

Paying a fairer share: a consultation on residence and domicile

December 2007



HM TREASURY



HM TREASURY

**Paying a fairer share:
a consultation on residence and
domicile**

December 2007

© Crown copyright 2007

The text in this document (excluding the Royal Coat of Arms and departmental logos) may be reproduced free of charge in any format or medium providing that it is reproduced accurately and not used in a misleading context. The material must be acknowledged as Crown copyright and the title of the document specified.

Any enquiries relating to the copyright in this document should be sent to:

Office of Public Sector Information
Information Policy Team
St Clements House
2-16 Colegate
Norwich
NR3 1BQ

Fax: 01603 723000

e-mail: HMSOlicensing@opsi.x.gsi.gov.uk

HM Treasury contacts

This document can be found in full on our website at:

hm-treasury.gov.uk

If you require this information in another language, format or have general enquiries about HM Treasury and its work, contact:

Correspondence and Enquiry Unit
HM Treasury
1 Horse Guards Road
London
SW1A 2HQ

Tel: 020 7270 4558

Fax: 020 7270 4861

E-mail: public.enquiries@hm-treasury.gov.uk or
residence&domicile@hmt.gov.uk

Printed on at least 75% recycled paper.

When you have finished with it please recycle it again.

ISBN 978-1-84532-375-2

PU434

CONTENTS

		Page
Chapter 1	Introduction	3
Chapter 2	Measures announced in the Pre-Budget Report	5
Chapter 3	Should further changes be considered?	11
Chapter 4	Responding to this consultation	15
Annex A	Definitions	17
Annex B	Data and analysis	21

INTRODUCTION

1.1 In an increasingly globalised economy it is crucial for the UK's competitiveness that the UK continues to attract international talent to this country. In key sectors, such as financial services, IT and public services, the UK's capacity to compete internationally is underpinned by large numbers of highly skilled workers who come here from abroad. As well as contributing directly to economic activity, international workers contribute to wider economic growth by bringing skills which complement those in the existing workforce. Moreover, people from abroad make a significant contribution both to GDP and to UK tax revenues. For example, non-domiciled residents contribute some £12 billion to GDP and £4 billion in income tax alone.

1.2 Maintaining the UK's competitiveness by ensuring that the UK remains an attractive place for workers with key skills was at the heart of the recently concluded review of the residence and domicile tax rules. Equally important was the principle that the rules applying to people from abroad should operate fairly.

1.3 It is only fair that people who have chosen to make the UK their home (and who enjoy favourable tax treatment over the long term, and even pass this on to their children) should make a reasonable tax contribution to the modern public services which support our society. Equally, it is not acceptable that anomalies and flaws in the current rules and practices effectively excuse people, in certain circumstances, from the need to pay UK tax. Nor is it fair that rules and practices designed for an age before rapid modern transport can be manipulated to avoid paying UK tax.

1.4 The package of measures set out by the Government in the Pre-Budget Report on 9 October 2007 was designed to strike the right balance between competitiveness and fairness and to deliver a modern tax system for the UK in the global economy. The changes announced were:

- firstly, resident non-domiciles who have been in the UK for longer than seven out of the past ten years will only be able to access the remittance basis of taxation on payment of an annual charge of £30,000, unless their unremitted foreign income or gains are less than £1,000;
- secondly, people who use the remittance basis of taxation will no longer be entitled to income tax personal allowances. Again, people with small amounts of foreign income will be exempt;
- thirdly, the Government will introduce changes to the residence rules so that days of arrival in and departure from the UK will count toward establishing residence. This brings the UK into line with international practice; and
- finally, the Government will amend the current rules to remove flaws and anomalies that allow individuals using the remittance basis of taxation to sidestep UK tax, where it is due on foreign income and gains.

1.5 The Government intends to introduce these changes from April 2008, and wishes to consult on how these changes will be implemented. This document sets out further detail of these changes as the basis for that consultation.

1.6 The Government also wants to consult on whether there is a case for any further changes to the rules on the treatment of non-domiciles to be considered. Chapter 3 of this document sets out some possible approaches which could be considered and seeks views on whether proposals have merit and whether the Government should consider pursuing them.

2

MEASURES ANNOUNCED IN THE PRE-BUDGET REPORT

2.1 The measures announced in the Pre-Budget Report address three key aspects of the current system, specifically:

- the contribution to the Exchequer made by non-domiciled residents and other remittance basis users;
- the flaws and anomalies which undermine the effectiveness of the existing system; and
- the role of the day counting rules and practices in establishing residence for tax purposes.

2.2 This package of changes has been designed to increase the fairness of the current rules and practices while safeguarding the UK's international competitiveness. Its overall effect will be:

- to remove elements of the current rules which give non-domiciles and those not ordinarily resident unfair tax advantages which are not open to the rest of the UK population;
- to ensure that everyone who has made their home in the UK pays a fairer share in tax; and
- to maintain a system which helps to make the UK an attractive destination for international workers.

Changes to the remittance basis

2.3 The Pre-Budget Report announced two changes to the way the remittance basis works. These changes will ensure that people who use the remittance basis of taxation will, in future, make a greater contribution to the UK during their period of residence here.

A new tax charge on longer term residents

2.4 Under the current rules a remittance basis user makes no contribution to the Exchequer in respect of their unremitted foreign income and gains, regardless of how long they remain resident in the UK. The new tax charge has been designed to remedy this, while striking an appropriate balance between fairness and competitiveness. It does so by ensuring that people who are here for longer than seven years make a greater contribution (less than 20 per cent of non domiciles), while the majority of mobile workers in key sectors remain unaffected.

2.5 The new charge will apply to remittance basis users who have been resident in the UK for more than seven out of the past ten tax years. People in this group will have the choice of either paying an additional tax charge of £30,000 a year to retain access to the remittance basis, or of moving to the normal basis of UK taxation (in which case their unremitted foreign income and gains would be subject to UK tax on an arising basis). This change is estimated to yield additional tax revenue of around £350 million in 2009-10 and £200 million in 2010-11.

2.6 This will be an annual tax charge, and each year individuals will have the choice of whether or not to pay the charge and claim the remittance basis. A decision not to claim the remittance basis in any given year does not close off the option of reclaiming

it in subsequent years. The charge does not, therefore, impact on an individual's non-domicile status.

2.7 The Government recognises that in some cases, remittance basis users who have small amounts of unremitted foreign income and gains, and modest income and gains in the UK, might be disproportionately affected by these changes. For example, it is possible for people on modest income in the UK to have a small amount of income accruing in overseas bank accounts.

2.8 To ensure that the new charge does not have a disproportionate impact a de minimis limit of £1,000 will apply. This means that a remittance basis user with unremitted foreign income and gains of less than £1,000 in a tax year will be able to retain access to the remittance basis for that tax year without paying the £30,000 charge.

2.9 The new charge will therefore impact on remittance basis users who have been resident in the UK for more than seven out of ten tax years, and who have more than £1,000 of unremitted foreign income and gains in any given tax year. Self-Assessment (SA) data shows that some 23,000 non-domiciled individuals meet the more than seven out of ten years criterion, of which, 20,000 are assumed to be above the de minimis threshold.

2.10 In addition, it is possible that individuals who are not ordinarily resident will also be liable to pay the new charge. However, given that this is an essentially temporary status and generally individuals will, in due course, establish ordinary residence in the UK, and thereby make a normal contribution to the UK tax system, the number affected by this measure is likely to be small.

2.11 Only those with unremitted income in excess of £80,000 are likely to pay the charge; others will find it less costly to opt out of the remittance basis.¹ It is expected that almost 4,000 individuals will pay the charge and that almost 14,000 more will opt out of the remittance basis in the long term and pay UK tax under the normal rules. It is estimated that almost 3,000 people will become non-resident in response to the charge in the long term.

New rules on personal allowances

2.12 A further change applies to remittance basis users. Under the current rules remittance basis users enjoy the double benefit of having two elements of their overall income and gains exempt from UK tax. Firstly, their unremitted foreign income and gains is not subject to UK tax. Secondly, they also enjoy the same tax-free personal allowances as other UK taxpayers.

2.13 Under the new rules, remittance basis users will lose automatic access to personal tax allowances, blind person's allowance, reductions for married couples and civil partners, reliefs on payments to trade unions, police organisations, and relief for payments for the benefit of family members. They will similarly lose access to the Annual Exempt Amount (AEA) on gains.

2.14 They will instead have a choice between continuing to use the remittance basis or continuing to enjoy their personal allowances. This choice will be made annually and it will therefore be open to an individual to opt out of the remittance in one year

¹ An individual whose marginal tax rate is the higher rate of 40 per cent will require £75,000 of unremitted foreign source income per year to generate a tax charge of £30,000. Personal allowances must be added to this to calculate the point at which it becomes more beneficial to pay the charge and lose personal allowances (see below) rather than opting out of the remittance basis. In 2008-09 the usual personal allowance is £5,435 so the minimum income required is £80,435.

and maintain their personal allowances and AEA for that year; then opt back in for the next year but lose their personal allowances and AEA for that year.

2.15 The ability to opt in and out of the remittance basis could open up avenues for avoidance and abuse. These will be addressed as part of the package to address flaws and anomalies discussed at 2.25 below.

2.16 As with the £30,000 tax charge discussed above, the new rules on allowances will include a threshold (or de minimis limit) set at £1,000, below which the new rules will not apply. Therefore, a remittance basis user who, in a given tax year, has unremitted foreign income and gains of less than £1,000 will be able to retain both access to the remittance basis and access to personal allowances and AEA.

2.17 It is estimated that just over 113,000 remittance basis users will lose personal allowances as a result of this reform. Almost 88,000 of these will be non-domiciles and almost 26,000 will be people who are not ordinarily resident. The usual personal allowance (£5,435 in 2008-09) is worth approximately £2,200 to an individual whose marginal tax rate is the higher rate of 40 per cent, and £1,100 at a marginal rate of 20 per cent. The removal of income tax personal allowances is expected to yield additional tax revenue around £230 million in 2009-10 and £150 million in 2010-11.

2.18 This change will come into effect on 6 April 2008.

Changes to day counting

2.19 The changes the Government is making to the way it counts days towards UK residence are intended both to modernise the current system and to bring the UK more into line with international practice.

2.20 According to current practice only whole days are counted towards establishing residence. As a result a non-resident can spend substantial periods of time in the UK without becoming resident, and therefore without becoming subject to UK tax on their worldwide income and gains. For example, it is currently possible for someone to spend five working days in the UK with these only counting as 3 days once the day of arrival and day of departure are discounted. This is increasingly anachronistic in an age of rapid modern transportation.

2.21 As the following table illustrates, this is out of step with wider international practice.

Country	Treatment
US	Part days count as full days of presence so days of arrival and departure count
France	Where the majority of the day is spent in France, it counts as a full day of presence so afternoon arrivals not counted
Canada	Part days count as full days of presence so days of arrival and departure count
Italy	Part days count as full days of presence so days of arrival and departure count
Japan	Days of arrival and departure count
Germany	Days of arrival and departure count
Netherlands	Part days count as full days of presence so days of arrival and departure count
Switzerland	Days of arrival and departure count
Australia	Part days count as full days of presence so days of arrival and departure count
New Zealand	Part days count as full days of presence so days of arrival and departure count
Ireland	Counts as a day of presence if present at midnight (so days of arrival count but not days of departure or same-day arrival and departure).

2.22 From April 2008, the change will mean that someone who is not resident in the UK but is spending significant time in this country will have both days of arrival in and departure from the UK counted towards establishing residence here.

Changing arrangements on day counting

Ms Y lives in the Isle of Man and normally works there. In 2007-08, she begins a three-year project in London for her Isle of Man employer which involves spending three working days in London each week. She arrives on Monday evening, works a full day on Tuesdays, Wednesdays and Thursdays, and returns to the Isle of Man on Thursday evening. Under normal practice during the year her days of arrival and departure are not counted, so each week spent in the UK counts as 2 days. Over her working year of 46 weeks, she thus spends 92 days in the UK. This is not enough to make her a UK resident under either the 183 days in one-year rule, or over the 90-day average over 4 years.

Under the changes from 2008-09 onwards her days of arrival and departure will be counted. Each working week she will be counted as spending 4 days in the UK. So the same working pattern for 2008-09 will mean 184 days are spent in the UK, and Ms Y will be regarded as resident in the UK.

Mr Z lives in Monaco. He works in Monaco and for some years has also worked part weeks in the City of London in a second employment. He arrives in London on Tuesday evening, works Wednesday and Thursday and returns to Monaco on Thursday evening. Under the normal practice his days of arrival and departure are not counted with the result that only 1 day a week (46 days a year) is spent in the UK when he is working, and even with some holiday in the UK, spends over 90 days here in any tax year.

From 6 April 2008, days of arrival and departure are no longer ignored. If he continues this pattern of working each week will count as 3 days, so that he will spend at least 138 days a year in the UK working. He would therefore become UK resident as over a 4 year period he would spend an average of over 90 days a year in the UK.

2.23 Some 17,000 non-residents are expected to be brought into UK residence by changes to day counting. A further 7,000 are expected to adjust their patterns of visits so that they remain non-resident. These changes are expected to yield additional tax revenue of around £20 million in 2008-09, £55 million in 2009-10 and £50 million in 2010-11.

Correcting flaws and anomalies

2.24 The current rules are subject to a range of flaws and anomalies which undermine their effective operation, thus subverting the intention that users of the remittance basis should pay UK tax on foreign income and gains that they bring into the UK. The Government proposes to address these through changes to take effect from April 2008.

2.25 The flaws and anomalies being addressed are:

- the 'ceased source' loophole, where foreign savings and investment income and gains cannot currently be taxed when remitted to the UK if the source of the income or gain no longer exists in that year. For example, with foreign bank interest, tax can be side-stepped by closing that bank account at the end of the tax year, transferring the interest to a new bank account, and then remitting it to the UK tax-free as the source of the interest no longer exists.

- The 'cash only' loophole which means HMRC can currently only tax foreign savings and investment income if it is brought into the UK as cash. If a remittance basis taxpayer turns foreign investment income into an asset outside the UK and then imports that asset, no UK tax can be charged on the income unless and until the asset is sold or turned into cash in the UK.
- The 'claims mechanism' loophole for foreign savings and investment income where income from a year in which a claim to use the remittance basis is made cannot be taxed if it is remitted in a subsequent year in which no claim is made.
- The problems in taxing remittances from 'mixed funds'. There are currently no statutory rules on the treatment of remittances from funds including some combination of relevant foreign income, employment income, capital gains and capital if they are remitted to the UK. These can sometimes give uncertain and unsatisfactory results where the remittance contains two or more of these elements which may or may not have been subject to UK tax.
- Alienation of income and gains through offshore vehicles or closely connected persons to avoid tax. The current rules can allow overseas income and gains to be alienated by an individual to some third party, such as an offshore trust or close relative, and then brought to the UK in such a way that the individual whose income or gain it was effectively has the use or enjoyment of it in the UK.
- The fact that certain anti-avoidance legislation, such as provisions introduced to prevent UK residents from making gains tax free in offshore structures, does not work effectively in relation to remittance basis users. This means, for example, that non-domiciled residents can avoid tax on gains accruing in non-resident trust or companies when they are remitted to the UK.

Consultation on draft clauses 2.26 Draft legislation to address these loopholes and anomalies will be published soon by HMRC for consultation. Final legislation will be included in the 2008 Finance Bill. That legislation will ensure that where people taxed on the remittance basis bring foreign income or gains into the UK, that income or gains will be taxed, whatever structures or mechanisms are put in place. So, for example, closing an offshore bank account, importing an asset rather than cash, remitting sums from a mixed fund or setting up complex offshore structures will not allow UK resident remittance basis users to avoid paying tax on foreign income or gains they bring into the UK. Similarly, anti-avoidance measures which currently apply to UK domiciles with offshore investments will apply to non-domiciles.

2.27 It is expected that around 30,000 remittance basis users will pay additional tax as a result of correcting these flaws and loopholes. The changes are expected to yield additional tax revenue of around £150 million in 2009-10 and £100 million in 2010-11.

2.28 Taken together as a package, the reforms announced at Pre-Budget Report are expected to yield additional tax revenue of around £800 million in 2009-10 and £500 million in 2010-11.²

² Total package figures do not always equal the sum of the component parts due to rounding.

3

SHOULD FURTHER CHANGES BE CONSIDERED?

3.1 Debate on the issues of residence and domicile broadly breaks down into two camps: those who wish to see the current rules retained, unamended, and those who would like to see the special rules of the remittance basis abolished in their entirety.

3.2 The Government has decided that leaving the current rules unchanged would offend against the principle of making the tax system fairer. The package of reforms announced at the PBR therefore addresses aspects of unfairness in the current rules, without putting at risk the UK's attractiveness as a destination for international workers and investors.

3.3 Before drawing a line under this debate, the Government wants to consult on whether further changes should be considered, to increase the contribution of non-domiciles.

3.4 The key question to consider is whether further changes could be introduced without putting the UK's competitiveness at risk by undermining the UK's attractiveness to the internationally mobile.

3.5 The approaches set out below have been identified as offering possible avenues to be considered.

A flat rate applied without a grace period

3.6 It would be possible to amend the new charge to apply it without a seven-year grace period and perhaps at a lower rate. This would make for a simpler charge by applying it to all non-domicile remittance basis users regardless of how short their stay in the UK might be.

3.7 Such a charge would continue to exclude those remittance basis users with less than £1,000 of unremitted foreign-source income and gains. It is expected that around 112,000 non-domiciles would then face a choice between paying the charge, or opting out of the remittance basis.

3.8 With a charge of £30,000 only those with unremitted foreign-source income in excess of £80,000 would be likely to pay; it is expected that this would apply to around 10,000 non-domiciles in the long term. It is estimated that around 16,000 non-domiciles would become non-resident in response in the long term (including the 3,000 expected to become non resident in response to the charge announced in the Pre-Budget Report), and the remainder would find it less costly to opt out of the remittance basis.

3.9 If, alternatively, the charge was set at £25,000 only those with unremitted foreign-source income in excess of about £68,000 would be affected¹. It is expected that this would apply to around 14,000 non-domiciles in the long term. The remainder would find it less costly to opt out of the remittance basis. It is estimated that around 16,000 non-domiciles would become non-resident in response in the long term (including the 3,000 expected to become non-resident in response to the charge

¹ An individual whose marginal tax rate is the higher rate of 40 per cent would require £62,500 of unremitted foreign source income per year to generate a tax charge of £25,000. Personal allowances must be added to this to calculate the point at which it would become more beneficial to pay the charge and lose personal allowances rather than opting out of the remittance basis. In 2008-09 the usual personal allowance is £5,435 so the minimum income required would be £67,935.

announced in the Pre-Budget Report), and the remainder would find it less costly to opt out of the remittance basis.

3.10 Under either alternative such a flat rate charge could raise around £300 million more than the charge announced in the Pre-Budget Report. However, this additional yield would come from applying the charge to mobile workers from day one of their stay in the UK. The main risk of such an approach would be its potential to create an obstacle for mobile workers who would otherwise come to the UK. It is estimated that the majority of mobile workers in key sectors such as financial services come to the UK on short-term contracts of around five years (see Annex B). For such workers the existing remittance basis rules (and the rules which will apply from April 2008) mean that the burdens and 'hassle factor' of needing to calculate relative tax liability between the UK and their home country do not arise.

3.11 The seven-year grace period reflects the reality that temporary workers in key sectors tend to come to the UK on a short-term basis. A charge that did not reflect this could make the UK a less attractive destination and thereby undermine UK competitiveness.

An additional, higher charge being levied on those here after ten years

3.12 It would be possible to build on the change coming in from April 2008 by placing a higher charge on people who are here for a longer period. Taking ten years as the cut-off point, it would be possible to increase the rate of the charge to, say, £50,000 a year.

3.13 This would mean that remittance basis users who had been resident in the UK for ten out of the past 12 years would pay £50,000 a year, while those who had been resident more than seven but less than ten would continue to pay £30,000.

3.14 Of the 4,000 expected to pay the charge announced in the Pre-Budget Report it is expected around 2,000 non-domiciles would continue to pay the £30,000 charge under this approach and 1,500 would be liable to pay the £50,000 charge.

3.15 Of non-domiciles resident for more than ten years, only those with unremitted foreign-source income in excess of £130,000² would be likely to pay, with the remainder opting out of the remittance basis.

3.16 This approach would be expected to yield approximately £50 million more per year than the measure announced in the Pre-Budget Report.

3.17 The logic behind such an approach would be that those who have longer-term connection to the UK should make a greater contribution in respect of their unremitted foreign income, without their being required to work out and declare in their UK tax return the quantum of that income and gains.

² An individual whose marginal tax rate is the higher rate of 40% would require £125,000 of unremitted foreign source income per year to generate a tax charge of £50,000. Personal allowances must be added to this to calculate the point at which it would become more beneficial to pay the charge and lose personal allowances rather than opting out of the remittance basis. In 2008-09 the usual personal allowance is £5,435 so the minimum income required would be £130,435.

Setting an upper time limit on access to the remittance basis for non-domiciles

3.18 An alternative approach would be to set an upper limit of the length of time over which a UK resident non-domicile could retain access to the remittance basis. A model is offered here by the inheritance tax rules under which someone who has been resident for 17 out of 20 years is deemed to be UK domiciled for inheritance tax purposes.

3.19 A time limit set at 17/20 years of residence (under which in the 18th year individuals would be deemed to be UK domiciled from that point forward) would be expected to affect around 2,000 individuals. Of these 2,000, those with unremitted foreign-source income and gains of less than £80,000 are already expected to opt out of the remittance basis as a result of the £30,000 charge announced in the Pre-Budget Report, so the only additional effect would be on those with unremitted foreign-source income and gains in excess of £80,000.

3.20 This approach would be expected to yield almost £50 million a year more than the measure announced in the Pre-Budget Report.

3.21 Under such an approach, long-term residents would lose the option of using the remittance basis and therefore would pay UK tax on the normal arising basis. This would mean that they would pay full UK tax on their unremitted foreign income and gains.

4

RESPONDING TO THIS CONSULTATION

4.1 The Government welcomes views on how the measures outlined in Chapter 2 will be implemented and on whether further measures (such as the approaches set out in Chapter 3) could be introduced without putting at risk the UK's competitiveness by undermining the UK's attractiveness to the internationally mobile.

4.2 Responses to this document should be sent via email to:

Residence&Domicile@hmt.gov.uk

Or to Residence and Domicile Consultation

HM Treasury
1 Horseguards Road
London
SW1A 2HQ

The deadline for responses is 28 February 2008.

A

DEFINITIONS

RESIDENCE

A.1 Residence plays a key role in determining whether or not an individual will be liable to pay UK income tax or capital gains tax on income and gains arising outside the UK. An individual who is resident in the UK will normally be liable for tax on income and gains regardless of where they arise, whereas an individual who is not resident here will not be liable for tax on income and gains arising outside the UK.

A.2 The general rule on residence is that any individual who is present in the UK for 183 days or more in any tax year is always treated as resident here for tax purposes.

A.3 Broadly speaking, individuals will also be regarded as being resident in the UK if:

- they usually live in the UK and go abroad for short periods, for example on business trips or holidays, even if these absences mean they are physically present in the UK for fewer days than they are absent;
- their home has been in the UK and they leave the UK intending to go abroad either permanently or for full-time employment extending over a complete tax year, but since leaving their visits back to the UK average more than 90 days in a tax year.

A.4 Individuals whose home has been abroad will be treated as UK resident for a tax year whether or not they spend 183 days or more here in a particular year if:

- they come to the UK intending to live here permanently or to remain for at least three years;
- they come to the UK for an extended period for a purpose (for example employment or study) that means they will remain here for at least two years;
- they come to the UK intending to remain for an extended period, perhaps stretching over several tax years, and they own accommodation or lease it long-term in the UK on arrival; or
- they visit the UK regularly, and after a period of 4 years these visits average more than 90 days in a tax year.

A.5 The taxation of overseas income and gains must also be understood in the context of Double Taxation Agreements. These agreements aim to eliminate the double taxation of income or gains arising in one country and paid to residents of another country. They do this by dividing the taxing rights that each treaty partner has under its domestic law over the same income and gains. However, in some cases income or gains will remain taxable in both countries and where this happens the UK will eliminate double taxation by giving credit for the foreign tax against the UK tax payable on the same income. It therefore does not follow that simply because someone is resident in the UK they will no longer be liable to tax in a country overseas on income or gains arising in that country.

THE REMITTANCE BASIS OF TAXATION, ORDINARY RESIDENCE AND DOMICILE

The remittance basis **A.6** The normal position is that someone resident in the UK is liable to tax on their worldwide income and gains in the tax year that they arise (the "arising basis").

A.7 The remittance basis of taxation is an alternative method of computing UK tax liability which may be used by UK residents who are either not domiciled or not ordinarily resident here. It only applies to the treatment of offshore income and gains. UK source income and gains are normally taxed on the arising basis. With the remittance basis, there is no charge to UK tax until the overseas income or gain is brought into (remitted to) the UK.

Ordinary residence **A.8** In general terms an individual is ordinarily resident in the UK if they have been, are, or having recently arrived intend to be, resident here year after year.

A.9 Generally, an individual whose home has been abroad will be treated as ordinarily resident on arrival if:

- they intend to live in the UK permanently or for at least 3 years;
- they intend visiting the UK on a regular basis for at least 4 years and those visits will average more than 90 days or more a tax year;
- they were previously ordinarily resident in the UK and have returned to the UK following a period of residence abroad for employment or similar such purposes.

Domicile **A.10** Domicile is distinct from nationality, residence or citizenship. An individual may only hold one domicile at a time. Individuals acquire a "domicile of origin" at birth, usually from their father. Children under the age of 16 have a "domicile of dependency" which follows that of the person on whom they are legally dependent.

A.11 Individuals over the age of 16 may adopt a "domicile of choice". However, in order to adopt a new domicile in another country an individual broadly needs to demonstrate that they intend to live there permanently or indefinitely. While someone with a foreign domicile who is resident in the UK but has connections elsewhere may retain their non-domicile status here, it would be a good deal more difficult for a UK domicile to change that status while still continuing to be resident in, or to have ties with, the UK.

A.12 The examples below show how access to the remittance basis because of non-domicile status affects taxation.

Example of the treatment of foreign income and gains under the arising basis

Mr A has always lived in the UK and is both domiciled and ordinarily resident here. He is employed and has a salary of £85,000. He has some savings income and investments in a couple of UK companies. Some time ago, he bought a holiday apartment abroad for £30,000, but sold it this year for £120,000, investing the money in an old farmhouse elsewhere abroad. The money from the sale of the foreign property went directly into a foreign bank account and was used to finance the purchase of the farmhouse, so it was never brought into the UK.

For the tax year 2007-08, Mr A will have to account for income tax on his UK employment salary for the year, for any interest earned on his savings during the year, and also for any dividends paid on his investments in the year. In addition, he will have to account for capital gains tax on the £90,000 gain realised on the disposal of the property. The income and gains have all arisen during the course of 2007-08, and they are taxed in that year.

Example of how foreign income and gains are treated under the remittance basis

Mr B has very similar circumstances to Mr A. He has always lived in the UK and is ordinarily resident here, but holds a foreign domicile of origin. He is employed and has a salary of £85,000. He has some savings income and investments in a couple of UK companies. Some time ago, he bought a holiday apartment abroad for £30,000, but sold it this year for £120,000, investing the money in another house abroad, where he intends to retire. The money from the sale of the property went directly into a foreign bank account and was used to finance the purchase of the second property, so it was never brought into the UK.

For the tax year 2007-08, Mr B will have to account for income tax on his UK employment salary for the year, for any interest earned on his savings during the year, and also from any dividends paid on his investments in the year. This income has 'arisen' during the course of 2007-08, and must be accounted for in that year.

However, unlike Mr A, he will not have to account for capital gains tax on the £90,000 gain realised on the disposal of the property abroad. Although the gain arises in 2007-08, it has not been remitted to the UK; therefore there is no tax liability on that gain here.

B

DATA AND ANALYSIS

B.1 This is an area where data is limited. Crucially the key variables of the number of people within different groups and the level of their overseas income and gains are inherently uncertain. Against this background, policy decisions have to be guided by informed judgements about the gaps in the available data. While this does not preclude analysis or policy development, it does argue for a prudent and cautious approach.

Numbers of individuals

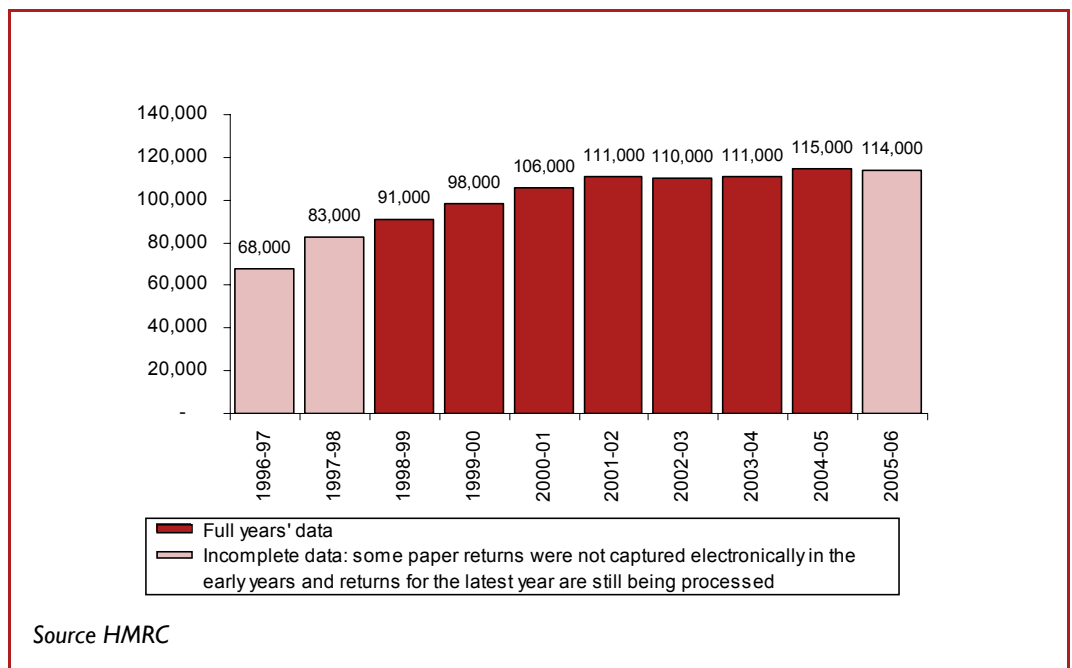
B.2 On numbers of individuals, it is important to note that not all people who have a foreign domicile or come from abroad fall under the category of non-domiciles under the tax system. The vast majority of those with a foreign domicile do not claim the remittance basis, and would get no financial benefit from doing so, unless they have significant foreign-source income and gains.

Self-Assessment data

B.3 The Self-Assessment (SA) system does provide a useful source of reliable data on individuals indicating non-domicile or not ordinarily resident status on their tax returns. This system records the number of SA cases as they are processed. It therefore presents a running total over the year. In order to achieve a sound basis for year-on-year comparison, it is now HMRC practice to draw on the system in August of each year to establish an annual figure. To allow comparison with previous years the number of individuals indicating non-domicile status was identified in August 2007 for all years up to 2005/06.

B.4 Chart 1 shows how the number of non-domiciled individuals has remained constant over the past five years. Note that some paper returns were not captured electronically in the early years so are missing from the data, and returns for the latest year are still being processed.

Chart 1: Number of individuals indicating non-domicile status



B.5 The latest estimate of the number of not-ordinarily residents is 29,000, for 2005-06.

Estimating foreign-source income

B.6 On foreign-source income and gains the difficulties in obtaining accurate data are, if anything, greater. Crucially, when looking at the issue of the remittance basis the very fact that users do not need to tell HMRC about their unremitted income or gains means that HMRC has no reliable means of knowing how much untaxed foreign-source income and gains this group has and HMRC cannot estimate it, let alone with any precision. The difficulties of trying to establish this figure are such that the Government has not routinely sought to make an estimate of it.

B.7 Work towards estimating tax foregone was carried out in 2003 at the start of the review, which resulted in a ballpark figure of around £1 billion per annum in tax foregone. This was based on what HMRC knew about unremitted foreign-source employment income from SA data, combined with estimates of unremitted foreign-source investment income drawn from estates declared for inheritance tax purposes and other published sources.

B.8 There is one area where hard data is available from tax returns: the £1 billion of unremitted foreign-source employment income that was reported on SA forms in 2000-01. Even this is likely to be an under-estimate because it is not directly part of the tax calculation, and the true figure was assumed to be around 25 per cent higher, i.e. £1.3 billion. At 40 per cent tax rate this would yield £520 million, which was scaled down by one-third to allow for the effect of double taxation agreements and other reliefs, resulting in a potential Exchequer yield of around £350 million.

B.9 On foreign source investment income, SA data in 2000-01 showed around 25,000 individuals with no reported employment income but who use the remittance basis and can be assumed to have other sources of income. It was assumed that 15,000 of this group would have substantial taxable income and gains.

- If these 15,000 are representative of other significant estates, their share of total marketable wealth would be around £75 billion (out of total marketable wealth of £3 trillion as estimated from a sample of estates declared for inheritance tax purposes and verified by Office of National Statistics data on personal wealth).
- A small number of super-rich remittance basis users are unlikely to be properly represented in the estates data as they are too small a group to be covered in the sample of estates, and so need to be added to this estimate. Analysis of other published but unofficial sources produced an estimated wealth of £65 billion for the super-rich.

B.10 Combining the estates data and the estimate for the super-rich suggested £140 billion of global wealth, yielding investment income of the order of £1.9 billion per annum. Around £500 million was assumed to be already taxed in the UK, leaving £1.4 billion in taxable income, which represented around £600 million in tax foregone.

B.11 In addition, there would also be some foreign-source investment income received by others. Around £400 million was assumed to be unremitted, and double taxation agreements would have reduced the tax due on that, perhaps to around £100 million.

B.12 Combining these sources gave a ballpark figure of around £1 billion in UK tax foregone. However, this is not a robust estimate of the sort required for policy making. The lack of administrative or other official data on the very wealthy, the need to use sources where we know little about how they were constructed, and the very many assumptions and judgements that need to be made on top of that, make any such estimates unreliable. In particular, the part of the analysis where data are least reliable is the estimate for the super-rich. Data on the very wealthy are inherently subject to very wide margins of uncertainty, so, taken together with the unofficial source used, this ballpark figure would be a very weak basis for policy-making. This exercise has therefore not been repeated.

B.13 There are and were no other available data sources that provide a complete picture of foreign-source income for remittance basis users. The ONS UK Balance of Payments (the Pink Book) tables on foreign-source investment income (tables 4.4, 4.5 and 4.7) contain figures for all UK taxpayers i.e. those currently using the arising basis or the remittance basis. However, information on household sector bank deposits is not separately identified (it is included in the estimate for "other residents"). What is more, there is little difference between the level of foreign-source income from the Pink Book and from HMRC data sources (i.e. UK taxable foreign-source income for arising basis and remittance basis users). This information source therefore did not enable us to arrive at a robust estimate of the foreign-source investment income of remittance basis users.

B.14 Again, the one reliable source of data on UK source income is the SA system. The annual SA data on incomes for 2005-06 is based on tax returns processed as at April 2007.

B.15 Table 1 contains the numbers of individuals and amounts of reported incomes for non-domiciles and not-ordinarily residents for 2005-06¹ (including information on unremitted foreign-source employment income).

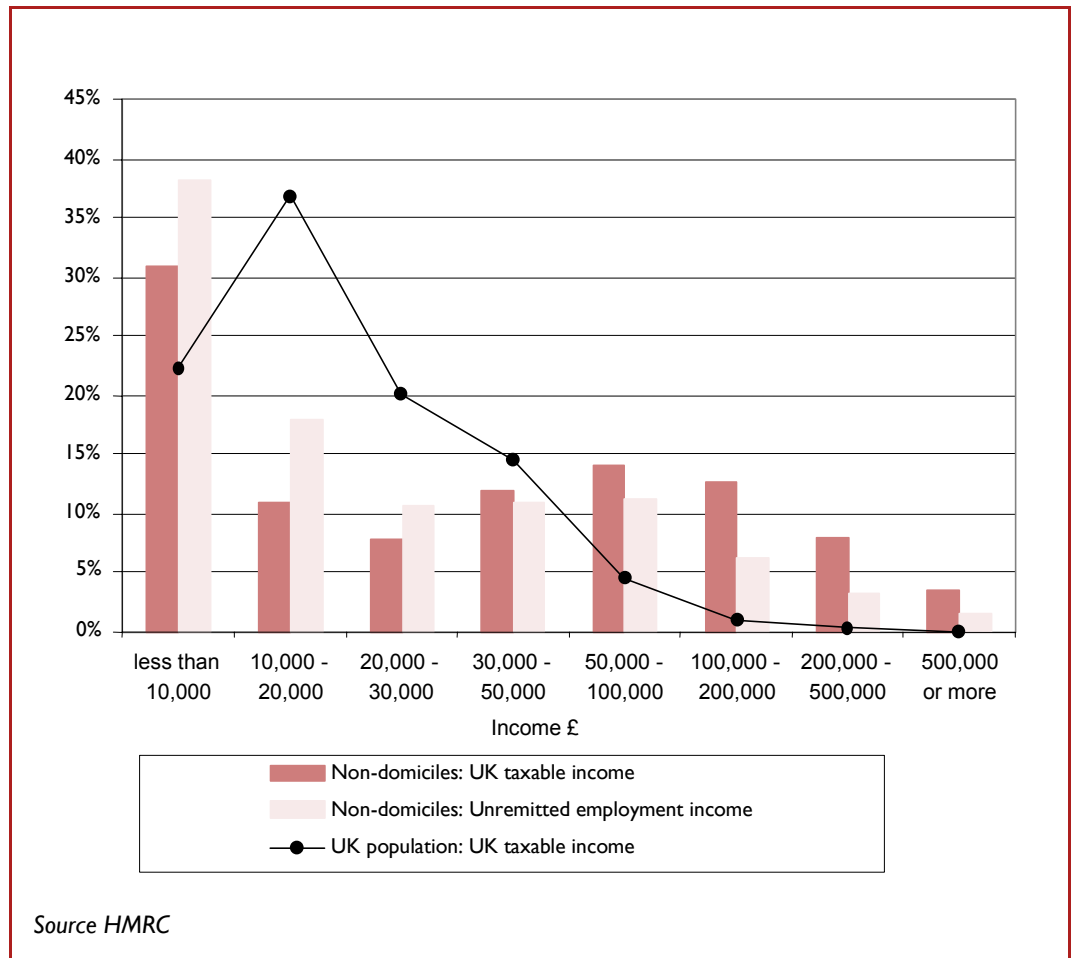
¹ As more returns were processed between April and August 2007, the number of non-domiciles in Table 1 for 2005-06 is lower than the number presented in Chart 1

Table 1: Reported incomes and tax liabilities of non-domiciles and not-ordinarily resident individuals 2005-06

2005-06	Amounts: £ billion	
	Non-domiciled	Not-ordinarily resident
Total no. individuals	111,000	29,000
Total declared UK taxable income of which:	11.9	1.0
Employment income	9.0	0.7
Self Employment or Partnership income	1.5	0.1
UK Dividends	0.5	< 0.1
Remitted foreign income	0.2	< 0.1
Other income	0.7	0.1
Total UK income tax liability	3.9	0.3
No. of individuals reporting on non-taxable remitted foreign employment income	13,000	4,000
Reported non-taxable foreign employment income	0.7	0.1

B.16 It is interesting to compare the distribution of non-domiciles and the main UK population by UK taxable income. A comparison of the distribution of non-domiciles by UK taxable income and by unremitted foreign employment income also provides a useful insight. Chart 2 presents these distributions. The graph shows that, compared with the whole UK population, there is a higher proportion of non-domiciles with greater than £50,000 or less than £10,000 in taxable and non-taxable income. The most common income band for the UK population at 37 per cent is £10,000 to £20,000. This proportion is more than twice that of either of the non-domicile proportions in this band.

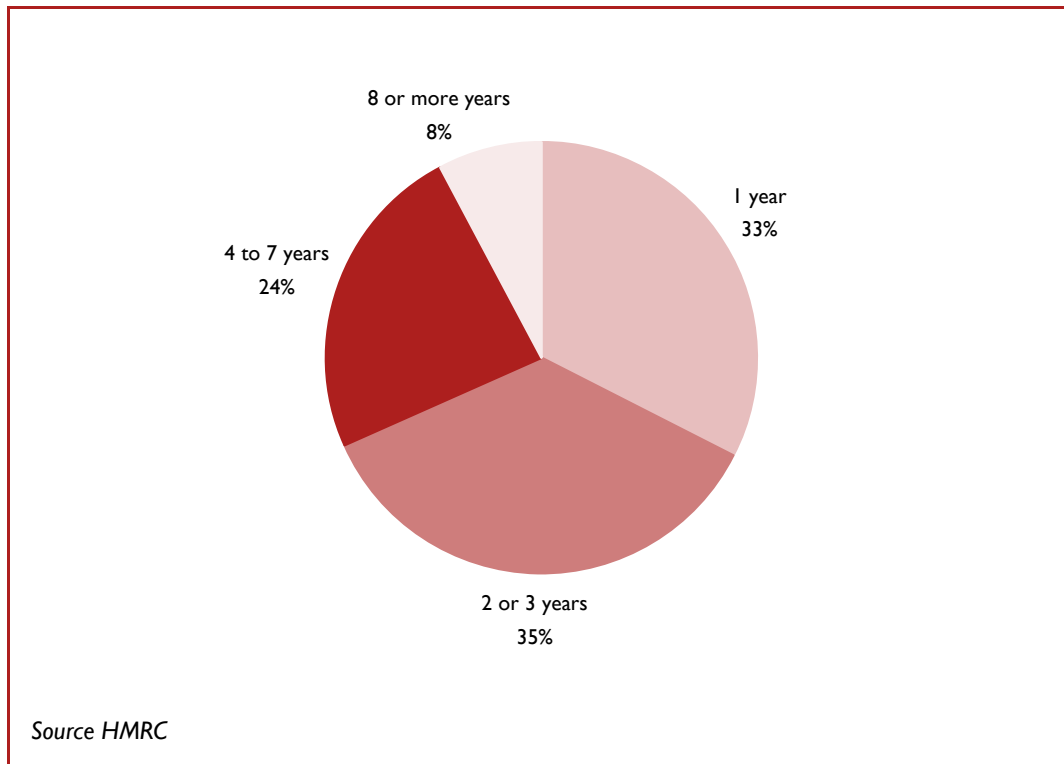
Chart 2: showing income distribution of the UK domiciles and non-domiciles



Length of stay B.17 On duration of stay, the SA system provides a time series of tax returns for the period 1996-97 to 2005-06. This has been used to estimate that, as at September 2007, approximately 23,000² had indicated non-domiciled status on their SA returns more than seven times in this ten year period. Note that some paper returns were not captured electronically in the early years so are missing from the data, and returns for the latest year are still being processed, but the number is not likely to change drastically.

B.18 Chart 3 shows the proportion of individuals indicating non-domiciled status for different numbers of years over the ten-year period.

² Chart 3 below shows that 23,000 represents approximately 8 per cent of the total number indicating non-domicile status at any point over the 10-year period. This is not equivalent to 8 per cent of the number indicating non-domicile status in any particular year.

Chart 3: The duration of stay of non-domiciled residents

B.19 HMRC conducted a small scale sampling exercise of non-domicile and not ordinarily residents SA tax returns in 2004. The exercise was based on around 3,000 cases processed by HMRC's Complex Personal Returns teams (CPR) and Expatriate teams, however this is not representative of all remittance basis users. The key findings on lengths of stay in the UK were as follows:

- the majority of expatriate cases stayed in the UK for less than five years; and
- the majority of cases dealt with by the CPR teams had been in the UK for at least five years and around a quarter had already been in the UK for more than 20 years.

Country of domicile B.20 In addition, information was collected relating to countries of domicile, nationalities and industrial sectors. Other key findings were as follows:

- the individuals whose cases were examined generally claimed to be domiciled in, and were nationals of, developed nations such as the USA, Japan, other Western European countries and Australia;
- the large majority of cases covered by the Expatriate teams started working for their current employers before they came to the UK i.e. they were seconded here; and
- only a minority of CPR team cases were secondees.

Employment sectors B.21 Table 2 below shows the breakdown of non-domiciles and not-ordinarily residents by sector of employment, again based on the 2004 sampling exercise, which as explained above is not representative of all remittance basis users.

Table 2: Non-domiciles and not-ordinarily residents by sector

	Expat Team non-domicile cases	Expat Team not-ordinarily resident cases	CPR Team non-domicile cases	CPR Team not-ordinarily resident cases
	Per cent	Per cent	Per cent	Per cent
Agriculture	<1	<1	<1	<1
Oil/Gas	11	12	1	1
Manufacturing	17	18	3	4
Construction	1	1	1	1
Utilities	<2	<2	<1	<2
Retail	1	<1	3	3
Hotels & Catering	<1	<1	1	<1
Transport	3	2	1	1
Telecommunications	3	3	1	3
Financial and Business Services	46	46	51	44
Of which: Financial Services	37	39	36	27
Public Administration and Private Provision of Public Goods	2	2	2	0
Other Services	13	13	37	44
Of which: not working	1	1	14	19
Unclassified	12	12	22	25

ISBN 978-1-84532-375-2



9 781845 323752 >