

# *PwC Law Firm Services*

News Alert for Law Firms doing business in the United Kingdom



In June, the UK Government announced several important tax-related proposals, including reform of the UK's residency law and expansion of the remittance regime.

The residency proposals would replace the current regime of limited statutory tests, supplemented by case law, with a comprehensive residency test that will apply beginning April 6, 2012.

Changes to the remittance regime, which is applicable to non-domiciled UK taxpayers, include increasing the remittance basis charge for longer term UK residents, as well as an exemption from capital gains tax for foreign currency held in taxpayers' bank accounts.

These changes are noteworthy for US law firms that have UK resident partners; non-UK partners that have been, or will be relocated to offices within the UK; and, UK-expatriate partners that are currently domiciled outside the UK and/or are paid in currencies other than the pound sterling.

## **I. Residency Proposals**

### ***Comprehensive test***

At present, the UK's residency law derives extensively from case law. Many of the related cases are out of date and difficult to apply to the modern world. This has led to much uncertainty for taxpayers, as well as many disputes over residency in the UK courts in recent years. Any test offering certainty and fairness is likely to be welcomed by taxpayers.

### ***Format of the test***

The proposal is that the test itself should break down into three parts -- Part A, Part B and Part C. Taxpayers who meet the conditions of Part A will be deemed a non-resident of the UK. Taxpayers meeting the conditions of Part B will be a UK resident. Anyone who cannot reach a definite conclusion from these two sets of rules, or who potentially falls into both sets of rules, will be subject to further tests in Part C to arrive at a definite conclusion as to their resident status. The proposal suggests that few taxpayers will be subject to the more complex tests set out in Part C of the proposals, although PwC anticipates the proposal may still affect a significant number for whom their UK tax resident status is material.

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## ***Part A***

Taxpayers meeting any of the following three tests will be regarded as a non-resident of the UK:

- Any individual who was not a UK resident in the three previous tax years and is present in the UK for fewer than 45 days in the current year;
- Any individual who, having been resident in the UK in one or more of the previous three tax years, is present in the UK for fewer than 10 days in the current tax year; or
- Any individual who leaves the UK to carry out full time employment abroad, spending fewer than 90 days in the UK and no more than 20 days working in the UK in the tax year.

For the first time a definition of what should be regarded as full time employment in this context is included in the proposals, which should go some way to removing the uncertainty under the current provisions.

### ***Full time working abroad***

The following conditions must be met for employment abroad to be regarded as "full time":

- The work must encompass at least one full UK tax year; and
- The individual must hold employments or offices (or be working in a trade or profession) with total working hours of at least 35 hours per week.

The number of hours required appears reasonable in the context of what might typically be regarded as full time working in the UK. While the level of UK workdays that it is proposed may be spent in the UK is lower than HMRC has accepted in the past, taxpayers may draw comfort from the greater degree of certainty that a comprehensive statutory test may offer.

### ***UK workdays permitted***

It is not clear whether the 20 UK workday de minimis threshold is intended to include any days spent on incidental duties, which under current law would not be regarded as UK workdays at all.

It is proposed that any day on which the individual works for at least three hours in the UK will count as a UK workday, even if the day does not count as a day of physical presence for the purpose of the main statutory residence test because the taxpayer is not in the UK at midnight. There may be some concern over the complexity of the record keeping required, given that taxpayers will need to know both days of presence at midnight and UK workdays, which may be entirely different.

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### ***Part B Test***

It is proposed that taxpayers will always be regarded as UK tax resident in the following circumstances:

- The taxpayer's only home is in the UK or, if he has more than one home, they are all in the UK; or
- The taxpayer is not working full time abroad and spends at least 183 days in the UK in the tax year; or
- The taxpayer is working full time in the UK (again the 35 hour test described above will apply). In addition, the work will only be regarded as a full time UK role if it covers a continuous period of more than nine months and over that period no more than 25% of the duties are undertaken outside the UK.

It is not clear how "home" is to be defined in these circumstances, although the proposal document indicates that accommodation either advertised "for sale" or "for rent" will be ignored, provided that the taxpayer actually lives in another residence. It is to be hoped that greater clarity will emerge on this and other aspects during the consultation period.

### ***Part C Test***

Where tests A and B do not produce a conclusive result, further tests are applied. The factors considered in the proposals, in combination with the time spent in the UK by the taxpayer, are:

- The presence of spouse and children;
- Accommodation that may be used as a residence and is so used by the taxpayer or his family; and
- Substantive employment (at least 40 days of UK working with a working day defined as at least three hours of UK working);
- UK presence in the previous two tax years; and
- Whether more time is spent in the UK than in other countries.

The application of these tests operates a system of weighting which balances these factors against the amount of time the taxpayer may spend in the UK before being regarded as a UK resident. The more factors that apply, the less time can be spent in the UK; but the tests are complex and apply differently for those arriving in and those departing from the UK.

The document suggests few people should need to apply Test C because the majority will clearly meet Test A or B. While this is true, PwC anticipates many taxpayers will be subject to the Part C rules. Further work will be needed to produce a regime which operates practically day to day.

In addition, the consultation document acknowledges that under the proposals it will be harder to become non-resident when leaving the UK after a period of residence than it will be to become resident when an individual first comes to the UK. This may be a particular concern for individuals leaving the UK other than to take up full time employment abroad.

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### ***Ordinary resident status***

The proposal suggests that reform of the law on ordinary residence is also required, but is not definitive about what should be done. Rather, there are two options proposed:

- Ordinary residence should be abolished and a form of overseas workdays relief retained instead; or
- Ordinary residence should be abolished but be put on a new statutory footing.

In either case, overseas workdays relief would be retained, but other aspects of the law -- such as the ability to access the remittance basis and the application of the transfer of asset abroad rules -- would also be affected. While the retention of overseas workdays relief in some form is very welcome, the current suggestion that it should last for a maximum of two years from arrival is disappointing. This is less generous than both the system which currently applies in the UK and most comparable expatriate regimes internationally (which usually allow three years of a more favourable status).

### ***Split year treatment***

At present, the UK operates concessions which split the tax year into resident and non-resident periods in some circumstances. It is proposed that something along these lines should be enacted, although with specific anti-avoidance legislation aimed at preventing short-term departures from the UK to avoid income tax on investment income.

## **II. Expansion of the Remittance Based Regime**

### ***Increased remittance basis charge for certain taxpayers***

Another proposal, in the form of a consultation document, recommends that an increased Remittance Basis Charge (RBC) of £50,000 should apply to taxpayers who have been resident in the UK in at least 12 out of the previous 14 UK tax years.

No changes are suggested in the operation of the RBC for taxpayers who have been resident in the UK in at least 7 out of the previous 9 UK tax years, which will continue to be set at £30,000.

### ***Nominated income***

At present, if income (or gains) that have been nominated to support the remittance basis charge is remitted, the taxpayer becomes subject to some punitive identification rules on the subsequent ordering of funds in respect of any future remittances made to the UK. This can be particularly difficult, because all money in an account may be affected by a nomination.

It is proposed that a de minimis threshold should be introduced so that £10 of nominated income or gains may be remitted without the taxpayer becoming subject to the identification rules that generally apply to nominated income. As these rules are especially complex, any relaxation in them is to be welcomed.

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### ***Foreign currency bank accounts***

Foreign currency (i.e., currency other than the pound sterling) is generally regarded as a chargeable asset for UK capital gains tax (CGT) purposes. As a result, the reporting position for many expatriates who are paid in foreign currencies or have foreign investments is especially complex. Many elect to be taxed on the remittance basis, regardless of the tax cost involved in doing so, to avoid the difficulty of reporting all relevant foreign currency transactions.

It is proposed that going forward, all amounts held in foreign currency bank accounts will be removed from the scope of CGT. While no detail of the proposal is included in the document, this proposal has the potential to improve the reporting position for many expatriates quite significantly, although CGT issues will remain on other investments made in currencies other than sterling.

### ***The Bottom Line***

Overall, the enactment of a statutory residency test will provide clarity and certainty in area of the tax law that has been quite murky and the subject of litigation. However, the time frame for consultation (which closes on September 9th) is extremely tight.

With respect to proposed changes to the remittance regime, an increase in the amount paid by long term UK residents will obviously be criticized by certain taxpayers to whom it would apply. However, other proposals included in the consultation regarding the taxation of foreign currency may ease the reporting position of many taxpayers, thus making the arising basis a more attractive option for many non-domiciled, long term UK residents.

Finally, the U.S. Internal Revenue Service's recent ruling (Revenue Ruling 2011-19) that the £ 30,000 remittance basis charge paid by a long-term nondomiciliary, along with his remittance base tax, is an income tax for which a foreign tax credit is allowable under section 901, has been welcomed by the international community.

PwC's UK and US Law Firm Services teams will continue to monitor the proceedings and keep our law firm clients informed on the results.

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#### **For more information, please contact:**

Stanley Kolodziejczak	+1 (646) 471 3160	Stanley.Kolodziejczak@us.pwc.com
Gregg Sincoff	+1 (646) 471 1335	Gregg.Sincoff@us.pwc.com
Clive Mackintosh	+44 (0)20 7804 5614	Clive.Mackintosh@uk.pwc.com
Keith Orr	+44 (0)20 7804 4791	Keith.Orr@uk.pwc.com

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Solicitation.

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