

HR & Tax Alert



Quality In Everything We Do

United Kingdom – Government issues consultation document on reforming the residence and domicile rules

December 2007

Executive summary

On 9 October 2007, as part of its Pre-Budget Report (PBR), the Government announced plans to reform the current rules on residence and domicile. At the time, the Government stated that it would consult on its proposals. It has now issued its consultation document and this Alert summarises the key points.

The key proposals

Introduction of a £30,000 levy

At the time of the PBR, the Government announced that individuals who have been resident in the UK for more than seven years will be able to use the remittance basis of taxation only if they pay an additional tax charge of £30,000 per annum.

The consultation document explains that the Government's intention is that the levy will apply to anyone who has been resident in the UK for more than seven years out of the previous ten years. It also makes clear that an individual with less than £1,000 of unremitted foreign income **and** gains will not be subject to the additional charge. The press release with the PBR mentioned only a limit relating to unremitted income.

The Government has invited comments on this proposal as well as some additions and alternatives including:

- Introducing the new charge without a seven year grace period, perhaps at a lower rate, which the Government has suggested could be £25,000 per annum.

- An additional charge on individuals who have been resident in the UK for ten out of the previous twelve years. The Government has suggested that the higher charge could be set at £50,000. There is no suggestion that the £50,000 would be in addition to the £30,000.
- The possibility of placing an absolute limit on the length of time someone could benefit from the remittance basis. The Government has suggested using the current deemed domicile rule for inheritance tax purposes which would mean that individuals who have been resident in the UK for seventeen years out of the previous twenty years would no longer be able to benefit from the remittance basis and would, instead, be subject to UK tax on their worldwide income and gains on the arising basis.

Withdrawal of the personal allowance and annual exemption

Under current rules, anyone who is resident in the UK is entitled to a personal allowance for income tax purposes and an annual exemption for capital gains tax purposes. The personal allowance allows individuals to receive an amount of income on which no income tax is due (£5,225 for 2007/08). The annual exemption allows individuals to realise an amount of net chargeable gains on which no capital gains tax is paid (£9,200 for 2007/08).

At the time of the PBR, the Government announced that no individual will be able to use the remittance

basis as well as claim personal allowances unless their unremitted foreign income is less than £1,000.

It is now clear that the retention or loss of personal allowances and the annual exemption will go hand in hand so that an individual who wishes to use the remittance basis will be able to benefit from one or both only if their total unremitted income and gains is less than £1,000.

The Government has also made it clear that people will be able to opt between the remittance basis (with the loss of personal allowances and the annual exemption) and the arising basis (which will allow the individual to benefit from personal allowances and the annual exemption) on a year by year basis. This could present individuals with tax planning opportunities but the Government has made clear that it will address this possibility as part of a package of measures to close what it regards as “tax loopholes”. The Government has not made any alternative suggestions to this proposal.

Changes to the day count test for residence purposes

At the time of the PBR, the Government announced its intention of changing the way in which days of presence are counted for the purposes of the “183 day test” and the “91 day average test”. These are two of a number of tests which are applied to determine whether someone is resident for UK tax purposes. The 183 day test states that anyone who is present in the UK for 183 days or more in a UK tax year is tax resident for that year. The 91 day average test states that someone who spends an average of 91 days or more per annum in the UK over a four year period will be regarded as resident and ordinarily resident for UK tax purposes.

In applying the above two tests, HM Revenue & Customs’ (HMRC) practice has been to ignore days of arrival and departure. The Government’s intention is that days of arrival and departure will now count as full days of presence.

The consultation document compares the UK’s current practice to that of certain other countries around the world. The Government’s view is that the UK is out of step with many other countries and

regards its current practice as “increasingly anachronistic in an age of rapid modern transport”.

The Government has not made any alternative suggestion to this proposal, for example a move to a “present at midnight” test.

Ernst & Young’s response

The Government has invited comments by 28 February 2008. Ernst & Young will be submitting a comprehensive response to each of the above proposals. It is Ernst & Young’s view that the Government’s proposals will create a considerable degree of extra complexity to the tax affairs of internationally mobile employees. Whilst the possible imposition of a £30,000 levy has received much coverage in the press, the potential withdrawal of personal allowances and the annual exemption may also cause what the Government calls a “hassle factor”. The new proposal of introducing a £25,000 charge for new arrivals is surprising. Most tax regimes have particular tax benefits for temporary residents.

It is disappointing that HMRC has not taken the opportunity to simplify the rules for when someone can be regarded as “not ordinarily resident” although in the present climate employers and employees should perhaps be thankful that the remittance basis for overseas employment income will be allowed to continue, albeit at a cost.

While these changes are making the UK look less attractive to non domiciliaries, the Irish Government has simultaneously announced changes to their tax regime that makes Ireland more attractive to British Citizens. In future, British Citizens resident in Ireland will be able to gain the benefit of the remittance basis on UK employment and investment income. Citizens from other countries will continue to be able to enjoy the remittance basis undisturbed and indefinitely.

Taken together these changes to UK and Irish law represent a significant encouragement for individuals to move to or take up employment in Ireland rather than the UK. Employers with a high number of expatriate employees may consider relocating parts of their workforce to Ireland.

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