Article

Working Abroad: An Analysis of the Impact of the Finance Act 2008 on Non-Domiciled Workers in the United Kingdom.

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Abstract

The purpose of this article is to outline some of the fundamental principles of U.K. taxation concerning individuals who divide their time in between the U.K. and other countries, and specifically, with reference to the changes in the Finance Act 2008. An individual's status of residence within the U.K. will have an impact on their tax burden, which needs to be taken into consideration when tax planning. It is important to note that the legislation found in the Finance Act 2008 can affect individuals *irrespective of nationality*. This article will focus on three main areas of taxation: firstly; a discussion of some of the nomenclature concerning domicile, secondly, an outline of the recent changes in tax law found in the Finance Act 2008, and thirdly, a critical analysis of the potential impact of these changes on non-domiciled individuals.

Keywords: Tax, Law, Finance Act 2008, U.K., Income, Domicile

1. Introduction

One of the fundamental principles of taxation is to allow a central, public, authority to raise capital to provide services which would not be economically viable, or desirable, for private enterprise to conduct. Generally, these services include those which support the welfare of the community, such as hospitals and primary and secondary education. Other, less obvious, examples of services funded by public money may be utilities, public transportation and postal services. Over recent years, the latter have been moving to the private sector, theoretically reducing some of the tax burden on citizens. Taxation, while unpopular however, permits a central authority to provide services which may be enjoyed by everyone resident within the scope of that authority. Generally, the provision for taxation may be seen as a benefit not only for a society, but also for an economy, as taxation allows a central authority or government to influence stability and the distribution of money, but this is beyond the scope of this discussion[1].

Perhaps as a result of the many different kinds of taxation (capital gains, inheritance, income etc.) the allocation of the tax burden attracts much controversy. Direct taxation can result in an onerous burden being placed on the individual, for example: Prime Minister Margaret Thatcher's highly controversial attempt to introduce a poll tax in the late nineteen-eighties, with ensuing civil disobedience. Conversely, an excessive burden placed upon corporate bodies, or individuals from overseas, may result in the loss of jobs and/or skilled persons from the U.K. Problems concerning the implementation of taxation are expedience, or necessity, and fairness. One of the purposes of taxation is to acquire capital for the purpose of investing in public services; however individuals who are not 'resident', in the dictionary sense, within the U.K. are unable to enjoy the benefits of taxation. Taken into consideration, is it unreasonable and unfair to compel such individuals to pay for something they are unlikely to have the quiet enjoyment of? In ***Allen (executors of Johnson, decd) v Revenue and Customs Comrs*** [2005] STC (SCD) 614, 8 ILTR 108, the deceased's estate was pursued for an outstanding inheritance tax payment notwithstanding that the deceased, Mrs Johnson, had lived in Spain for a great many years, and only came to the UK as a visitor on account of her declining health. This can be contrasted against individuals who have acquired considerable wealth working in the UK, and who relocate abroad for the sole

[1] Angharad Miller and Lynne Oates discuss the principles of taxation in more detail in: Miller, A., Oats L. (eds.) *Principles of International Taxation* (Tottell Publishing Lts: Haywards Heath, 2006) ch. 1.

purpose of avoiding their tax burden. In ***Reed v Clark*** [1985] STC 323, 58 TC 528, the respondent relocated to the USA for a period covering an entire tax year. By doing this, Clark hoped to avoid paying tax on his previous year's income; his purpose was almost exclusively for tax avoidance. Ultimately, it was decided that Clark's sabbatical in the USA did comply with s108 of the Income and Corporation Taxes Act 1970 (since repealed), and he won his case. Thus, one of the challenges posed by taxation is for it to be seen as to not unduly punish those resident within the U.K. who are not able to enjoy the benefits of their tax payments, while not allowing those who enjoy the benefits of taxation to escape their burden.

2. Status: Resident, Ordinary Resident, Domicile

Resident, *ordinary resident*, and *domicile* are terms used by HM Revenues & Customs to establish an individual's tax liability (if any). The terms have derived their significance with the development of common law. ***Udny v Udny*** (1869) LR1 Sc & Div 441 defines domicile as having four distinct elements: firstly, that domicile is distinct from citizenship or nationality; secondly, the so called 'domicile of origin' rule states that everyone has a domicile, which in the case of a legitimate child would pass down from the father, and with an illegitimate child, from the mother; thirdly, that should an individual choose another domicile to that of his birth, the original domicile remains latent until the individual rescinds his chosen domicile; finally, that the status of the child depends upon the father. So, the creation of domicile as a legal term establishes a way of enforcing a tax burden through the courts. Though ***Udny v Udny*** provides that an individual may acquire another domicile, the circumstances of this were unclear. The later case of ***IRC v Duchess of Portland*** [1982] Ch 314, determined the extent to which an individual must live in another country to acquire that domicile was examined. The respondent hoped to demonstrate that she had shed her domicile of choice (in the U.K.) and revert to her domicile in Canada by maintaining property there and visiting occasionally. Analysing these circumstances, the High Court developed a two-prong test to determine whether an individual had abandoned their domicile of choice: firstly, an individual should cease to intend to live permanently in that country, and secondly, should cease to inhabit that country. The respondent failed the test on the second prong as she continued to inhabit the UK for extended periods. While possible to change one's domicile, in practice it is difficult. This case can be compared with ***Plummer v IRC*** [1988] All ER 97, where a U.K. national sought to demonstrate that she had adopted a domicile of choice in Guernsey. However, the claimant had retained property in the UK which was deemed as evidence that she had not desired to relieve herself of her domicile of dependency. Thus should someone wish to retain property in the domicile of origin, they must be able to demonstrate that this is not their main residence. This can be ruling conflicts with chapter 2 s830 (2) of the Income Tax Act 2007, which states when determining residency, any living accommodation available to the individual within the U.K. must be disregarded. The decisions in ***Plummer*** and ***Duchess of Portland*** seem to indicate the bias of the courts towards public policy; once acquiring domicile in the U.K. (either through dependency or choice), an individual must go to extreme lengths to prove their intent to change their domicile; the courts are reluctant to allow them to escape their tax burden.

The current guidance form issued by HM Revenue & Customs, IR20 (in the process of being re-written), contains the most up-to-date nomenclature concerning residency and ordinary residency. Section 3.3 of this document stipulates that an individual shall be resident in the U.K. if they spend at least 183 days in any tax year or an average of 91 days or more over four years in the UK. S831 (1) of the Income Tax Act 2007 amends this where an individual who has no intention of setting up residence in the U.K., and spends *less* than 183 days in the U.K., they *may* still be liable for income tax, subject to conditions in the Income Tax (Earnings and Pensions) Act 2003 and the Income Tax (Trading and Other Income) Act 2005. These new provisions have yet to be tested and seem, *prima facie*, intent on closing a legal loophole. In ***Reed (Inspector of Taxes) v Clark*** [1986] Ch 1, the court held that for an individual to be resident in the UK, they must be resident there for part of the tax year. In addition, if the individual established themselves in another country, they may also be considered to be ordinarily resident of that country, depending on how they conduct their business. Section 830 (2) of the Income Tax (Trading and Other Income) Act 2005 lists types of income which will not be taxed for non-residents, including royalties from sound recordings. This would imply that the decision in ***Clark*** (who was a musician), is good law as of writing.

Under the common law in ***IRC v Lysaght*** [1928] AC 234, an individual was deemed to be ordinarily resident in the U.K. if their residence was not casual, but part of their ordinary life. Importantly, this left the question of how much time an individual may spend in the U.K. before being considered ordinarily resident open. Recent notes, particularly section 1.3 in IR20 defines ordinary residency as being different from residency where an individual spends 183 days or more in the UK in a tax year, or someone who usually lives in the UK but who has happened to have spent an entire tax year away from the UK. Miller and Oats note that the chief difference between ordinary residence and residence is that ordinary residence is much more difficult to shed, being appraised by an individual's sustained conduct rather than their transitory actions[2].

In outline, The Financial Act 2008 makes a number of changes to the test of residence. One significant change concerns an amendment to the Income Tax Act 2007, where, generally speaking, an individual must remain in the U.K. for 183 days or more to be considered resident. s24 of the Finance Act 2008 amends s831 of the Income Tax Act 2007, where an individual's transit period may contribute to the 183 day test of residency period. Furthermore, Schedule 7 s809H of the Act changes the principles of the remittance of cash. An individual who has spent at least seven of the past nine years resident in the UK, and wishes to continue remitting tax payments (in contrast to normal UK income tax rules) must pay an additional sum of £30,000. An individual who does not remit funds will be taxed on their total income, regardless of whether it is remitted to the UK or not (provided they stay more than seven years)[3].

3. New Rules on Taxation - Paying a Fairer Share

The Finance Act 2008 makes three significant changes to the tax burden of non-domiciles. The first change concerns personal allowances and the remittance basis of taxation. From 6th April 2008 individuals paying through the remittance scheme will no longer have access to personal allowances, as was the case previously. Circumstances which may attract a charge are listed in Schedule 7 s809A-E; Schedule 7 s809F outlines the charges should any of the conditions in s809A-E be met. Section 809H (2) states that any gains in excess of £2,000 (relating to s809D) will be taxed as an income, and this includes capital gains. In addition, individuals using remittance will lose their annual exempt allowance on their capital gains. In addition to the changes in the amount of gains taxable, the Act also reviews the mechanisms for bringing funds into the country. These are detailed in *The Budget 2008 Notes.*[4]To summarise, the mechanisms include 'ceased source', whereby

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[2] Angharad Miller and Lynne Oates discuss the principles of taxation in more detail in: Miller, A., Oats L. (eds.) *Principles of International Taxation* (Tottell Publishing Lts: Haywards Heath, 2006) p.31.

[3] *How to use the Remittance Basis of Taxation*: http://www.hmrc.gov.uk/nonresidents/coming-to-the-uk.htm (last visited 9th September 2010).

[4] Form BN104 at: http:// www.hmrc.gov.uk/budget2008/notes-pdf.htm (last visited 28th August 2010).

previously untaxed income will be liable to taxation upon remittance to the U.K., 'cash only' meaning that only cash or assets converted into cash in the U.K. will be taxable (this excludes most items of clothing); the 'claims mechanism' which now permits foreign savings to be taxed if remitted to the U.K., regardless of the tax year in which the gains were made. However, the most striking changes relate to the increased exposure of non-resident trusts to taxation (paragraph 19 of the aforementioned document); taxation of non-domiciled beneficiaries will now be possible, and any decision to re-base trusts must be declared to HMRC. According to Malcolm Finney, the Finance Act 2008 will have a substantial effect on s87 of the Taxation of Chargeable Gains Act 1992[5], section 87 (1) of the aforementioned Act exempts non-resident/ordinarily resident trustees from the charges listed in that section. This was in effect a loophole which afforded non-domiciles tax planning. However, the Finance Act 2008 provides that beneficiaries of such a trust, provided they are resident in the U.K., will now fall foul of these provisions. Still more provisions are detailed in section 8 of IR20. There is some respite for non-domiciled investors, as capital gains may be opted in and out of the remittance based system; the consequence of this being that investors may no longer be taxed on their capital gains losses. The last substantial change is detailed in Schedule 7 s809C and s809H(2) in the Finance Act 2008. This concerns a new £30,000 surcharge that non-domiciles who have been resident for more than seven of the past nine years will have to pay, in addition to their remittance tax, should they choose to continue to pay by remittance. There is included in Appendix 1 a flow diagram which HMRC have provided as an aid to determining liability on this remittance based charge. Those primarily affected are individuals who are *resident, ordinarily resident* and *non-domiciled*. Domiciled and non-resident individuals will be unaffected by the remittance based charge.

In addition to placing a tax burden on remitted income, the new tax rules also provide for capital gains tax to be levied on overseas gains and foreign assets. Section 2.95 of the December budget report 2007 outlines exemptions from taxation, though these are mostly related to personal items which do not bring financial reward. U.K. assets held in offshore trusts will not be taxed under the new rules – provided the funds remain outside the U.K. Section 2.97 provides that offshore trusts shall be subject to the same rules as U.K. based trusts, and the government argues that this will not be a disincentive for individuals wishing to invest in the U.K. Until recently, non-domiciled workers in the U.K. could expect that

[5] Finney, M. *Non-Resident Trusts Posts FA 2008*, http://www.taxationweb.co.uk/tax-articles/capital-taxes/non-resident-trusts-post-fa-2008.html (last accessed 2nd September 2010).

their offshore funds would not attract a tax burden provided that they were not resident or ordinarily resident. Trust funds are not the only source of gains targeted by the new legislation. Assets are defined in the Tax of Chargeable Gains Act 1992 s21 (1) as being all kinds of property, and previously the rules of taxation concerning assets only affected individuals who were resident in the U.K. upon their disposal (s12)[6]. The latest changes in taxation widens the obligation and calls into question established principles of resident, ordinary resident and domicile.

4. Analysis and Criticisms

Consultation to the new rules listen in the December 2007 pre-budget report were canvassed, and these were raised in the March 2008 *Paying a Fairer Share* consultation document. Unsurprisingly, a number of concerns were raised; particularly vocal were the finance, higher education and arts sectors. These concerns were listed under four areas: the impact on competitiveness; removal of personal allowances; days counted towards residency, and the £30,000 remittance based charge.

Industry concerns about the impact on competitiveness are listed under sections 2.11 – 2.19 of the March 2008 consultation document. The financial sector raised two points: 1) that the very nature of non-domiciles makes them highly mobile and because of this mobility they may remove themselves from the U.K.; 2) as a direct result of this, the investment of foreign capital may become more limited. Concern marked in the higher education sector regarded non-domiciled workers as a substantial (20% of the workforce) and invaluable resource, and consequentially, the quality of teaching in higher education may suffer. Furthermore, the arts sector complained that the new rules may result in donors leaving the U.K. and presumably taking their donations with them. Thus, the overall anxiety expressed by the three sectors was concern about losing skilled workers and the consequences of this happening.

Sections 2.52 – 2.57 detail the concerns about the loss of personal allowances. Several issues were raised, but broadly relate to: concerns that low income non-domiciles will be punished by the new rules to the extent that they may not file a self-assessment tax return, fearing double taxation, and also because they may not understand the bureaucratic

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[6] See Morse G. & Williams D. (eds.) *Davies; Principles of Tax Law*, (London: Sweet & Maxwell, 2008) p243.

procedures of completing the forms; concern that the spouses of non-domiciles will have to fill in self-assessment returns even if they do not remit any foreign income or gains; and that employers will have difficulty complying with the new PAYE (Pay As You Earn) requirements for non-domiciled employees. Most of the objection to the changes in personal allowances seems to stem from possible confusion – individuals are reluctant to change from a system they know and understand.

Concerns about the changes to the days counted towards residency are listed in s2.62 – s2.70. Workers in the airline industry expressed a particular concern that days would be counted resident upon arriving in the U.K. even if it was for the sole purpose of commuting to work, before travelling to another destination. They also expressed the fear that this may result in them becoming resident, and that they would not be protected by double-taxation agreements, thus some crews may deliberately rest to avoid this scenario. Further, it was suggested by some business individuals that very short periods of time spent in the U.K. (especially for meetings) may be counted towards residency, resulting in them inadvertently acquiring residential status.

Lastly, in s2.22 – s2.36 the concern about the £30,000 remittance basis charge was raised. The chief concern was that the charge may punish middle-income families, and U.S. citizens in particular, as they would not get credit in the USA for tax paid in the U.K. Other concerns made related to the spouses of non-domiciled workers who may receive a tax bill after seven years, even though they have no U.K. based income.

In response to these concerns, the government raised a number of counter points. Regarding competitiveness, the response was to simply state that the U.K. would remain competitive place to live (as per s2.16 of the March 2008 consultation document), with respect to the new rules; in effect, nothing would change. Though previously, only remitted cash could be taxed, the government estimated that the new rules would only affect 113,000 remittance users per year. Appendix A lists the process by which the affected individuals would be decided. Nevertheless, the government did not acknowledge magnitude of the contribution that these individuals make to U.K. economy, and the effects of their departure may be considerable. Regarding the £30,000 charge, the government's response to this was to estimate that 90% of non-domiciled workers would not be affected by the charge; due to their mobile nature they would seldom stay in the U.K. beyond the seven-year respite. The government added in s2.58 that the current remittance sstem should not allow non-domiciles to continue 'to receive the double benefit of the remittance basis and personal allowance'.

However, a concession, or amendment was made regarding days counted to be resident due to complaints made by airline crews. To address this, the government stipulated that only individuals staying past midnight on any given day will have that day counted towards their period of residency (s2.71).

Seemingly, the government is pursuing a policy of closing what they regard as loopholes enabling individuals to escape their tax burden. The scope of the potential for increased revenue is documented in s2.17 of the December 2007 budget report, which ranges from an increased yield of £230 million in 2009-2010, but only £150 million in the year 2010 – 2011. The 30% decrease in revenue would seem to acknowledge that, initially, the new measures will result in some individuals leaving the U.K. This may be tacit confirmation that the argument put forward by the finance and educational sectors that skilled workers will be lost. Additionally, this large increase in revenue reflects the government's belief that many resident and ordinary resident (but non-domiciled) individuals are not contributing enough. Thus, there seems to be a concerted effort to make the process of taxation on individuals (whether domiciled or non-domiciled) more uniform. Having a uniform system of taxation would be advantageous politically because of increased transparency regarding domiciled citizens, and those who are ordinary resident, i.e. they enjoy the benefits of living in the U.K.

5. Final Thoughts and Conclusion

As of writing there is no case law testing the extent of the new rules. However, one of the most recent cases concerning domicile and residency, ***Gaines-Cooper v Revenue & Customs Comrs*** [2007] STC (SCD) 23, 9 ITLR 274 raises some suggestions as to how the courts may rule on cases involving residency and domicile. One point made was that 'residency' is now a question of fact, to be determined by HMRC; 'ordinary residence' implies some kind of continuity, as juxtaposed against a 'temporary purpose' which implies only a transient visit. In this respect, the courts have sought to clarify or narrow the meaning of terms relating to residency, and according to precedent (the decision in ***Gaines-Cooper*** was affirmed) they can be expected to be applied more strictly in the future. When considered together with the new tax rules concerning non-domiciles, the court's more confident application of the terms of domicile would seem to bode ill for non-domiciles wishing to reduce their tax burden. The new rules endeavour to level the playing field regarding the taxation of domiciled and non-domiciled residents by increasing the exposure of non-domiciles' income and gains to the U.K. taxation system, from which they were previously hidden (sometimes using s86 and 87 of the Taxation of Chargeable Gains Act 1992). Consequently, remittance based system will not be as easy for non-domiciled to exploit to reduce their tax burden. In this regard, the new system of taxation can be said to be fairer than the previous system, because all *residents* within the U.K. are treated more equally than they were. The system of remittance offered distinct advantages principally because it is difficult to track remitted funds; such a system is favourable for non-domiciles seeking tax avoidance. However, it could be argued that the new rules are unfair on non-domicile, because they increase the likelihood of no-domiciles suffering double taxation on their assets – that is to say their offshore assets may be taxed twice according to the tax rules of the U.K. and wherever the off-shore assets are based. This could make the U.K. a less attractive place to work, but probably more likely, will result in new workers not declaring taxable assets. Those who are already in the U.K., and especially those who have lived in the U.K. for more than seven years will be punished most heavily under the rules, and it is quite possible that long-term non-domiciles will have to reconsider their decision to work in the U.K. The impact this will have on the wider economy is difficult to ascertain at this stage; and until cases testing the new rules reach the courts, it is difficult to say how they will be enforced. Overall, the changes are necessary to show transparency in the system of tax for non-domiciles; indeed further simplification may be desirable. The £30,000 remittance charge is undeniably harsh on low to middle-income families, and perhaps a better way of modernising taxes would be desirable to abolish the system of remittance altogether, instead of giving individuals the opportunity of paying the remittance charge or subjecting their assets to income tax. Such a move is in effect, putting someone between a rock and a hard place, and also of 'punishing' people for investing themselves in the U.K. Because of this, the seven-year-rule does rather discourage individuals from making a long-term commitment to the U.K., which must be detrimental as these workers are highly skilled and have contributed greatly.

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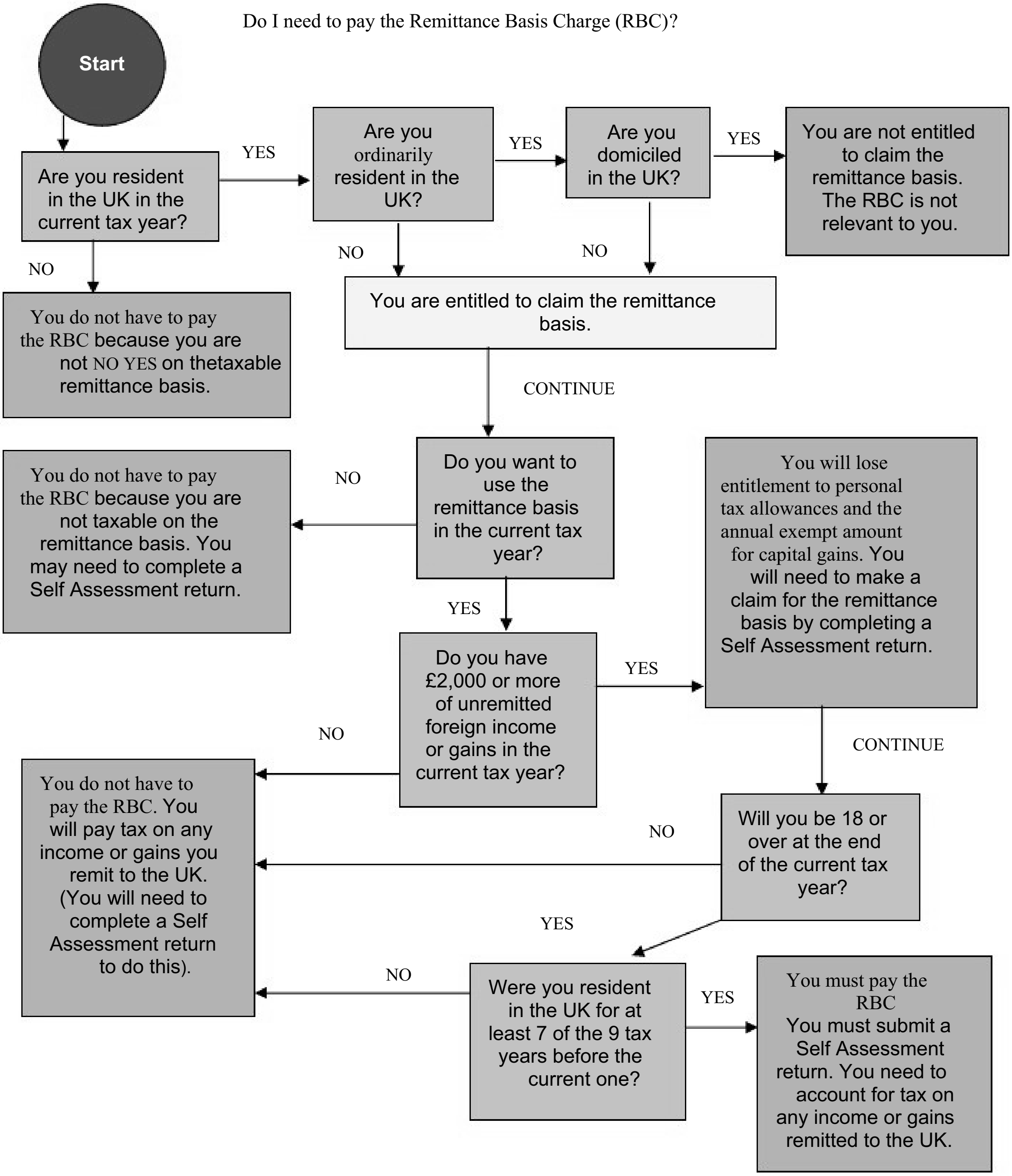
Do I need to pay the Remittance Basis Charge (RBC)?



Note: The flowchart is a broad guide to help you decide if you need to pay the RBC. You have a choice each year about whether to claim the remittance basis. If, in a particular year, it would be more beneficial for you to pay tax on your worldwide income and gains than to pay the RBC, you may choose not to claim the remittance basis.

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