

Residence & Domicile 2020/2021

Residency and domicile is a complex subject but in R03 you are only likely to get three questions and will only be expected to understand the basics.

- HMRC will always seek to tax any **income** arising in the UK regardless of where someone lives.
- An individual's residency and domicile status determines their UK tax liability on overseas income and gains.

For tax purposes individuals will either be:

- UK resident and UK Domicile
- UK resident and non-UK Domicile
- Non-UK resident and UK Domicile
- Non-UK resident and non-UK Domicile

The majority of questions in the exam will be based on individuals who are UK resident and domicile.

- Residency status can change from one tax year to another and is primarily based on the time someone spends in the UK each tax year and/or whether they work full time in the UK.
- Domicile status tends to be long term and difficult to change. For exam purposes someone who sees the UK as their long term home would be considered to be UK domicile.

Practical impact: Income Tax

Individuals who are **UK resident and domicile** will be taxed on income **no matter where it arises in the world**. This is called the arising or accrual basis.

Paul is UK resident and domicile. He has a cottage in Spain which he rents out. The profits from this will be subject to UK tax

Non-domiciles can elect to pay tax on the **remittance basis** and only pay tax on overseas income if it is sent to the UK.

Pavel works in the UK and is classed as **resident but non domicile**. He has a flat in Warsaw that he lets out. By electing to go on to the remittance basis he pays UK income tax on his salary but no UK tax on the rental profits provided these aren't remitted to the UK.

Igor is a Russian musician who does a short tour of concerts in the UK. He will probably be classed as **non-resident and non-domicile**. He will be liable to pay UK income tax on these earnings.

The final category is **non-resident but domicile** which usually applies to UK nationals who work outside the UK

Jack moved from the UK to live and work in the USA. He has substantial investments in the UK.

He will not pay UK tax on his US income but will have to pay UK on the investment income.

Let's summarise what we've done so far.

Tax status	Payment basis	Impact
Resident and domicile	Arising	Liable to UK tax on worldwide income
Resident and non-domicile	Remittance	Not liable to tax on overseas income
Non resident, UK domicile		Only liable to tax on UK income
Non resident, non domicile		Only liable to tax on UK income

Different countries may seek to tax the same income. In the first example Paul has income arising in Spain and being both resident and domicile the profits are liable to UK income tax. However the Spanish tax authorities may also want to tax this.

This is a very complex area and outside the scope of R03 but you should be aware of the following:

- The UK has tax treaties with most other countries that sets out which jurisdiction the income will come under. As a very general rule:
- Income from employment will be taxed in the country where the work takes place
- For UK domiciles, non-employment or investment income will be taxed in the UK but credit given for any tax deducted or paid in the country where the investment is located.
- Non-domiciles will not incur UK tax on income arising outside the UK unless remitted to the UK

Practical Impact: CGT

Individuals who are **UK resident and domicile** are liable to pay CGT on **UK and worldwide gains**.

A person who is **resident but non-domicile** will be liable for CGT on **gains on UK assets**. If they have elected to be taxed on the remittance basis they will only pay UK CGT on overseas gains if remitted to the UK.

Non-resident Individuals are not liable for CGT on UK based assets except for gains on **UK residential property** sold or disposed after 6 April 2015.

The base cost for calculating the gain will be the value at 6 April 2015 or acquisition value if purchased after that date. The gain will be calculated in the normal way and the rates will be 18% and 28%. The annual exemption will also be available.

There is also specific anti-avoidance legislation to prevent individuals avoiding UK CGT by becoming non-resident for a short period and realising gains whilst non-resident.

This will apply if:

- The assets sold were owned when the individual became non-resident.
- They were UK resident for 4 of the last 7 tax years
- The period of non-residence is less than five years.

This is termed **temporary non-residence**. The five years is five calendar years plus 1 day, for example May 4 2015 to May 4 2020.

If they return to the UK within the five years the gain will be taxable in the year of return without the benefit of the annual exemption.

Practical impact: IHT

The general rule is that:

- Individuals with UK domicile are liable for IHT on assets held anywhere in the world.
- Individuals with non-UK domicile are only liable on their UK assets.

Lifetime transfers to a non-domiciled spouse/CP

Lifetime transfers to a non domiciled spouse are only exempt on the first £325,000. The logic of this is that as the overseas assets of a non-domiciled spouse a UK domiciled individual could transfer property to their non-domicile spouse who would then transfer it overseas. It would then escape IHT completely.

There are two key points about this £325,000 limit.

- It applies to both lifetime gifts and transfers on death.
- It is a lifetime allowance.

Jack is UK domicile and gifts £400K to his non domiciled spouse, Veronique.

Assuming no previous gifts were made, £6,000 will be exempt under annual exemption and £325,000 under non-domiciled spouse's exemption. This gives a total of £331,000 and the balance of £59,000 is a PET

If Jack dies 10 years later and leaves everything to Veronique, there is no spousal exemption and everything above the Nil Rate Band will be chargeable at 40%

Determining Residency and Domicile Status

Residency

Since 6 April 2013 there has been a **Statutory Residence Test (SRT)** that determines an individual's status for that tax year. Time spent in the UK is the key factor but other factors will also be taken into consideration. These include whether the individual:

- has a home in the UK .
- was previously resident in the UK in the last three tax years
- is working in the UK
- has other close ties to the UK

A tax year can be split so an individual is resident for one part and non-resident for the other.

HMRC follow a three stage process to determine an individual's residency status.

The first stage is to establish whether a person is **non-resident** by applying the **automatic overseas tests**. If one of these is met the individual is non-resident status and no further action is necessary.

If an individual doesn't meet these tests then a series of **automatic UK tests** are applied. If one of these is met the individual is **resident** and that is the end of the process.

Should neither of these tests are passed then residency status is determined by what are termed **sufficient ties** tests.

Automatic Overseas Tests

An individual will be non-resident if they meet **one** of these automatic overseas tests

- If they were resident in one of the three previous tax years and spend fewer than **16 days** in the UK (First overseas test)

- If they were non-resident in the three previous tax years and spend fewer than **45 days** in the UK. (Second overseas test)
- They work full time outside the UK with no significant breaks.

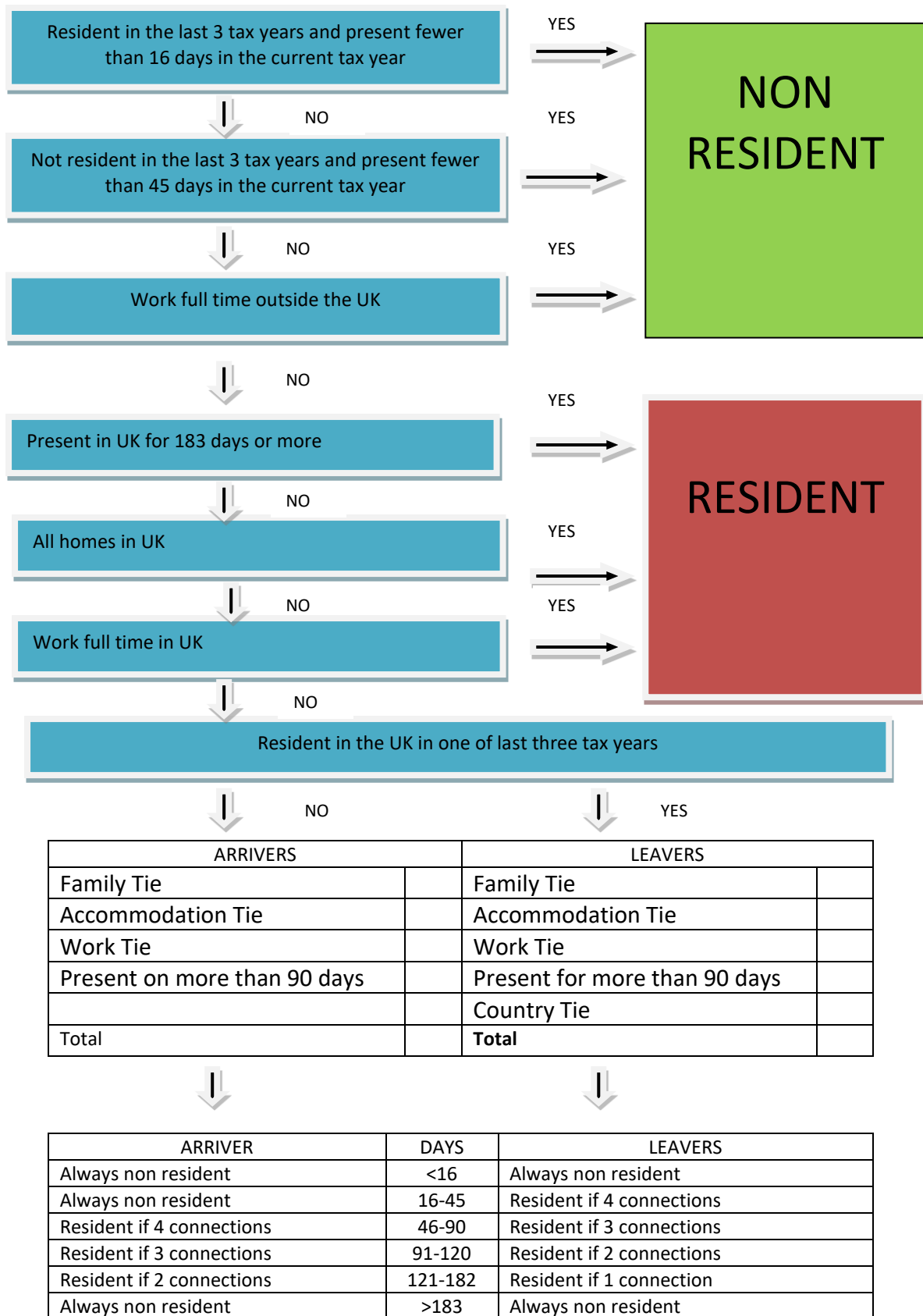
Automatic UK Tests

An individual will be resident for that year if they meet one of these automatic residence tests

- They spend **183 days** or more in the UK (First UK test)
- They have only one home and that home is in the UK or if you have two or more homes all those homes are in the UK (Second UK test)
- You work full time in the UK with no significant breaks. (Third UK test)

If their residency status cannot be established by these tests, HMRC will then consider what ties the individual has with the UK.

A full flow chart is shown on the next page



Domicile

Domicile is a more nebulous concept than residency and is based on common law rather than statute. Residency is determined by the statutory residency tests and can vary year to year. An individual's domicile is what might be considered their "homeland" and usually remains the same through their life. It is not the same as being a UK citizen as it is possible to be born in the UK and live here permanently and still not have UK domicile.

There are four ways of acquiring UK domicile:

- Domicile of origin
- Domicile of dependency
- Domicile of choice
- Deemed domicile

Domicile of origin is taken at birth and is determined by the country of birth of the father. A baby born anywhere in the world to a British born father and American mother will have UK domicile. If the father was American and the mother British, the child would not have UK domicile of origin. If there was no father alive at the time of birth they take the domicile of their mother

Domicile of dependency is the status of a child born to UK domicile father. At 16 they may under certain circumstances be able to elect to become non-domicile at 16.

Jack was born in the UK to a UK domicile father. When he was five, the family moved to the USA. Jack considers the US to be his permanent home and has no contact with the UK so at 16 he elects to become non-domicile.

Conversely Faisal's father was born in Pakistan but Faisal now considers the UK his permanent home and at 16 becomes UK domicile. (Domicile of choice)

Deemed Domicile

Until recently a non-domicile could keep that status indefinitely even if they lived permanently in the UK. This made the UK a tax haven for the world's ultra-wealthy. They could be UK resident but as non-domiciles using the remittance basis they wouldn't be liable to tax on non UK income.

This is no longer possible since once an individual has been UK resident for 15 tax years out of the past 20, they will be treated as **Deemed Domicile**. This means they cannot use the remittance basis and are liable to UK tax on their worldwide income.

Jose has been continuously resident in the UK since 2004/2005 and has kept his non-domicile status. From 2019/2020 he will be deemed domicile.

Individuals who have become deemed domicile under the 15/20 would have to be non-resident for 6 tax years before resetting the clock under this rule.

The Remittance Basis Charge

Once a non-domicile becomes resident they can elect to pay tax on the remittance basis without paying any charge.

Once they have been resident for **seven out of the last nine tax years**, they will be taxed on the arising basis unless they pay an annual **Remittance Basis Charge (RBC) of £30,000**. They will also lose their income tax Personal Allowance and CGT annual exemption. If foreign income and/or gains are less than £2,000 in a tax year the remittance basis can be used without paying the RBC.

Leora is non-UK domicile but is UK resident. She works in the UK and pays tax under PAYE. She has a deposit account with a bank in Jersey which pays £500 a year interest.

Provided she does not bring it into the UK she can use the RB and no UK tax will be charged.

The RBC is increased to £60,000 if they are resident for **twelve out of the last fourteen years**.

Once an individual has been resident for **fifteen out of the last twenty years** they become deemed domicile and cannot claim the remittance basis.

In practice this is an extremely complicated subject but for the exam you just need to be aware that after being resident for 15 out of the last 20 years individuals become deemed domicile and are taxed on the arising basis.

Having paid the RBC, you can offset this against tax due on any income remitted to the UK.

Losing UK domicile.

Individuals who had UK domicile of origin can become non-domicile but this is only likely to be accepted by HMRC if there is evidence that all their ties with the UK have been broken. This would be evidenced by:

- Setting up home in the new country
- Selling any UK property
- Breaking all ties with the UK
- Working or establishing a business in the new country
- Taking citizenship/acquiring voting rights in the new country
- Setting up a business
- Effecting a will in the new country.

Even if HMRC accept the individual is non-domicile, they will immediately be treated as being UK domicile should they become resident at some time in the future. Individuals in this situation are termed **Former Domiciled Residents (FDR)**.

Deemed domicile and IHT liability

The 15/20 rule applies to IHT so once an individual becomes deemed domicile they will be liable to IHT on worldwide assets. There is one slight difference for IHT. If an individual becomes deemed domicile they can lose this **for IHT only** by becoming non-resident for four tax years.

Veronique became deemed domicile in 2014/15. If she becomes non-resident in 2018/19 from 2022/23 she will only be liable for IHT on UK assets. If she becomes resident in 2023/24 she will again be liable to IHT on worldwide assets.

She would have to be non-resident for six tax years to reset the clock and start a new 15/20 period.

An FDR becomes deemed domicile in the tax year they become resident but this rule is eased slightly for IHT. They will be allowed to return for a limited period without affecting their domicile for IHT purposes. This is up to the end of the first tax year in which residence is re-established provided they have been non-resident for the two previous years.

Isaac is an FDR who now lives in Israel and is non-domicile. On July 1 2018 he returns to the UK as his father had become seriously ill. He remains until May 1 2019 when he returns to Israel. He would not be deemed domicile for IHT in 2018/19, under the “period of grace” and 2019/20 as he would be non-resident under the Statutory Residence Test.

If Isaac was resident in the UK for more than 183 days in 2019/20 he would be deemed domicile and subject to IHT on worldwide assets. If he leaves in early 2020 he will lose his deemed domicile in 2020/21, that is the year after he loses his residential status.