SQUIRE SANDERS | LEGAL COUNSEL WORLDWIDE

UNITED KINGDOM TAX BULLETIN

Squire, Sanders & Dempsey

February 2010

Special Residence Edition

Two cases decided this month are of such importance, and have made so many headlines, that this month's Bulletin is devoted to the subjects of Residence and Ordinary Residence.

Residence

The Court of Appeal have now published their judgment in the case of *Gaines-Cooper v HMRC.* The decision has a number of interesting features relating to the application of the HMRC booklet IR20. This is of major significance to anybody seeking to leave the UK to become non-resident, and the important elements are explained in detail in this Bulletin.

Ordinary Residence

The Tax Tribunal has published their decision in the case of *Tuczka v HMRC,* and this is no less significant in relation to the tax treatment of people coming to work in the UK. Again, the important elements are explained in detail in this Bulletin.

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CURRENT RATES — February 2010

Indexation

Retail price index: January 2010	217.9
Inflation rate: January 2010	3.7%

Indexation factor from March 1982:

to April 1998	1.047
to January 2010	1.743

Interest on Overdue Tax

Interest on all unpaid tax is now charged at the same rate with effect from 29 September.

The formula is Bank base rate plus 2.5% which gives a present rate of 3%.

There is one exemption: Quarterly instalments of corporation tax bear interest at only 1.5%.

Repayment Supplement

Interest on all overpaid tax is now payable at the same rate.

The formula is Bank base rate minus 1% but with an overriding minimum of 0.5% which applies at the present time.

Official Rate of Interest: From 1 March 2009 4.75%

Gaines-Cooper v HMRC

Last week the Court of Appeal dismissed Mr Gaines-Cooper's application for Judicial Review of the refusal by HMRC to treat him as not resident in the UK. This has caused considerable anxiety because of the uncertainty which has been created around this whole subject – which has been exacerbated by the case of *Tuczka v HMRC,* referred to below. It would be difficult to have missed the press coverage.

We were the advisors to Mr Gaines-Cooper in this case, and I am authorised to speak freely about it – and about some of the matters which have not appeared in the press reports.

Contrary to some of the articles, this case is not about domicile. It is all about Residence and the application of the HMRC practice set out in their (in)famous booklet IR20.

When Mr Gaines-Cooper left the UK in 1976, he took the trouble to satisfy the precise requirements of the Revenue practice set out in IR20. This says that if you leave the UK permanently or for at least three years, you will be treated as not resident providing you do not visit the UK for more than 183 days in any tax year, or for an average of more than 90 days each year. Mr Gaines-Cooper satisfied these requirements and expected HMRC to honour their statements in IR20 and treat him as being non-resident.

HMRC consistently argued that they were not bound by IR20 and that the taxpayer could not expect to rely on it; it gave rise to no legitimate expectation which could support an application for Judicial Review. IR20 was merely guidance – but HMRC were never able to explain what purpose is served by issuing guidance which they can disregard if they feel like it.

The Court of Appeal gave such short shrift to these arguments that HMRC changed their stance completely and issued a new skeleton argument saying that of course they were bound by IR20 and other statements of practice. This climb down did not protect them from judicial criticism for suggesting otherwise – nor for their attempts to prevent the Judicial Review even being heard in the first place. This had resulted in criticism during the course of the hearing and an order for costs against HMRC. To put the matter beyond doubt, the Court of Appeal specifically confirmed that where HMRC has given an assurance that they will treat the taxpayer in accordance with the terms of its guidance, they will not be permitted to resile from that assurance – although of course they can change it for the future. Furthermore, the Court of Appeal confirmed that it was plainly within

the Revenue's power to provide guidance about how they propose to deal with taxpayers in various circumstances.

HMRC had another argument. Although they were of course bound by IR20, Mr Gaines-Cooper did not satisfy its terms. This came as a surprise to Mr Gaines-Cooper (and everybody else) because he clearly did satisfy its terms. No, no, said HMRC. There is one term you did not satisfy – you did not make a distinct break with the UK and sever all social and family ties with the UK.

It is obviously fair and reasonable for HMRC to say that you can only get the benefit of IR20 if you satisfy all its conditions. However, the condition which HMRC said was not satisfied did not appear in IR20 at all. No matter, claimed HMRC; this condition can be implied. This naturally upset Mr Gaines-Cooper, who said: If you had told me that's what I should do then I would have done it. You cannot impose this condition now and apply it retrospectively for decades – that is just not fair. How could anybody expect that such a fundamental condition as the severing of all family and social ties could be something which does not even have to be mentioned – it can be implied. However, the Court of Appeal agreed with HMRC, deciding that this was not only a reasonable interpretation which HMRC were entitled to adopt, but it was the correct construction of IR20.

So Mr Gaines-Cooper lost his appeal because he should have known that within IR20 there was an implied condition which he also needed to satisfy. He should have severed all social and family ties with the UK. However, this seems altogether too simple. A taxpayer is entitled to know what this means. How many days can I spend in the UK? My mother lives in the UK – does she have to move abroad too? Can I come to the Lords Test or the Wimbledon Finals? Can I come back to the UK for a wedding or a funeral? Who knows? These are all social and family ties, so they must be fatal to any claim to have become non-resident. Surely they are too trivial. Maybe so, but if they are too trivial, then it is the degree to which family and social ties have been severed which is crucial. So not only do we have to know that there is a condition which needs to be implied, we also need to know the precise degree of severance which is necessary – and that must be implied as well.

I do not know what the ordinary taxpayer (or his advisors) are supposed to make of all this. I know what the man on the Clapham omnibus would say.

Nobody has any problems with HMRC changing their practice – that is their undoubted right. The complaint is when they try to apply such a change retrospectively. It was an important part of the

case of Mr Gaines-Cooper that this requirement represented a change of practice which was being retrospectively imposed.

During the course of the hearing, the Court of Appeal drew attention to the spontaneous eruption from the professional tax community regarding the approach HMRC had adopted in respect of Mr Gaines-Cooper. Numerous articles were published highlighting this change of practice. Professional tax advisors knew that to establish non-residence you had to leave the UK and not come back for more than 90 days each year. If you did that, you satisfied IR20 and HMRC gave you a non-resident ruling. Such rulings diminished after 1997 and the introduction of self assessment because there was no longer any requirement for HMRC to give a ruling, but that remained the understanding of the profession – and this understanding was even supported by correspondence from HMRC (interestingly contained in the HMRC witness statements). However, the Court of Appeal took the view that it was unlikely that HMRC would have adopted a clandestine change of interpretation and HMRC were able to explain this all away by saying that this "flurry in the hen coop" was merely a response to a closer and more rigorous scrutiny of claims to non-residence.

It will clearly take further litigation or some firm and specific guidance before taxpayers can have anything like the clarity about their tax affairs to which they are entitled. In 1936 the Income Tax Codification Committee said that state of the law on this subject was intolerable and should not be allowed to continue. Unfortunately, the 35 years of comparative stability provided by IR20 has now been blown away by HMRC, and we are back to a state of intolerable uncertainty – and to make it worse, we have self assessment placing the responsibility for accuracy on the taxpayer.

Leave has been sought by Mr Gaines-Cooper for an appeal to the Supreme Court.

Leaving for Employment Abroad

There was one helpful clarification which did emerge from the appeal – not in respect of Mr Gaines-Cooper but in the joined appeal of *Davies & James v HMRC* which was heard at the same time. The taxpayer was claiming to have become non-resident because he had left the UK for full-time work abroad. This gives rise to a different set of conditions within IR20. If somebody leaves the UK to work full time abroad under a contract of employment, their absence from the UK and the employment abroad both last for at least a whole tax year, and they do not come back to the UK for more than 90 days a year, they will be treated as not resident.

But what is the difference here? That is exactly what Mr Gaines-Cooper did, but he had an implied condition imposed upon him. HMRC say there is no implied condition where somebody goes to work full time abroad. Working full time abroad is by definition (in their view) making a distinct break, and you do not have to satisfy anything else. There is no need to sever any social or family ties – you just have to be working full time abroad.

It is extremely difficult to understand that when paragraph 2.8 says "if you have left the UK permanently or for at least three years" it carries an implied term that you must sever all social and family ties within the UK. But in paragraph 2.2, where it says "if you leave the UK to work full time abroad", there no such implication.

Nevertheless it will be of considerable comfort to those seeking to become non-resident on the basis of full-time foreign employment. However, you have to be really careful – particularly if you are planning to leave now. If you leave the UK on 31 March 2010 to work in (say) Geneva, but you spend a week in Geneva organising your paperwork and finding a flat and do not start work until 7 April, HMRC will not accept that you have become non-resident; your full-time employment would not have started at the beginning of the tax year, so you would not have been working abroad for the whole tax year. So for goodness sake do not have a holiday before starting your new job if that is likely to cross the tax year; start the new job first and then have the holiday.

Tuczka v HMRC

The case of *Tuczka v HMRC* TC 366 deals with a completely different aspect of residence. Dr Tuczka was not leaving the UK to establish non-residence. He came into the UK to work and became resident – the only question was whether, and when, he became Ordinarily Resident.

We were the advisors to Dr Tuczka as well, and I am authorised to speak freely about the matter – and to mention some matters which do not appear in the published material. As always, the best bit is at the end.

This is important because a person who is resident but not Ordinarily Resident is liable to tax on his UK earnings – and his foreign earnings are taxable only on the remittance basis. If, however, he is resident and ordinarily resident he is liable to tax on the whole of the earnings from the employment, irrespective of how little of those earnings are earned in the UK.

Dr Tuczka is an Austrian gentleman who came to work in the UK expecting to be here for less than three years. He had no intention of staying in the UK; his purpose in coming here was to obtain some international experience and to return to Austria. HMRC claimed that he should be ordinarily resident shortly after his arrival. Dr Tuczka disagreed. It was his understanding that the law provided he did not become ordinarily resident until he had been here for three years or was here for a settled purpose – and he was neither. His accommodation in London was very basic, he maintained a home in Austria where his family lived, and he made frequent trips home. He was gaining the relevant experience here but was interviewing back in Austria with a clear intention of returning there within three years.

Dr Tuczka was not relying on IR20. The Tax Tribunal had no jurisdiction to consider IR20 anyway because it was not the law, but just HMRC practice. His claim was on the basis of the strict legal position. Interestingly, last year in the case of *Genovese v HMRC* SpC 741, the Special Commissioner (John Clark) had set out the law clearly. He had drawn attention to the celebrated House of Lords judgment in *Barnet London Borough Council v Shah,* in which it was said that it was necessary for the person to be in the UK habitually and that this required a period of three years.

Mr Clark had confirmed that a period of three years was needed to establish ordinary residence. However, he took the view that if a person became ordinarily resident during a tax year, he must necessarily be ordinarily resident for the whole of that tax year, so the ordinary residence status had to commence at the beginning of the tax year in which the first anniversary fell.

So that was clear. This conclusion conveniently matched the new practice note HMRC 6 (which replaced IR20 on 6 April 2009), so the legal test and the Revenue practice had neatly fallen into line.

This was fine with Dr Tuczka. He was not concerned with IR20, but the clarity of the legal analysis was wholly supportive of his case. Imagine how delighted he was when he found that the Tribunal judge who would be hearing his appeal would be the same Mr Clark.

The case proceeded and, having heard the evidence and all the arguments, Mr Clark was faced with a bold submission from HMRC that he had decided *Genovese* wrongly. HMRC also referred to the hitherto unreported 1922 case of *Gout v Cimitian* which has not been cited in any other case on residence. However, Dr Tuczka's case was much stronger than that of Mr Genovese, so we waited for the judgment with confidence.

How wrong we were. The Tribunal agreed with HMRC that *Genovese* was indeed wrongly decided and that Dr Tuczka was therefore ordinarily resident from the first year.

Mr Clark said that it is well established that an individual can be ordinarily resident from the time of his arrival providing his residence is voluntarily adopted and for a settled purpose. The suggestion in *Genovese* that a longer period of time is necessary to establish a pattern of habitual residence was wrong. Although Dr Tuczka had clearly intended to leave the UK, his intentions were irrelevant – other than to show his residence here was voluntarily adopted. What mattered was whether there was a degree of settled purpose. Coming here for employment was a settled purpose. In his form P86 Dr Tuczka said he had come here to work and expected to be here for two and a half years. The working bit was relevant, but the fact that he was going to leave within three years was irrelevant. His intentions had to be disregarded. What was important was his purpose. His purpose was to work here from the outset, so he was ordinarily resident from the outset.

It seems to me that the distinction between intention (which is irrelevant) and purpose (which is crucial) is a bit … er, blurred. One might say that Dr Tuczka intended to work here and his clear purpose was to gain experience before returning to Austria within three years. Therefore he was not ordinarily resident. No, no. Anybody can see that would be completely wrong.

On the basis of this judgment there is little practical difference between residence and ordinary residence, so that a person who comes here for work will become ordinarily resident almost immediately on his arrival – irrespective of his intentions. Unless of course it is this decision which is wrong and *Genovese* was right. I think we will need another case to clarify the position.

One interesting feature of the whole episode is that HMRC had always insisted that the purchase of a flat in the UK by Dr Tuczka meant that he was ordinarily resident immediately. That's what it says in IR20 although there is no law or authority to support it. The Tribunal agreed with Dr Tuczka that the purchase of the flat was not determinative of ordinary residence status.

The truly extraordinary part of the judgment comes at the end. We now know that coming to the UK voluntarily to work for a significant period is a settled purpose. We know that we should look back over a (say) three-year period of continuous employment to see that the purpose must therefore have been settled from the outset. The fact that the individual may have intended to leave must be disregarded. Such a person must surely be ordinarily resident shortly after his arrival.

That is not how it would have been under IR20 where paragraph 3.12 says

> *If you are treated as ordinarily resident solely because you have accommodation here and you dispose of the accommodation and leave the UK within three years of your arrival, you may be treated as not ordinarily resident for the duration of your stay if this is to your advantage*.

That was of course irrelevant because it was HMRC practice which had no part of the appeal. Indeed, the Tribunal said that they had not been influenced by IR20; their view was based on the law, not on HMRC practice. However, the Tribunal then set out the strict legal position:

> *Acquisition of a property would not necessarily prevent an individual from establishing that he or she was not ordinarily resident provided that the property was sold within the period specified in IR20; in other words an individual could buy instead of renting, based on the same commercial approach as expressed by Dr Tuczka and still not prejudice the ordinary residence status as long as the property was held for a limited period*.

This is a bizarre statement by someone who is not considering and not being influenced by IR20. Anyway, we are left with the proposition that if somebody comes here for a settled purpose, works here, buys a flat here and lives here for just under three years, he can leave and be regarded as not ordinarily resident for the whole period. However, if he stays for three years, he will be regarded as ordinarily resident from the outset. How can this possibly be consistent with the rest of the judgment? How is IR20 relevant to this? How is the three-year period relevant when the judge has just said that the references to the three-year period set out in *Genovese* were wrong?

One might say this gives those coming to the UK for less than three years a let-out clause – but in truth it undermines the whole basis of the decision and places the concept of ordinary residence in such a confused and chaotic state that another case is essential to resolve this uncertainty.

This decision will be viewed with alarm by foreign employees coming to work in the UK – or those who have already arrived here and find themselves ordinarily resident and liable to tax on their worldwide earnings. They may well say, “We did not sign up for this – this is not what HMRC is telling us”. And HMRC cannot wash their hands and blame it all on the court, because it was HMRC who were arguing contrary to their own published practice.

A corporate executive who comes to the UK for six months each year and spends the remaining six months working in other parts of the world will now be liable to full UK tax (at 50% shortly) on the whole of his worldwide income. I wonder how he will choose to show his disappointment.

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Articles and Publications – February 2010

Peter Vaines: Taxation: The End of Ordinary Residence

Peter Vaines: *New Law Journal:* A New Dawn

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