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United Kingdom *Special Report* – More Changes to Statutory Residence Test in Finance Bill 2013

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The introduction of a Statutory Residence Test (SRT) in the U.K. with effect from 6 April 2013, has been the subject of a number of previous reports in *Flash International Executive Alert*. Draft legislation was published in December 2012 (see *Flash International Executive Alert* 2012-226, 13 December 2012) and, following additional representations made to HM Revenue & Customs, further changes to the SRT have been incorporated in the legislation published today (28 March) as part of the Finance Bill 2013.[1] This *Flash international Executive Alert* examines these changes and the potential impact on employers with globally-mobile employees.

Background

Currently there is no single statutory test for residence in the United Kingdom. The extent of liability to U.K. tax on earnings depends on a person's residence status in the United Kingdom, but, to date, this has essentially been determined by case law. In June 2011, the government published a consultation document on SRT (see *Flash International Executive Alert* 2011-099, 20 June 2011), and a summary of responses to the original consultation and draft legislation was published on 21 June 2012 (see *Flash International Executive Alert* 2012-118, 21 June 2012). The draft legislation referred to above was then published and final legislation on the SRT is now included in the Finance Bill with further amendments.

Statutory Residence Test

The SRT will apply for the purposes of income tax, capital gains tax, and inheritance tax with effect from 6 April 2013 – i.e., the tax year 2013/14 (a U.K. tax year runs from 6 April to 5 April). It will not apply for U.K. social security (National Insurance Contributions (NICs)) or other non-tax purposes.

The overall structure of the SRT has not changed since the draft legislation was published in December 2012. There are, however, several changes to some of the individual tests in the final legislation.

Conclusive Tests on U.K. Residence

An individual will be regarded as **non-U.K. resident** if he or she meets one of five automatic overseas tests as follows:

- 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; or
- the individual was resident in the U.K. in one or more of the previous three tax years and is present in the U.K. for fewer than 16 days in the current tax year; or

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- the individual spends “sufficient hours” working overseas and he or she is present in the U.K. for fewer than 91 days in the tax year and fewer than 31 days are spent working in the United Kingdom. (**Note, this is the most significant change to the automatic overseas tests**).

An individual who does not meet any of the above tests will be regarded as **resident** in the U.K. when he or she meets one of the following U.K. tests:

- he or she is in the United Kingdom for 183 days in a U.K. tax year – a day in the U.K. for this test is a day where the individual is present in the U.K. at midnight; or
- he or she has a home in the U.K. for a period of more than 90 days (of which only 30 need to be in the current tax year) and is present at that home for at least 30 days during the tax year; or
- he or she spends “sufficient hours” working in the U.K., assessed over a 365-day period.

There are two further automatic overseas tests and one further automatic U.K. test if the taxpayer dies within the tax year.

If the above tests are not satisfied, then particular ties an individual may have with the U.K. and the number of days that the individual spends in the U.K. have to be considered.

Becoming U.K. Resident

If an individual is regarded as not resident in the U.K. for all of the three previous U.K. tax years, the particular ties to be considered are whether the individual has:

- a U.K. resident family (*family tie*);
- a substantive U.K. employment (including self-employment) (*work tie*);
- available accommodation in the U.K. *(accommodation tie*);
- spent 90 days or more in the U.K. in either of the previous two tax years (*90-day tie*).

The combination of the number of ties the individual has with the U.K. and the number of days the individual is in the U.K. determines whether the individual has become U.K. resident as shown in the table below.

Where non-U.K. resident throughout the previous three years

Days Spent in U.K.	**U.K. Ties**
<46	Always non-U.K. resident
46 to 90 days	4 ties makes you resident
91 to 120 days	3 ties makes you resident
121 to 182 days	2 ties makes you resident
>182 days	Always resident

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Determining Residence for Individuals Who Are U.K. Resident in One or More of the Previous Three Tax Years

When an individual has been U.K. resident in one or more of the previous three U.K. tax years, the ties to be considered are whether an individual:

- has a U.K. resident family (*family tie*);
- has a substantive U.K. employment (including self-employment) (*work tie*);
- has available accommodation in the U.K. *(accommodation tie*);
- has spent 90 days or more in the U.K. in either of the two previous tax years (*90-day tie*):
- spends more days in the U.K. in the current tax year than in any other single country (*country tie).*

These above-noted five "sufficient ties" tests are combined with day counting as shown in the table below.

Days Spent in U.K.	**U.K Ties**
<16	Always non U.K.-resident
16 to 45 days	4 ties makes you resident
46 to 90 days	3 ties makes you resident
91 to 120 days	2 ties makes you resident
121 to 182 days	1 tie makes you resident
>182 days	Always resident

"Sufficient Time" Working Overseas

The draft legislation included a "full-time work abroad" test which was defined as being in full-time work abroad for at least one tax year with days in the U.K. being less than 91 days, and the number of days working in the U.K. being less than 31 days. A day was counted as being a U.K. day if the individual was present in the U.K. at midnight. A working day was defined as a day on which more than three hours of work were performed.

The final legislation has replaced this test with one of working for "sufficient time" overseas. This is defined as working sufficient hours overseas for at least one tax year with days in the U.K. being less than 91 days, and the number of days working in the U.K. being less than 31 days. Again a day is counted as being a U.K. day if the individual is present in the U.K. at midnight. A working day is defined as a day on which more than three hours of work is performed.

KPMG Note: Full-Time Work Abroad Test to Sufficient Time Test

The change is in respect of how you calculate whether you were in full-time employment abroad compared to having sufficient hours worked abroad. The exact mechanics of this test are beyond the scope of this newsletter with very detailed rules contained within the legislation on how to determine whether the test is met (for example, specifying the use of 366 days rather than 365

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where 29 February is included). An employee who works 35 hours a week on average with 30 days in the U.K. could not have met the definition of full-time work abroad under the draft legislation. That employee could however meet the sufficient time test included in the final legislation. The change, although appearing complicated, is therefore likely to be beneficial.

Although the distinction between incidental and substantive duties is not relevant for the purposes of this test in the same way as it was not relevant for the full-time work abroad test in the draft legislation, the distinction remains important for the purposes of calculating the tax liability of the employee. When the employee is regarded as being non-U.K. resident, incidental duties will continue to be deemed to be performed offshore and only substantive U.K. duties are taxable.

KPMG Note

General Effect of Legislative Details on SRT

The level of detail included in the legislation brings added complexity to the SRT. However, the legislation has been designed to give an individual certainty when reviewing his or her residence status by giving precise instructions on the detail needed to perform the necessary calculations so that there is only one possible outcome. Following the confusion which has developed surrounding residency through the relevant case law in recent time, this certainty is to be welcomed.

It is also important to note that travel within the U.K. where the costs are borne by the employer will be regarded as a U.K. work-day where the journey takes more than three hours. This will be important for individuals who return more frequently to the U.K. and transit through one of the major transportation hubs to return to their home locations. Under previous rules, these days would not necessarily have been included when calculating the number of U.K. work-days and therefore individuals may find it harder to meet the limits on work-days included in the automatic overseas tests.

The legislation also contains provisions relating to days spent in the U.K. due to exceptional circumstances which prevent the individual leaving the United Kingdom. This is limited to a maximum number of 60 days. No circumstances such as emergency evacuations back to the U.K. appear to be included and the stated view of the U.K. tax authority, HMRC, has been that this will usually only apply to events that occur while an individual is in the United Kingdom and which prevent that individual from leaving the United Kingdom. This leaves open the possibility of particular statements and easements being issued when there are situations such as war abroad resulting in individuals being evacuated to the United Kingdom.

"Sufficient Time" Working in the U.K.

As with the test for full-time work overseas, the draft legislation proposed that an individual should be treated as working full-time in the U.K. where over 75 percent of the days worked are days worked in the U.K. over a 365-day period. This test has been changed with a formula introduced to determine whether an individual has spent "sufficient time" working in the U.K. over that 365-day period. Again, the scope of the calculations are beyond that of this newsletter, but the provisions are very detailed in order to foster the individual's certainty over his or her residence position.

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KPMG Note (cont'd)

A change in these proposals ensures that the 75-percent test applies to the 365-day period and not to the days in the tax year concerned. Under the original draft, the 75-percent test appeared to apply to the work-days in the year and, as a consequence, couldn't apply to assignees who arrived in the last quarter of the tax year.

Split Years

Under current U.K. tax rules, an individual is either resident or non-resident in the U.K. for the whole tax year. However, under Extra Statutory Concession (ESC) A11, when an individual arrives in or leaves the U.K. part way through the tax year, the taxpayer has the option of splitting the tax year into periods of residence and non-residence in certain circumstances.

As part of the SRT, the split-years are incorporated into statute.

The tax year will be split when a person:

- becomes resident in the U.K. by virtue of his or her only home being in the U.K.;
- becomes resident by starting full-time employment in the U.K. and working for sufficient hours during a period of 365 days;
- establishes his or her only home in a country outside the U.K. and satisfies the condition that within six months of ceasing to hold any U.K. property, the individual's ties are to that overseas country and not with the U.K.;
- loses U.K. residence by satisfying the overseas work criteria;
- establishes his or her only home in the U.K.;
- ceases working full-time abroad and becomes resident.

In the year of departure, the number of working days permitted will be pro-rated down from the 30 days permitted for a full tax year. Similarly, the number of days of presence will be pro-rated from the 90 days for a full tax year.

The legislation has also put on a statutory footing, the concession that split-year treatment can also apply to a spouse or partner who accompanies his or her spouse or partner on assignment.

KPMG Note

Again, the legislation provides a high level of detail relating to the various situations in which split-year treatment is available. Although these do add complexity to the draft legislation, they result from the desire to achieve certainty.

Under the SRT, the individual is resident for the whole tax year, even when the split-year treatment applies. The individual's tax liability for the overseas part of the year is, however, calculated as though he or she were non-resident during the period.

It is worth noting, that the legislation does not specifically state that the tax year is split at the time the individual leaves or arrives in the United Kingdom. In many cases, that will be the result, but it

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KPMG Note (cont'd)

should not be assumed to be so. It is possible to become non-U.K. resident before actually leaving the U.K. and become resident before returning. Care should be taken when looking at the split-year rules and assessing this point.

Ordinary Residence

In addition to the concept of residence for tax purposes, the U.K. presently has a separate concept of "ordinary residence." Again, there is no statutory definition of this for tax purposes. Currently, ordinary residence signifies that residence in the United Kingdom:

- is for a settled purpose;
- forms part of the regular and habitual mode of the individual's life;
- arises further to the individual coming to the U.K. voluntarily (but the fact that an individual has been sent to the U.K. by his or her employer does not make the individual's presence involuntary).

Individuals can be regarded as U.K. resident and ordinarily resident (ROR) or U.K. resident but not ordinarily resident (RNOR). The distinction is important because, with one exception (non-U.K.-domiciled employees of a non-U.K.-resident employer where there are no U.K. duties and no earnings are remitted to the U.K.), ROR employees are taxable on their worldwide earnings whether remitted to the U.K. or not. RNOR employees are also taxable on their earnings for U.K. duties whether they are remitted to the U.K. or not. Such employees, however, can elect for the remittance basis, and then their earnings for non-U.K. duties are only taxed in the United Kingdom if remitted to the United Kingdom. This is commonly referred to as "overseas work-days relief" (OWR).

The Finance Bill legislation abolishes the concept of ordinary residence for tax purposes and introduces a new OWR (which we intend to further discuss in a later *Flash International Executive Alert*).

International Transportation Workers

As mentioned previously, the SRT rules have been modified for international transportation workers. This term is no longer defined in the legislation. Instead these employments are referred to as "Relevant jobs on board vehicles, aircraft or ships." If you think these rules will apply to you or to your employees, please speak to your usual professional tax adviser.

KPMG Note

While the extra level of detail in the legislation adds to the complexity of the SRT, the legislation has been designed to provide certainty wherever possible. A number of the tests appear similar to common practices, but they differ in the detail. Globally-mobile employees and their employers will need to be aware of all the changes and understand how they will be impacted. Particular care will be needed with the concept of split years and when qualifying for non-residence on the basis of meeting the "overseas work criteria."

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Footnote:

1 See: http://www.publications.parliament.uk/pa/bills/cbill/2012-2013/0154/13154.pdf .

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Your Assignment Abroad: 50 Most Common Concerns **– Back by Popular Demand!**

Should I sell my home?

What is COLA?

What is tax equalization?

Whether it is during a pre-assignment orientation or a tax counseling session, international assignees have many questions. Our time with them is limited and there is a lot of information to remember. The 'new & improved' "**Your Assignment Abroad: 50 Most Common Concerns"** booklet, prepared and published by KPMG, provides an easy-to-read guide for assignees and program managers and addresses key assignment-related questions.

The booklet aims to explain the basic questions when going on international assignment. It is a favorite among program managers for orientations and counseling sessions.

If you would like a copy, please contact your local KPMG professional or Alison Shipitofsky at ashiptofsky@kpmg.com.

The information contained in this newsletter was submitted by the KPMG International member firm in the United Kingdom. The information contained herein is of a general nature and based on authorities that are subject to change. Applicability of the information to specific situations should be determined through consultation with your tax adviser.

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