

# Lights out?

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In the run up to the 1992 General Election, *The Sun* famously asked, "Will the last person to leave Britain please turn out the lights?" Similar sentiments were widely voiced by the UK resident non-domiciled community (non-doms) and their advisers after the announcement of the changes to residence and the taxation of remittances in the December 2007 Pre-Budget Report, enacted in an amended form in Finance Act 2008. Twenty months on, and with additional changes on the way, have the lights gone out in the homes of non-doms around the country, or are they still burning brightly?

## Changes affecting non doms

There have been many articles written over recent months discussing the nature of the changes in UK tax legislation which affect non-dom UK residents. The following changes have particularly attracted the attention of the UK's mobile and wealthy non-dom taxpayers:

### Finance Act 2008 (FA 2008)

FA 2008 introduced significant changes to the operation of the remittance basis of taxation, applying from 6 April 2008. From that date, non-dom individuals who have been resident in the UK for 7 out of the last 9 tax years will need to pay an annual £30,000 flat tax charge in order to qualify to be taxed in the UK on their foreign income and gains only when they remit them.

They also have to give up their entitlement to annual exemptions and allowances. Short term residents do not need to pay the £30,000 charge, but they must generally make an election for the remittance basis to apply and lose their exemptions and allowances.

The definition of a remittance has also been substantially extended. The new definition is generally reasonable in principle, but in many cases it is tortuous to apply to a specific set of facts, can result in significant uncertainties, and can allow the actions of one person to create a tax charge on another without the latter's consent, or even knowledge.

FA 2008 introduced a new "midnight" test for determining the number of days spent in the UK, although there is still no clear statutory framework for determining residence beyond the 183 day presence test.

Following the publication of the 2007 Pre-Budget Report, HMRC showed a welcome willingness to engage positively and discuss the proposals with interested parties, such as the Chartered Institute of Taxation. As a result, some of the most worrying of the changes initially announced, (for example, the extension of s86 TCGA 1992 to non-dom settlors of trusts), were withdrawn, and others were amended. Nevertheless, those changes that remained did significantly affect the tax position of non-doms.

## IR20

At around the same time as FA 2008, HMRC controversially withdrew its long standing guidance on residence set out in IR20. This was accompanied by a series of court cases, including *Grace*, *Shepherd*, and *Genovese*, in which HMRC refused to be bound by its own guidance.

HMRC has made it clear from the outset that HMRC6, issued as a replacement for IR20, does not have legal effect, and cannot be relied upon in any particular case. This has the benefit of preventing individuals from taking false comfort from what are intended only to be general guidelines, but the downside is that it forces taxpayers to try to determine their UK residence status on the basis of a patchwork of court cases, some of which are more than 100 years old, and most of which were decided in a period when even the richest and most cosmopolitan individuals were much less internationally mobile than many are today.

In the more recent cases of *Gaines-Cooper* (2008) and *Grace* (2009), the taxpayers claimed that they had ceased to be UK resident, but the Court held in each case that they had failed to demonstrate that they had severed all connections with the UK, and therefore ruled that they remained resident here. HMRC6 states that issues such as continuing connections with the UK will now be taken into account when considering whether an individual falls into the category of non-UK resident, and individuals must prove their intent to 'leave the UK permanently or indefinitely'.

The change to the method of counting days for the purposes of the 90 day residence rule means that it is also now much more difficult to live outside the UK and travel back here for business or family reasons without becoming UK resident. 'Frequent flyers' will have to watch very carefully the number of visits they make to the UK.

No longer is it possible to emulate the approach of wealthy entrepreneurs such as *Stelios Haji-Ioannou* and *Philip Green*, who previously made their home in Monaco and flew back to the UK every week to run their businesses!

The practical implications for those who wish to be treated as non-UK resident are significant. How do they prove their intent to leave the UK permanently or indefinitely? They may need to take their children out of school and relocate them. They certainly need to acquire a home in their new country of residence, and possibly sell or let their UK house on a long term basis. They must consider giving up membership of

all UK clubs and societies, and, if at all possible, they should not come back to the UK at all in the first year. They definitely now need to seek advice from an expert personal tax adviser well in advance of any move.

## Finance Act 2009 (FA 2009)

The future changes to income tax introduced by FA 2009 have indirectly added to the concerns of wealthy non-doms. From April 2010, the UK will join Austria, Belgium, the Netherlands and Scandinavian countries, as the only European countries to impose a maximum income tax rate of 50% or more. The restriction of tax relief on pension contributions for taxpayers with an income of over £150,000 is also likely to have a disproportionate impact on non-doms.

## How have non-doms reacted?

The psychological effects of these changes on UK resident non-doms have been very significant. As a firm with a large number of City based non dom clients, we have seen a substantial movement of short term residents away from the UK in recent months. There is no single reason for this decision to leave the UK, but some themes recur regularly in our clients' thinking.

For individuals who have not developed deep ties with the UK, the recession has had an undeniable impact. Many newly redundant bankers have decided to leave London to try their luck elsewhere, rather than stay put and look for a new job in the UK, where until very recently prospects for high salaries and big bonuses have appeared limited.

The draconian nature of the original proposals in the 2007 Pre-Budget Report caused some clients a great deal of concern. In its aftermath, we witnessed a stampede of advisers coming to the UK to extol the virtues of competing tax jurisdictions. Many practitioners and clients have, for example, been invited to seminars extolling the joys of living in Switzerland!

Even after HMRC responded to the concerns of practitioners by moderating the proposals, clients were left feeling deeply nervous about further possible changes in legislation. Some of our clients are convinced that it is only a matter of time before a UK government, desperate to raise more revenues, will revisit the basis on which non-doms are taxed.

Although we have been able to pass on the Government's reassurance that the £30,000 annual charge will not be increased during the current

Parliament, clients are sceptical about how long this will continue after the election. In addition, having seen HMRC apparently renege on its long established approach to residence as set out in IR20, clients are concerned that if they do not leave the UK now, HMRC might move to challenge other areas retrospectively in the future. "What's to stop HMRC from changing its mind about how 'domicile' is defined?" is not an uncommon question.

Furthermore, the introduction of the 50% tax rate significantly reduces the fiscal advantages of working in the UK. Contrary to the oft presented picture of non-dom high earners, most of our clients have been perfectly content to pay tax on all of their UK earnings, and have not entered into any form of tax planning more exotic than maximising pension contributions. A common refrain amongst these clients is the feeling that, whereas they are happy to pay a substantial amount of tax on their earnings, losing more than half of their pay in tax and national insurance is not acceptable.

The reaction of short term residents is not particularly surprising. Such people are typically young and often single. Their skills are internationally transferable, and they relish the adventure that a new job and new location can bring. What has been much more unexpected to us is the increase in the number of clients who have spent much of their lives in the UK, who have married and had families here and who had previously intended to remain here for the foreseeable future, who are now seriously thinking about changing their residence. For these individuals, the 50% tax rate and the £30,000 annual remittance "fee" have made the UK suddenly feel like a high tax country.

The lights are certainly starting to go out, but we haven't yet been plunged into total darkness – let's hope that this is not to come!

