

The Statutory Residence Test and its implications for employers

Liability to UK income tax and capital gains tax is dependent, very significantly, on the residence status of the individual. The term 'residence' appears many times in UK tax legislation but until now this has never been properly defined in that legislation.

Instead, the determination of an individual's residence status can depend on a whole range of factors particularly how long they spend in the UK in a tax year. The other factors which can affect the position have been established over almost 200 years in the courts.

Some recent high profile cases have highlighted just how difficult it can be to become not resident and how even short periods of time in the UK can be decisive. This makes tax planning very difficult and uncertain for individuals planning to leave the UK permanently or even just for periods of work outside the country.

New statutory proposals

Things are now about to change. Draft legislation has now been published which will lead to the introduction of a 'Statutory Residence Test' (SRT) with effect from 6 April 2013. However, the proposals could affect plans being made now, so we wanted to let you know the basic changes as they relate to internationally mobile employees. Their residence status could have implications for your business in terms of matters such as PAYE compliance. Currently it is not planned that the SRT will apply for National Insurance purposes.

We must stress however, that these rules may still change. Further, the proposals will not be used to determine residence or non-residence for any tax year prior to 2013/14.

One step at a time

The SRT consists of a series of tests that need to be considered in sequence. If residence status can be determined by the first set of tests then there is no need to proceed to any further tests. A modification of the rules will determine residence in year of death but are not detailed further in this letter.

Satisfying any one condition in the first set of tests (Automatic Overseas Test) will lead to the conclusion that the individual is not resident in the UK for a relevant tax year.

Under the Automatic Overseas Test, these alternative conditions for an individual arriving in the UK are:

- an individual coming to the UK will be treated as not resident if they have been not resident in all of the three preceding tax years and in the relevant tax year spend less than 46 days in the UK or
- if they have been resident in one of those years then they will only be not resident if they spend less than 16 days in the UK in the relevant tax year.

If employees come to work for you for the first time in 2013/14, they may be treated as not resident if they satisfy one of those conditions. If they spend more than 45 days in the UK they will need to consider the other tests.

Sending employees overseas

If you are planning to send a UK based employee overseas to work, then they may be treated as not resident providing the work will cover at least a complete UK tax year and amount to at least 35 hours per week on average over the period of absence.

In addition, to qualify they must not spend more than 90 days in the UK in that tax year and if they have working days (defined as at least 3 hours) in the UK these must not exceed a total of 30. A day counts as a day of presence if they are in the UK at midnight. A working day does not have to be a day of presence.

This new rule has one significant difference to the current practice that allows returns to the UK to not exceed 90 days per year on average during the period of employment abroad. Instead, the new limit is an absolute and so time back in the UK for whatever purpose must be carefully monitored.

What if the Automatic Overseas Test does not apply?

If the Automatic Overseas Test cannot be satisfied then the Automatic Residence Test has to be considered. This determines that your employees are conclusively UK resident if any one of its three conditions is met:

- they spend more than 183 days in the UK (this reflects the current situation) or
- they work full time for a twelve month period in the UK or
- their only home(s) is/are in this country.

The issue of a home could be an important factor particularly if the employee leaves their family behind in the UK. The provision of a base overseas will probably be regarded by HMRC as a home and would prevent that test applying but an employee who is required to move around staying hotels could have a problem if the Automatic Residence Test needs to be considered.

How the Sufficient Ties Test works

If a conclusion has not been reached on either of the two previous tests, it is necessary to move to the Sufficient Ties Test. Here a distinction is made between individuals who have not been resident at all in the UK in the previous three UK tax years and those who have had at least one year of residence in the UK in the same period..

The process in the Sufficient Ties Test is to look at a combination of the time an individual spends in the UK in a tax year and the factors that connect them to the UK. In simple terms, the greater the number of connecting factors which apply, then the smaller the number of days permitted in the UK before residence is triggered.

Previous non-residents

An individual who has been not resident in the UK in each of the three previous tax years must consider the combination of factors and days as follows:

Days in UK	Number of factors
up to 45	Always not resident
46 - 90	4 factors to be resident
91 - 120	3 factors to be resident
121 - 182	2 factors to be resident
183 or more	Always resident

The proposed factors can be summarised as follows:

- where spouse or children under 18 are resident in the UK (there are special rules where the children are only at school in the UK)
- there is accessible residential accommodation in the UK which is actually used in the year
- you undertake substantive employment or self-employment in the UK covering at least 40 working days
- there are at least 90 days of presence in the UK in either of the two preceding tax years.

Previous residents

An individual who has been resident in the UK for at least one of the three previous tax years must consider the combination of factors and days as follows:

Days in UK	Number of factors
up to 15	Always not resident
16 - 45	4 factors to be resident
46 - 90	3 factors to be resident
91 - 120	2 factors to be resident
121 - 182	1 factor to be resident
183 or more	Always resident

The four factors listed for previous non-residents apply to previous residents. However, there is an additional factor which applies to these individuals. This may be particularly pertinent for employees as there will be a connection with the UK if the individual spends more time in the UK than in any other country. This could be of significance if you send an employee on a roving assignment rather than to a single location.

Planning considerations

Clearly the presence of these factors can change from year to year and it will always be important to plan time in the UK with great care. For example, an employee coming into the UK to work, never having spent more than 90 days in the UK in any previous year, may be able to spend up to 182 days in the first year without triggering residence (depending on the type of accommodation made available to them) because they will only have one counting factor. If the employment continues then there will be two counting factors in the following tax year.

We would be happy to discuss the potential impact of these changes on your employees and their impact for you.