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# Non-Resident & Offshore Tax Planning

By Lee Hadnum LLB ACA CTA

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TAX GUIDE - "Non-Resident and Offshore Tax Planning"

### **Published by:**

Taxcafe UK Limited

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Eleventh Edition, June 2010

ISBN 978-1-907302-21-3

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## Chapter 1

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# Introduction

This guide is designed to help those living or working abroad pay less tax on their UK income and investments. It also contains important information for those who live in the UK but wish to use the offshore tax rules to shelter their income and gains from the taxman.

This is an important and sophisticated area of tax planning. Moving yourself or your assets abroad is in many respects the ultimate form of tax avoidance and in some cases it is possible to reduce your tax bill to zero. However, there are also many traps to avoid and pitfalls to negotiate.

This publication highlights some of the key tax-planning opportunities and dangers, focusing on the UK's four major taxes: income tax, capital gains tax, inheritance tax and corporation tax.

Throughout we have tried to keep tax jargon to a minimum and illustrate the main points with examples.

A significant portion of the guide is devoted to the potential non-resident – individuals who are considering moving overseas and have heard that this may bring with it substantial tax benefits.

We look at the tax-saving opportunities, as well as the practical steps and dangers to bear in mind, when considering a move abroad.

In Chapter 2 we explain the concept of 'non residence' which has a huge effect on the amount of income tax and capital gains tax you pay. We also explain the concept of 'domicile' as there are a number of special rules for individuals who are UK resident but not UK domiciled. Domicile is also crucial when it comes to inheritance tax planning.

In Chapter 3 we list the steps you need to take to convince the taxman that you are non-resident and discuss some of the traps the authorities have set to catch 'phoney emigrants'.

Chapters 4, 5 and 6 take a detailed look at income tax, capital gains tax and inheritance tax-planning strategies for non-residents. The information contained in these chapters is extremely important for any would-be tax exile or emigrant and should be read carefully.

In Chapter 7 we focus our attention on non-domiciled people living and working in the UK and explain how they can use their special status to obtain tax savings. There have been a lot of changes in this area in recent years. We look in detail at how these changes affect the tax position of non-domiciliaries living in the UK.

In Chapter 8 we look at the income tax, capital gains tax and inheritance tax implications of working and travelling overseas because, aside from the 'permanent emigrant', many reading this guide may be considering working abroad at some point. After reading this guide you should have a clear understanding of how working abroad will affect your UK tax position.

Chapter 9 explains how you can use a number of reliefs to avoid being taxed twice – once in the UK and again in another country.

Offshore trusts and offshore companies are sometimes viewed as the preserve of the very wealthy. This is not necessarily the case and we have outlined in Chapters 10 and 11 how these structures can help you save tax and how to avoid the detailed tax anti-avoidance rules.

Reducing tax on property investments is a top priority for many UK residents and non-residents. The guide contains numerous examples with a 'property theme' and in Chapter 12 we take a closer look at how non-resident and non-domiciled investors should structure their property purchases.

Your residence status is often the critical factor when it comes to paying both UK and foreign taxes. But what if you can avoid being resident in ANY country? In Chapter 13 we take a brief look at how you can become a 'tax nomad' and avoid both UK and overseas taxes.

Throughout this guide we attempt to identify practical steps that can be taken to mitigate UK tax, although the tax regime of any relevant overseas country should also be borne in mind.

This is where double tax treaties come in. In Chapter 14 we explain the importance of these treaties in further detail.

Finally, Chapter 15 takes an in-depth look at buying property abroad and how to plan your affairs to avoid both UK and overseas income tax and capital gains tax.

We occasionally use some abbreviations. In particular, capital gains tax may be referred to as CGT, inheritance tax as IHT and HM Revenue and Customs as HMRC.

A lot of expat and offshore tax planning depends on getting dates and timing right, so many of the examples are based on specific tax years.

Remember that the UK tax year runs from April 6th to April 5th.

The tax year running from April 6th 2010 to April 5th 2011 may be referred to as the 2010/2011 tax year or just 2010/11.

**Finally, remember that offshore tax planning is an extremely complex area and the relevant tax legislation, as well as HMRC's practices, can change quickly. You should never take any action until you have spoken to a suitably qualified professional who can advise you based on your personal circumstances.**

## Residence, Ordinary Residence & Domicile

### 2.1 WHY DO RESIDENCE & DOMICILE MATTER?

The short answer is, they affect the amount of tax you have to pay.

UK residents who are also UK domiciled (we'll explain domicile later) have to pay UK income tax and capital gains tax on their 'worldwide income and gains'. In other words, no matter where in the world your assets are located or in what country your income is earned, it all falls into the UK tax net.

Those who are UK resident but non-UK domiciled can claim to be subject to UK income tax on income from foreign assets when they bring it into the UK. But from 6th April 2008 being taxed on this basis has a number of consequences.

If you are a non-resident you do not have to pay UK tax on non-UK income. However, you still have to pay UK tax on your UK salary, business profits (if the business is carried out in the UK), pension income and investment income. There are, however, some special rules that can reduce the tax non-residents pay on some types of UK income.

Capital gains tax depends on both your residence and 'ordinary residence'. If you cease to be resident in the UK without also ceasing to be ordinarily resident here, you will remain liable to UK capital gains tax in respect of gains on your worldwide assets.

If an individual ceases to be both resident and ordinarily resident, he is outside the scope of UK capital gains tax, even on UK assets.

So clearly your residence and domicile have a huge effect on the size of your UK tax bill. The crucial question is how do you qualify for these reliefs and exemptions?

## **2.2 BECOMING NON-RESIDENT**

There is no formal legal definition of 'residence'. The Revenue's practice – based on a mixture of statute and court decisions – has historically been to regard you as resident in the UK during a tax year if:

- You spend 183 days or more in the UK during the tax year, or
- Although here for less than 183 days, you have spent more than 90 days per year in the country over the past four years (taken as an average). You will then be classed as UK resident from the fifth year.

**These rules have no statutory force and are guidance only.**

For example, an individual who regularly returns to the UK for 87 days per tax year may still be regarded as UK resident.

This is a crucial point to remember. Although the time limits are undoubtedly important, they are not necessarily decisive any longer. In various court cases in the last few years HMRC has argued that an emigrant remains UK resident if strong ties to the UK are retained.

Simply restricting your visits to the UK after you have left will not necessarily be enough to establish non UK residence.

The first change to this effect was in 2005 and came out of the Commissioners' decision in the 'Shepherd case'.

This case examined whether an airline pilot had ceased to be UK resident.

Mr Shepherd was an airline pilot employed by a British company, flying long-haul flights which started and ended at Heathrow. He retired on 22<sup>nd</sup> April 2000 and decided to live abroad. In October 1998 he started renting a flat in Cyprus and lived there before purchasing an apartment in 2002.

While working, he continued to stay in his UK family home before and after each flight, remained on the UK electoral roll and had all his correspondence sent to the UK.

The taxman said that he was UK resident as he remained in the UK for a settled purpose, to perform the duties of his employment and to continue to see his wife, family and friends.

Mr Shepherd argued that he had ceased to be resident, having established a new home in Cyprus.

His visits to the UK were less than 90 days, and the rest of his time was spent in Cyprus and flying (the majority of his time was actually spent flying).

The Special Commissioner found that his presence in the UK was substantial and continuous and there was no distinct break. Therefore he remained UK resident.

The crux of this decision was that Mr Shepherd worked in the UK, stayed in the family home and visited friends. In this context the simple fact that he had spent less than 90 days per tax year in the UK did not make him non UK resident.

In my view this decision was not surprising and essentially represents a change in emphasis, rather than a new change in practice.

The 90-day limit was never in itself a rule that established non UK residence. To actually establish non residence you would need to show that you have left the UK permanently (for at least three years) or for a settled purpose/employment, and that any UK visits averaged less than 90 days.

In this case, Mr Shepherd couldn't establish that his new life was overseas.

Therefore the impact of this case shouldn't be as widespread as the newspapers reported. Mr Shepherd's position was also made worse by the fact that he couldn't even establish 'treaty residence' in Cyprus (treaty residence is where a person is considered to be a resident in accordance with the terms of a tax treaty).

Another case ('Gaines-Cooper') looked at the method of calculating the 90 day average and could have important repercussions for those just under the limit.

As mentioned previously, it's never advisable to be in this predicament as the 90 day limit is not set in stone – if you approach this figure the taxman could argue that you are UK resident, especially where there is evidence showing you have strong UK ties. This was confirmed in the revised Revenue guidance issued in March 2009 which makes it clear that having close ties to the UK can still make you UK resident. In particular they have stated that:

*"Your status is determined by the facts of your particular case. It is not simply a question of the number of days you spend in the country".*

Previously Revenue and Customs accepted that, when calculating the number of days spent in the UK, the days of arrival and departure could be ignored. A common practice was to arrive on a Friday and depart on a Sunday. This would then be classed as only one day in the UK.

The Commissioners disagreed and argued that the number of nights spent in the UK should be considered. In the above example this would mean two days in the UK.

Revenue and Customs published guidance shortly after this stating there had been no change in their application of the 90 day rule.

However, as from 6th April 2008 new legislation has been introduced so that any day when you are present in the UK at midnight will be classed as a day spent in the UK for the purposes of the 90 and 183 day rules.

The key point is that you have to establish residence overseas. Only then does the 90 day rule come into the picture. If you then meet the 90 day rule you'll remain non-UK resident. If, however, you've never really left the UK you remain UK resident, whether or not you pass the 90-day test.

The Gaines-Cooper case looked at much more than just number of days spent in the UK when deciding a taxpayer's residence. The Commissioners decided to apply the law rather than the Revenue guidance. As we know, the law is pretty vague in this area so the

Commissioners said that residence should be given its natural and ordinary meaning.

As there is no legislation which lays down the required number of days spent in the UK, it's necessary to take into account all the facts of the case and look at a taxpayer's life in some detail.

The Commissioners stated that it's important to look at the existence of other ties to the UK, including the duration of an individual's presence in the UK, the number and frequency of visits, the place of birth, family and business ties and the nature of visits and other connections with the UK.

The availability of living accommodation in the UK should also be taken into account, although this has always been the case and traditional advice has been to sell or rent out any UK property prior to going overseas.

Most of these guidelines are common sense. The taxman wants to stop people claiming non residence solely on the grounds of days spent in the country, even though the UK is their home in all other respects.

In the Gaines-Cooper case, the Commissioners decided that the evidence added up to UK residence being retained: the individual was born in the UK, went to school here, had strong UK business ties, made regular visits, and his wife and son lived in the country.

As stated above, Revenue and Customs published a statement in January 2007 explaining that there has been no change in practice in relation to residence and the '91-day test'.

In particular it states that the taxman will continue to:

- Follow the published guidance on residence and apply it fairly and consistently.
- Treat individuals who have not left the UK as remaining resident here.
- Consider all the relevant evidence, including the pattern of presence in the UK and elsewhere, to determine whether or not a person has left the UK.

This was also confirmed in the revised guidance that HMRC issued for non UK residents.

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