Leaving on a jet plane

CHRISTOPHER STONE explains the implications of *Gaines-Cooper v HMRC* for non-residence.

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Residence status is an extremely important concept in personal taxation and underpins an individual's liability to income and capital gains tax. The Court of Appeal's judgment in the joined judicial review applications of *Gaines-Cooper v HRMC; Davis & James v HMRC* [2010] EWCA Civ 83 will have practical application for thousands of people seeking non-resident status. In a decision on the status and application of IR20, HMRC'S guidance leaflet on residence, the court upheld the department's interpretation of chapter 2 , confirming that HMRC had not applied the guidance unfairly in these cases and the appellants had no legitimate expectation caused by a change of practice. This article explains the court's decision and sets out the practical implications of the judgment for those advising clients on their residence status. All chapter and paragraph references are to the IR20 leaflet (www.lexisurl.com/ir20) unless specified otherwise.

What is IR20?

IR20 ('Residents and non-residents liability to tax in the UK') will be familiar to many practitioners as it has been in circulation, with several revisions, since 1973. It was published by HMRC as a booklet to guide taxpayers through the 19th and early 20th century case law on the thorny issue of residence. The version considered by the Court of Appeal was the 1999 update and specifically chapter 2 entitled 'Leaving the UK'. IR20 has now been replaced with HMRC6 (see below for more detail), but the Court of Appeal's decision on its correct interpretation will still be of direct relevance for taxpayers seeking to determine their residence status before 5 April 2009. As Moses LJ (who delivered the main judgment) stated, the case also went to 'the heart of the relationship between the Revenue and the taxpayer'.

KEY POINTS

- A brief summary of the two cases.
- IR20 and leaving the UK to work full-time abroad.
- Determining whether a taxpayer has left the UK in other circumstances.
- Has there been a distinct break with the UK?
- The importance of other factors in residence status.

The status and purpose of the guidance was much in debate before the Court of Appeal. The preface to IR20 states that it reflects the law and 'offers general guidance on how the rules apply, but whether the guidance is appropriate in a particular case will depend on all the facts of that case'. However, the appellants contended that rather than providing general guidance the booklet contained 'bright-line' tests which HMRC had to apply, so that if a taxpayer came within those parameters HMRC had no discretion but to treat him as non-resident.

By the end of the hearing, the two parties were not, in fact, far apart on the need to apply IR20. HMRC confirmed that they did consider themselves bound by IR20 and if, in fact, a taxpayer did satisfy the conditions for non-residence, he would be treated as such. However, HMRC highlighted the fact-specific nature of each of the tests in chapter 2 and argued that although they were bound to apply IR20, they were not bound to accept a taxpayer's assertion that he satisfied the tests. Moses LJ recognised that IR20 is full of 'value judgments' that are fact-specific and that paragraphs 2.2 and 2.7 to 2.9 do not contain any bright-line tests.

As an example of this, paragraph 2.2 deals with working full-time abroad under a contract of employment. A taxpayer may state that he has worked full-time abroad for a year, satisfied the day-count test, and expect to be treated as non-resident. If HMRC is satisfied that he has, in fact, worked full-time abroad for a year, they are bound to treat him as non-resident. However, they are perfectly entitled to challenge the taxpayer's assertion and determine whether the employment was in fact full time; these are questions of fact in each case. A recent example of this is *Hankinson v HMRC* (TC319) (see 'A closer look', *Taxation*, 18 February 2010, page 19), in which Mr Hankinson's employment abroad was found not to be full time.

The appellants' cases

The tortuous route by which these joined appeals reached the Court of Appeal does not require full repetition here. Suffice to say

IR20, PARAGRAPHS 2.7 TO 2.9

Leaving the UK permanently or indefinitely

2.7 If you go abroad permanently, you will be treated as remaining resident and ordinarily resident if your visits to the UK average 91 days or more a year …

2.8 If you claim that you are no longer resident and ordinarily resident, we may ask you to give some evidence that you have left the UK either permanently or to live outside the UK for three years or more. This evidence might be, for example, that you have taken steps to acquire accommodation abroad to live in as a permanent home, and if you continue to have property in the UK for your use, the reason is consistent with your stated aim of living abroad permanently or for three years or more. If you have left the UK permanently or for at least three years, you will be treated as not resident and not ordinarily resident from the day after the date of your departure providing:

- your absence from the UK has covered at least a whole tax year; *and*
- your visits to the UK since leaving:
  - have totalled less than 183 days in any tax year; and
  - have averaged less than 91 days a tax year.

2.9 If you do not have this evidence, but you have gone abroad for a settled purpose (this would include a fixed object or intention in which you are going to be engaged for an extended period of time), you will be treated as not resident and not ordinarily resident from the day after the date of your departure providing:

- your absence from the UK has covered at least a whole tax year; *and*
- your visits to the UK since leaving:
  - have totalled less than 183 days in any tax year; and
  - have averaged less than 91 days a tax year.

If you have not gone abroad for a settled purpose, you will be treated as remaining resident and ordinarily resident in the UK, but your status can be reviewed if:

- your absence actually covers three years from your departure; or
- evidence becomes available to show that you have left the UK permanently;

providing in either case your visits to the UK since leaving have totalled less than 183 days in any tax year and have averaged less than 91 days a tax year.

that the court was hearing applications for judicial review of the decisions of HMRC not to treat the appellants as non-resident (in the case of Mr Gaines-Cooper for the years 1993/94 to 2003/04 and for Messrs Davies and James in the years from 2001/02). One important procedural distinction was that Mr Gaines-Cooper had appealed the department's decision to the Special Commissioners and lost on both residence and domicile. Messrs Davies and James, concerned that a finding of fact against them before the Special Commissioners might prohibit their legitimate expectation argument, took the judicial review route before a statutory appeal.

Briefly stated, Messrs Davies and James argued that they should be non-resident in 2001/02 because they had left the UK to work full time in Belgium in March 2001 and had satisfied the day-count test in every year since. Therefore, their primary argument was under paragraph 2.2 of chapter 2. In the alternative they argued that they had left and remained abroad for three years and as such satisfied paragraphs 2.8 and/or 2.9.

Mr Gaines-Cooper contended that he had left the UK in 1976, had satisfied the day-count test in every year since then and as such had satisfied the tests in either paragraph 2.8 and/or 2.9.

The notorious day-count test (which is contained within each of the non-resident tests) states that during an absence from the UK the taxpayer must total less than 183 days in the UK in any one tax year and must average less than 91 days per tax year. The appellants relied upon their adherence to the day-count test as support for their contention that they were non-resident. It was stated in argument that, essentially, to satisfy the test in paragraph 2.8, a taxpayer had simply to leave the UK by getting on a plane and stay abroad for three years, ensuring that he satisfied the day-count test in that period. The Court of Appeal accepted HMRC's view that compliance with day count was not a means of achieving non-residence but of ensuring that a taxpayer, once he has become non-resident, does not lose it by coming back too frequently.

Interpretation and application

UK residence is 'adhesive'; a taxpayer can become resident in another country but still remain resident in the UK (see IR20, paragraph 1.4). In order to become non-resident in the UK a taxpayer must do enough to divest himself of residence status. The key distinction for practitioners to understand in attempting to apply IR20 to their clients is how this is achieved on the one hand under paragraph 2.2 and on the other under paragraphs 2.7 to 2.9.

The parties were in agreement that in paragraph 2.2 the only requirement is to leave the UK to work full-time abroad under a contract of employment for at least one whole tax year. That is sufficient by itself to achieve non-resident status and there is no further requirement for social and family ties with the UK to be cut. This is in line with case law (see *Re Combe* (1932) 17 TC 407) and statute (TA 1988, s 335). Visits back to the UK are therefore permitted, as long as they are within the day-count.

However, practitioners must still bear in mind that there is no guarantee that HMRC will accept that a taxpayer is working full-time abroad. This is a question of fact in each case and the factors listed in paragraph 2.5 will be relevant. The timing of departure may, as in the case of Messrs Davies and James, also be crucial. Although HMRC accepted during their investigation that the appellants *may* have started full-time employment at some point after 6 April 2001, they did not accept that the appellants had left the UK to work full-time abroad in March 2001. As the departure

did not take place – on HMRC's view – before the start of the 2001/02 tax year, the appellants could not be non-resident for that whole tax year. They may have been eligible for split-year treatment (paragraph 1.5), but that would have helped only in relation to income tax whereas the appellants were seeking to avoid a charge to capital gains tax.

Cutting the ties

The more controversial part of the Court of Appeal's judgment – and the part that caused Ward LJ some 'trouble' and led him to sympathise with the appellants – was the interpretation it gave to paragraphs 2.7 to 2.9. In contrast to paragraph 2.2, the court held that for these paragraphs there is a requirement on a taxpayer to cut ties sufficient to divest himself of residence. In order to fully understand the distinction it is necessary to set out the material parts of those paragraphs – see IR20, paragraphs 2.7 to 2.9.

The Court of Appeal agreed with HMRC that the tests contained in these paragraphs are defined by the heading: 'Leaving permanently or indefinitely'. Those adverbs determine the nature and quality of the 'leaving'. Ignoring for a moment the detail of the subsequent paragraphs, the departure of the taxpayer from the UK must be such that he has 'left permanently or indefinitely' and this is the underlying question that a practitioner should ask his client. If he has retained substantial social and family ties in the UK, can it really be said that he has left indefinitely?

The appellants sought to rely on the reference to three years in paragraphs 2.8 and 2.9 and argued that because they were in fact absent for at least three years (in that they claimed to have satisfied the day-count test for those years) they should be treated as non-resident. The Court of Appeal held that although an intention to live abroad for three years may be a necessary condition to satisfy HMRC that a taxpayer intends to leave indefinitely, it is not sufficient by itself.

More than mere absence

It is clear from the wording of paragraph 2.8 that more than mere absence is required. The paragraph sets out examples of the evidence that HMRC might seek from a taxpayer claiming to be non-resident. It is quite clear from the examples that HMRC will seek evidence of the nature and quality of a taxpayer's connection with another country (i.e. what steps have been taken to acquire a *permanent* home abroad) and the nature and quality of connection with the UK (i.e. whether the reason for maintaining a UK home is consistent with living abroad permanently or for three years or more). These are just examples of what evidence might be required. HMRC might further ask whether the maintenance of social ties (e.g. membership of a sports club) or business ties is consistent with leaving indefinitely. Other relevant factors may include continuing to have a doctor in the UK or a pattern of regular visits (for more than a temporary purpose) back to the UK. This will be the most problematic aspect for a practitioner to advise upon, but any adviser should bear in mind that the underlying question is whether the taxpayer has left indefinitely.

The appellants accepted that paragraph 2.9 does not provide a separate test from 2.8. If it was an easier test there would be no purpose to 2.8. Rather, it deals with evidence and timing. Fundamentally, the question remains whether a taxpayer has left indefinitely and therefore any departure for a settled purpose within 2.9 must be consistent with a distinct break from the UK sufficient to divest the taxpayer of residence – there must be a sufficient severing of ties.

While the Court of Appeal's interpretation of the tests for non-residence in paragraphs 2.8 and 2.9 is more stringent than many practitioners (and certainly the appellants) would have wished, the judgment does at least clarify the important distinction between going abroad for full-time employment (paragraph 2.2) and leaving permanently and indefinitely (paragraphs 2.7 to 2.9).

Change of policy

The appellants contended that even if they were wrong on the interpretation of IR20, HMRC had previously required no severing of ties for paragraphs 2.7 to 2.9 and they had a legitimate expectation that that practice would continue to apply. It is possible for HMRC practice to give rise to a legitimate expectation, but there must be a 'clear, unambiguous and unqualified representation' to a taxpayer (*R v IRC, ex p MFK Underwriting* [1990] 1 WLR 1545 at 1569 (Bingham LJ)). Unfortunately for the appellants, they could point to only one letter from one inspector to a particular practitioner that supported the contention of their witnesses that there had been a change of practice. The Court of Appeal accepted that there had been an increased level of policing and a tendency not to take claims of non-residence at face value, but this was not sufficient to amount to a change of practice.

HMRC6

HMRC6 ('Residence, Domicile and the Remittance Basis' at www.lexisurl.com/hmrc6) was published by HMRC as a replacement to IR20 and governs all residence issues from 6 April 2009. In chapter 8 it sets out how a taxpayer may become non-resident by leaving the UK. In many respects, the new guidance has simply made explicit what the Court of Appeal held was already the case in IR20; e.g. it states that the act of leaving indefinitely will not automatically lead to non-resident status because HMRC will look, among other factors, at the connections that are retained with the UK. Severing of ties sufficient to divest a taxpayer of residence status will remain a key factor that all practitioners will have to be aware of.

The appellants have sought permission from the Court of Appeal to take the three questions of interpretation, application and change of practice to the Supreme Court. The court's decision is still awaited at the time of publication. ■

Christopher Stone, a barrister at Devereux Chambers, was instructed in the case by HMRC alongside Akash Nawbatt and Ingrid Simler QC, also of Devereux Chambers. Christopher's views should not be taken to be guidance from HMRC.