstances such as a serious illness. All such days must be reported, although the days attributable to exceptional

circumstances are normally excluded.

There are some circumstances whereby days in which the individual is present in the U.K. at midnight are disregarded. Transit days during which the individual is travelling from one country outside the U.K. to another, but arrives in the U.K. as a passenger whilst en route to the final destination may not count as days spent in the U.K. Note that activities engaged in by the individual while in the U.K. on a transit day may count towards residence if activities unrelated to transit through the U.K. are undertaken. This may include catching up with friends or family and visiting tourist attractions.

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In addition, in some circumstances where an individual is present in the U.K. on more than 30 days during a tax year without being in the U.K. at midnight, subsequent days may count as days spent in the U.K. under a deeming rule.

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Split Year Treatment

Normally, an individual is either resident or nonresident for the *whole* of the U.K. tax year, which runs to April 5 – an historical anachronism from when income tax was introduced as a "temporary measure" in 1798. One of the most complex aspects of the S.R.T. is where an individual is entitled to "split" the tax year into the residence portion and the nonresidence portion.

Split Years – Concessions

Prior to April 2013, a tax year could be split only in accordance with concessions granted by H.M.R.C. Concessions do not have the force of law and were not applied in abusive fact patterns. Usually, these concessions only allowed a splitting of the year of arrival in or departure from the U.K. in limited circumstances, where the individual was taking up permanent residency in another country or undertaking full-time employment abroad spanning a full tax year. Under the old regime, the rules for split years for capital gains were significantly different to those for income tax.

For example, an individual leaves the U.K. in September 2012 and in the following December sells a business at a substantial gain. Here, it would have been critical to utilize the relevant concession to ensure nonresident status at the time of the disposal in December 2012.

Split Years – S.R.T.

Under the S.R.T., one of eight defined cases must be met for split year treatment to apply for both income and capital gains tax. The S.R.T. rules will often require that various conditions must be met in the tax year in issue and in the preceding and subsequent years. Although complex, the S.R.T. gives greater certainty. Split year treatment is granted by law and applies in broader fact patterns than the concessions that existed prior to S.R.T.

The cases where an individual can split the tax year are numerous and include starting to have full-time employment overseas, ceasing to have a home in the U.K., starting to have a home in the U.K., or being the partner or spouse of someone who

is in one of these situations. It will be much harder to split the tax year where the individual is not moving to take up full-time employment. However, it should be possible, with planning, for an individual who leaves the U.K. in, say, September 2016 to feel quite confident that they are not resident in the U.K. when a large capital gain arises in, say, December 2016, on which they would look to avoid U.K. tax.

There can be substantial amounts of tax on the line for internationally mobile clients and substantial risk and reward for their tax advisors. More than ever, advisors must understand the full circumstances of a client's affairs in order to provide appropriate advice – usually, requiring a far better understanding than would be normal for preparing a simple domestic tax return. Adding to the complexities, advisors must carefully consider matters such as whether employment constitutes "full-time" work and whether accommodation counts as a "home" under the *still* rather uncertain definition included in the S.R.T. legislation and associated H.M.R.C. guidance.

For purposes of the S.R.T., a person's home is generally considered to be a place that a reasonable onlooker with knowledge of the material facts would regard as that person's home. A home can be a building, vehicle, vessel, or structure of any kind. It will be a property that an individual uses with a sufficient degree of permanence. However, H.M.R.C. guidance states that a place can remain a home even if the individual does not stay there continuously. The guidance uses the example of an individual who moves out temporarily and whose spouse and children continue to live in that property. If an individual moves out of a home completely and makes it available for leasing, it will not be the individual's home. In addition, a place that has never been capable of functioning as a home cannot be a home (*e.g.*, a property in a state of disrepair that is not habitable). A property that is used periodically and as nothing more than a holiday home or temporary retreat does not count as a home.

Temporary Nonresident

The U.K. is mindful that individuals may seek to leave the U.K. for a short period in order to crystallize a capital gain or an item of significant income while nonresident. There are now quite wide ranging rules that charge such a "temporary nonresident" on capital gains and certain items of income (*e.g.*, a dividend from a closely-held company) if the individual is nonresident for less than five years.

For example, Bruno leaves the U.K. in September 2016 and achieves nonresident status. In May 2017, he sells shares in his U.K. business and derives a gain in the amount of £1 million while nonresident. He returns to the U.K. in June 2021. He has not been away for a full five years. Hence, the capital gain on the £1 million is charged in the tax year of his return to the U.K. (*i.e.*, 2021/22).

CORPORATIONS – RESIDENT OR NOT?

When Will a Company Be Tax Resident in the U.K.?

Background

This is an area of increasing interest for the U.K. tax authorities. Beyond companies incorporated in the U.K., a company registered overseas will be regarded as tax resident in the U.K. if its place of "central management and control" is in the U.K. Subject to limited exception, U.K. statutory law has been largely unchanged in this area for 28 years. However, case law has developed during that period such

that considerable care must be taken to prevent a company registered outside the U.K. from becoming U.K. tax resident. This is a problem for a company registered abroad that is run by a dominant U.K.-based entrepreneur or has significant operations in the U.K.

A U.K.-resident company will be liable to U.K. tax on worldwide profits and gains, whereas a nonresident company can be charged only on the following:

- Profits from a permanent establishment in the U.K.
- Certain types U.K.-source income (such as rent)

U.K.-resident companies are normally liable to corporation tax, which is currently imposed at the rate of 20% and will fall to a 17% rate by 2020.

Occasionally, a company will seek to be treated as U.K. tax resident. The purpose may be to benefit from treaty reliefs or low corporate tax rates, or to facilitate shareholder tax benefits if, for example, a loan made to such a company proves irrecoverable. Normally though, the worldwide group may be at pains to avoid a company being regarded as U.K. tax resident, particularly if it is registered in a low-tax jurisdiction.

Central Management and Control

Since 1988, when statutory provisions were introduced, any company – wherever registered – can be regarded as tax resident in the U.K. if its place of central management and control is in the U.K. We are looking, here, at the highest level of decision making, and this will normally be where the directors meet and make key decisions.

The principles have been expounded in a number of leading U.K. tax cases. For example, in an old case dating from 1935, a South African company was held to be resident in the U.K. as the controlling board of directors exercised its powers in the U.K. As the judge stated, "A company resides . . . where its real business is carried on . . . and the real business is carried on where the central management and control actually abides."

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To avoid U.K. residence, worldwide groups should arrange for directors' meetings to be held outside the U.K. and for key decisions to be recorded and minuted at these meetings. Following the recent *Laerstate* case, it is helpful if the minutes can also include the information that the directors used in order to make the decisions. Wherever possible, all directors should physically attend board meetings rather than attend by telephone or video cam.

H.M.R.C. is mindful that non-U.K. companies based in low-tax countries may not be controlled by the local board of directors. Recent press commentary has focused on certain directors who claim to be directors of thousands of companies and cannot therefore have, or be expected to have, an intimate knowledge of the companies and their activities.

The U.K. tax authorities from time to time issue clarification of their practices in certain areas, and Statement of Practice 1/90 still has considerable influence and continues to be studied by tax advisers. One important point made by the statement is that H.M.R.C. will first attempt to ascertain whether the directors in fact exercise

central management and control. If they do, the tax authorities will endeavor to determine the location where the directors exercise central management and control. This is not necessarily where they meet.

In cases where the directors apparently do not exercise central management and control, the tax authorities will look closely to establish where and by whom it is exercised. For privately held companies, it may be where a dominant owner is located if the owner usurps the power of the board in relation to decision making. The difficulty with many of the older central management and control court cases is that most were decided at a time when electronic communication was either in its infancy or lacking altogether.

The Laerstate BV Case – A Reminder of Principles and Proper Administration

A Dutch registered company, Laerstate BV, was adjudged to be resident in the U.K. as central management and control was exercised in the U.K. The company owner was U.K. resident and seems to have taken key decisions with little or no recourse to the other director, who was Dutch resident and adjudged to be a mere cypher.

This leads to an interesting dichotomy. Where the board of directors of a non-U.K. company is local and consists of local advisers, local management personnel, and a representative of the parent company, the practical need for formalities may be significantly less than where the local board consists of a trust company officer and a local managing director. Non-U.K. companies in the latter group may find it prudent to emphasize steps demonstrating that the board meets outside the U.K., and makes all major strategic decisions. For these companies, the following steps may be taken to support non-U.K. residence:

- Regular minutes should be prepared to evidence local decision making.
- Board of directors meetings that are pre-printed in advance of the meeting should be avoided.
- Sound or video recordings of board meetings should be undertaken to prove that all directors actually participate in decision making.
- The board should comprise directors of proper experience, meet regularly, and receive sufficient information to make decisions.
- The majority of the board of directors should consist of individuals who are not resident in the U.K.

Impact of Double Taxation Agreements

As with individuals, a company may find itself resident in two or more countries. It will therefore be a dual tax resident. Quite often, the relevant U.K. double taxation agreement will contain a tiebreaker provision determining the country in which the company will be treated as tax resident for treaty purposes. Normally, this will deem the company to be tax resident in the country where the place of effective management is situated. Although this is a similar phrase to central management and control, commentary on the O.E.C.D. model suggests that it is really where the day-to-day operations of the business are conducted.

It could be, for example, that a company is treated *prima facie* as tax resident in the U.K., as the directors meet there and make key strategic decisions. If it is deemed

to also be resident in another jurisdiction, say France, perhaps this is the "place of effective management," as the executives and workforce operate there. So, for treaty purposes the company is resident in France. It should be noted that the U.K.-U.S. Income Tax Treaty does not have a place of effective management provision but determines that corporate residence for treaty purposes will be resolved by "mutual agreement" between the two tax authorities. Ordinarily, U.S. income tax treaties provide an ultimate tiebreaker based on place of incorporation.

CONCLUSION

The U.K. provisions concerning the tax residence of both individuals and companies are important both for mobile individuals and worldwide groups. It may be expensive in tax terms to become resident in the U.K., although occasionally there are benefits in deliberately triggering residence.

For individuals, the position in the vast majority of cases is much clearer since the introduction of the S.R.T. in April 2013. Although, there are some areas of practical difficulty, such as exists in the definition of the term "home." In total, the provisions are complex, but at least statutory provisions and implementing guidance are available for use by advisers.

For companies, the U.K. tax authorities are becoming increasingly vigilant, and the nebulous concept of central management and control requires due consideration by worldwide groups. Recent case law suggests that directors should be aware of the information used in making decisions and should record the steps in the decision-making process in the minutes of a meeting of the board of directors of the local company. As with many provisions of tax law that are based on economic substance, the decision is made based on facts. This places undue emphasis on the importance of following form that will be helpful in demonstrating substance, especially in fact patterns that are not clear in themselves. Boards of directors or subsidiary companies are themselves subsidiary to the decision of the principal investor.

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