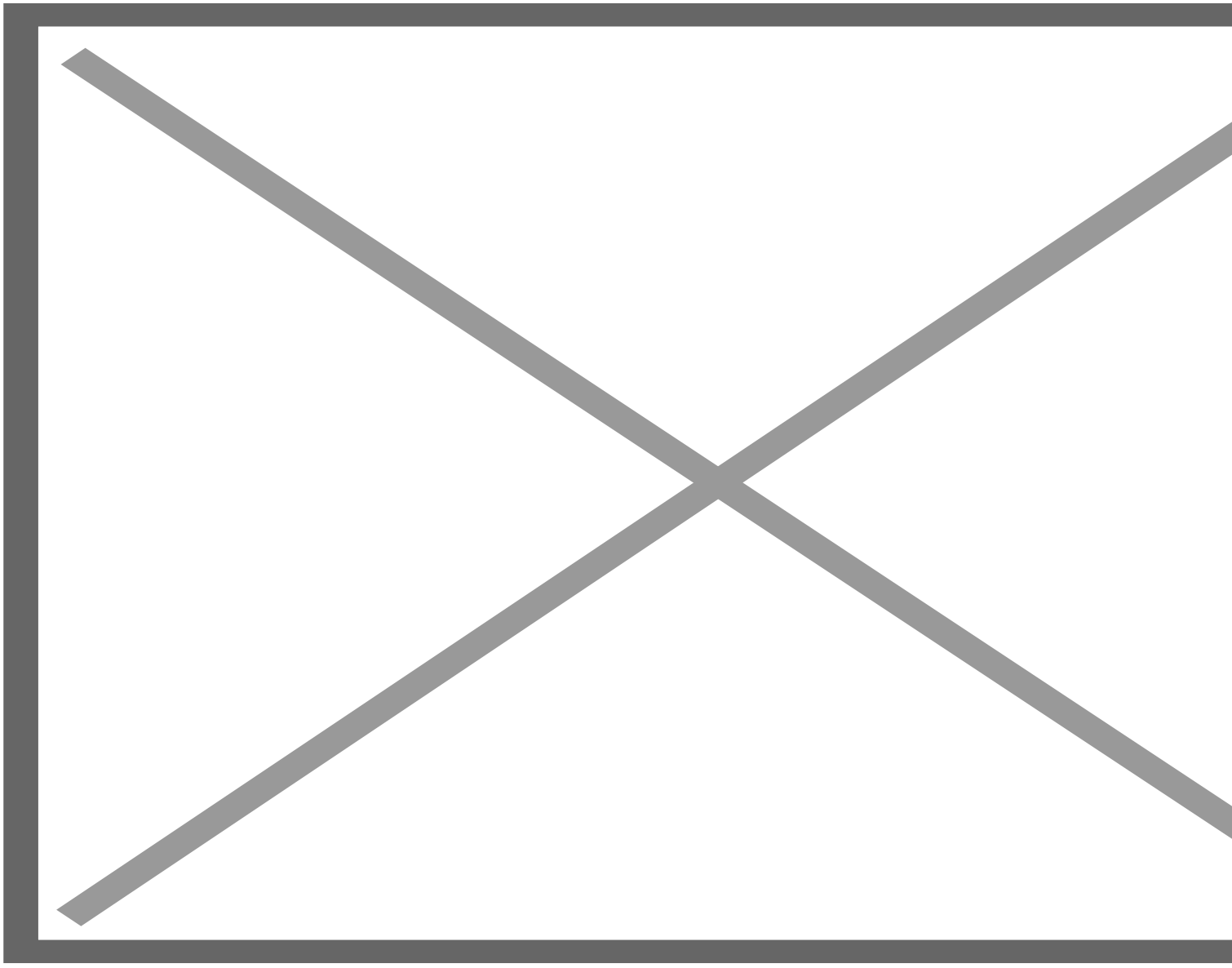
Celtic complexities

Personal tax



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Simon and *Sharon McKie* highlight a number of issues with the new intra-UK residence rules

Key Points

What is the issue?

Residence within particular countries of the UK is now of practical importance and will become more so

What does it mean to me?

Advisers with clients who either spend time in Scotland or have residential property there will have to consider whether they are Scottish taxpayers. This is likely also to be true for Wales, Northern Ireland and perhaps England in the future

What can I take away?

The residence rules have become even more complicated and the professional bodies need to take action on the issue quickly

The importance of intra-UK residence is likely to increase as a result of the new tax-raising powers of Scotland and Wales. As a result of these changes each nation needs its own statutory definition of a taxpayer.

These are found in the Scotland Act 1998 ss 80D–80F; and the Government of Wales Act 2006 GWA 2006 ss 116E–116H. Each is, in effect, a definition of residence within one of the constituent countries of the UK, of intra-UK residence.

The Scotland Act has had a definition of a 'Scottish taxpayer' since its enactment in 1998 and there have already been three major versions of it. Until now, however, it has been of theoretical importance only. On 6 April 2016 it will, for the first time, determine in part the tax liabilities of Scottish taxpayers. The importance of intra-UK residence is likely to increase substantially in the years ahead.

The SRIT

The Scottish parliament has the power to set a Scottish rate of income tax (SRIT) to be used to calculate the rate paid by Scottish taxpayers on certain income. This is set to come into force in 2016/17, but it has yet to be determined. The rates, which will be charged on the relevant income of Scottish taxpayers, are found by deducting 10% from each of the basic, higher and additional rates (the 'UK equivalent rates') and adding the SRIT. Holyrood has the power to set the income tax rates applicable to certain income of Scottish taxpayers, but all of them must deviate from the normal UK rates by the same amount and will apply to the same bands of income as in the UK generally.

These rates will apply to the non-savings income of Scottish taxpayers that would otherwise be charged to the UK-equivalent rates. They are not charged on dividend income, which would otherwise be charged at the various general UK dividend rates, except dividend income charged on the remittance basis under ITTOIA 2005 s 832. Non-savings income is a residual category of income that is not savings income. Savings income is income:

(a) that is within ITA 2007 s 18 subsections (3) or (4) being:

- interest;
- purchased life annuities with certain exceptions;
- profits on deeply discounted securities;
- accrued income profits;
- certain chargeable event gains; and

(b) that is not relevant foreign income charged in accordance with ITTOIA 2005 s 832 (relevant foreign income charged on the remittance basis).

So all relevant foreign income charged under the remittance basis is subject to the SRIT regardless of whether it would otherwise fall within the categories of income listed above. Thus interest income, most purchased life annuity income and profits on deeply discounted securities will be chargeable to the SRIT if the remittance basis applies, but will not be if it does not. Income that is nominated under ITA 2007 s 809H(2), if that income would be savings income if it were not subject to the remittance basis, will be savings income and therefore not subject to the SRIT because s 809H(2) operates by treating such nominated income as not being subject to the remittance basis.

There is a further anomaly. Foreign income that would be non-savings income, whether or not it were remitted (such as rental income), and is nominated under ITA 2007 s 809H(2) or is treated as nominated under ITA 2007 s 809H(4), will be subject to the SRIT. This will not affect the remittance basis charge, but it will affect what income and gains it applies to, the detailed calculation of the charge and whether the tax paid is income of the Scottish or the UK government.

The WRIT

Provisions in respect of the Welsh Rates of Income Tax (the 'WRIT') were inserted into the Government of Wales Act 2006 and the Income Tax Act 2007 by the Wales Act 2014. These provisions allow separate Welsh rates to be set for the purposes of calculating the Welsh Basic, Higher and Additional Rates (Government of Wales Act 2006 s.116D) which are to apply to the non-savings income of Welsh Taxpayers, so these powers would allow the Welsh Assembly to vary the rates applying to the three tax bands by different amounts.

The power to set the WRIT, however, is only to come into force after a positive vote in a referendum of Welsh electors (Wales Act 2014 ss.12 – 14).

Imminent developments

The Scotland Bill 2015 now before parliament contains provisions, in accordance with the proposals of the Smith Commission Report, conferring on Holyrood the power to set the rates of income tax and the thresholds at which they are paid for the non-savings income of Scottish taxpayers. These provisions are to come into force for tax years appointed by the Treasury by regulation.

No similar extension of the powers of the Welsh assembly has been proposed.

Before the recent General Election, the Scottish National Party, the Labour Party and Plaid Cymru all advocated an increase of the Additional Rate of tax to 50%. Whether the Scottish Parliament and/or the Welsh Assembly would go it alone if the UK's Additional Rate remained at 45% is unclear.

Ever looser union?

The Smith Commission Report on Scottish devolution states that all other aspects of income tax, inheritance tax, capital gains tax, corporation tax, National Insurance contributions and oil and gas receipts are to continue to be reserved to the UK parliament. This is, however, unlikely to mark the final position on fiscal devolution in the UK. The Scottish National Party has called for the Scottish parliament to have 'fiscal autonomy' and Plaid Cymru said in its general election manifesto that it wanted the same 'deal' on taxation as Scotland.

Although the Northern Ireland assembly does not have analogous powers over income tax, the Corporation Tax (Northern Ireland) Act 2015 confers on it power to set its own rate of corporation tax. If further powers were devolved to Scotland and Wales over direct taxation, there would seem to be no principled basis on which to deny Northern Ireland similar powers.

The UK government's chosen method for allowing matters affecting only England to be dealt with only by English MPs is through changes to the standing orders of the House of Commons rather than through legislation. At the time of writing it is not clear how matters that affect only England are to be defined. But, as the Scottish parliament is to have the power to determine the rates and bands of income tax applying to Scottish taxpayers, MPs in England may demand the exclusive right to set the rates and bands that apply to English taxpayers.

Scottish and Welsh taxpayers

A Scottish taxpayer's non-savings income will be subject to the Scottish basic, higher and additional rates; a Welsh taxpayer to the Welsh equivalents; and a UK resident who is neither a Scottish nor a Welsh taxpayer to the UK rates. One might ask, what will happen to a person who is both a Scottish and a Welsh taxpayer. The legislation is silent on the matter. The draftsman appears to assume that it is not possible to be a Scottish and a Welsh taxpayer for the same year.

Scottish taxpayers

There are two tests to determine who is a Scottish taxpayer.

They are a test specific to Welsh parliamentarians that we shall not examine further and, what we shall call, the 'General Scottish Taxpayer Test'. This can apply to any individual except one who is a Welsh parliamentarian for any part of the year. Under this test:

> '(1) For any tax year, a Scottish taxpayer is an individual …
> (a) who is resident in the UK for
> (b) income tax purposes … and
> who, for that year, meets Condition A, B or C.'

Three points should be noted. First, it will be seen that, as one does for residence in the UK, one determines whether an individual is a Scottish taxpayer for a whole fiscal year. Unlike residence in the UK, however, there are no split year rules to take account of the special circumstances that apply in the first and last year of 'residence'. The result is that the SRIT may apply to income arising in the overseas part of a split year. Second, one will be a Scottish taxpayer only for a year in which one is UK resident. Third, the legislation makes no distinction between Scottish taxpayers who are domiciled in Scotland and those who are not.

Condition A – close connection with Scotland

An individual meets Condition A if they have a close connection with Scotland.

Defining a close connection

SA 1998 80E states the circumstances in which an individual has a close connection 'with a part of the UK'. They may have such a connection if they have one or more 'places of residence' in the UK.

Central to the definition of a Scottish taxpayer is the concept of a 'place of residence'.

Interestingly, the phrase does not appear in the UK statutory resident test (UK SRT) where the word 'residence' is never used in the sense of a physical place, but only in the sense of a tax status. The term 'residence' is, of course, important in the CGT relief for disposals of main residences. But its use there relates to a different tax and has a different purpose. What is more, 'place of residence' is used nowhere in the legislation conferring that relief. Any conclusions as to the meaning of the phrase drawn from the definition of 'residence' or 'main residence' in the CGT legislation must be tentative. In the UK SRT the draftsman's decision to use the concept of a 'home', rather than the phrase 'main residence' with its long history in CGT relief, appears to have been deliberate. It is clear that, although 'home' and 'main residence' may be related, their meaning in these statutory contexts cannot be exactly the same. Still less can the meaning of 'home' in the UK SRT be equivalent to that of 'residence' without qualification in the CGT main residence relief.

Whatever a 'place of residence' may mean in the Scotland Act's definition of a Scottish taxpayer, it is not the same as the meaning of 'home' in the UK SRT or of a 'main residence' in the CGT relief.

HMRC, however, have published draft guidance on the definition of a Scottish taxpayer. This suggests that the phrase 'place of residence' in the SRIT and the word 'home' are synonyms. It treats the case law relating to the meaning of the phrase 'main residence' and the word 'residence' in the CGT legislation as if it determined the meaning of the phrase 'place of residence' in the definition of a Scottish taxpayer.

If the draftsman, in defining a Scottish taxpayer, had wished to deploy the concept of a 'home', however, it seems strange that he should not have adopted that word rather than the phrase 'place of residence'. This is particularly so because the first definition of a Scottish taxpayer in SA 1998 did use the concept of a home in the notion of 'a principal UK home'. What is more, the substantial amendment in 2014 to the definition of a Scottish taxpayer was made after the enactment of FA 2013, which contained the UK SRT. It would be strange if, in two Acts, where the second one utilised the earlier, the draftsman should have chosen to express the same concept in different words.

It is clear that, at the heart of the test for determining whether an individual is a Scottish taxpayer and of that in the equivalent Welsh provisions, is an imprecise and uncertain concept.

The definition of a close connection with a part of the UK also uses another imprecise concept: that of 'living at a place', for which no definition is given. The draft guidance has no discussion of what it may mean.

Condition B – day counting

An individual meets Condition B if they:

> '(a) … do not have a close connection with England, Wales or Northern Ireland (see SA 1998 s 80E), and (b) … spend more days of that year in Scotland than in any other part of the UK.'

Where days are spent is determined by reference to a 'midnight rule' akin to that in the UK SRT. It is subject to an exception that closely follows the transit exception to the day-counting rule provided in the UK SRT. It is odd, however, that it applies only to journeys in and out of the UK rather than in and out of Scotland. There is no equivalent in the definition of a Scottish taxpayer to the UK SRT's exception to the general day-counting rule for exceptional circumstances or its special deeming rule that applies when an individual enters and leaves the UK on the same day.

Condition C – Scottish parliamentarians

An individual meets Condition C if, for the whole or any part of the year, he is a member of Parliament, or of the European Parliament, for a Scottish constituency or is a member of the Scottish Parliament (Scotland Act 1998 s.80D(4)). We shall refer to this as being a 'Scottish Parliamentarian'.

The Welsh Parliamentarian Test

We have seen that Scottish Parliamentarians are, under the General Scottish Taxpayer Test always Scottish Taxpayers. The equivalent Welsh provisions provide that Welsh Parliamentarians are always Welsh Taxpayers. If Welsh Parliamentarians, therefore, were subject to the General Scottish Taxpayer Test it would have been possible for them to be both Scottish Taxpayers and Welsh Taxpayers. It seems that it is for this reason that Welsh Parliamentarians are excluded from the General Scottish Taxpayer Test and that there is a specific test (which we call the 'Welsh Parliamentarian Test') which applies only to Welsh Parliamentarians who are also Scottish Parliamentarians.

The effect of this test is that a Welsh Parliamentarian will be a Scottish Taxpayer only if the number of days in the fiscal year on which he is a Scottish Parliamentarian exceeds the number of days on which he is a Welsh Parliamentarian or, if those numbers are equal, he has a close connection with Scotland or spends more days in Scotland than in any other part of the UK.

Welsh Taxpayers

The Government of Wales Act 2006 contains provisions which are the same as the provisions in the Scotland Act 1998 defining who is a Scottish Taxpayer with the substitution of Wales, Welsh, Assembly and Welsh Parliamentarian for Scotland, Scottish, Scottish Parliament and Scottish Parliamentarian and vice versa.

Interaction of the Scottish and Welsh general taxpayer tests

GWA 2006 contains provisions defining who is a Welsh taxpayer equivalent to those of SA 1998.

The rules for determining whether or not a UK resident individual who is neither a Welsh nor a Scottish parliamentarian during a year is a Scottish or Welsh taxpayer may be summarised:

(a) If they have only one place of residence in which they live for at least a part of the year and that is in Wales or Scotland they will be a taxpayer there.

(b) If they have more than one place of residence in the UK and they live in a place of residence in the UK for at least a part of the year they will be a Scottish or Welsh taxpayer, as the case may be, if they have a place of residence in Scotland or Wales, as the case may be, for longer than they have a place of residence in any other part of the UK.

(c) If neither (a) nor (b) above applies and they do not have a close connection with England or Northern Ireland and they spend more days of the year in either Scotland or Wales than in any other constituent country of the UK, they will be a taxpayer of the country in which they spend the most days.

The Parliamentarian Tests

In respect of Scottish and Welsh Parliamentarians:

1. If the individual is a Parliamentarian during the year in respect only of Wales or only of Scotland he will be a taxpayer of the country of which he is a Parliamentarian.
2. If at a time in the year he is a Scottish Parliamentarian and at the same or another time in the year he is a Welsh Parliamentarian he will be a taxpayer of the country of which he is a Parliamentarian for the greater number of days in the year or, if he is a Parliamentarian of the two countries for an equal number of days, the country of which he is a taxpayer is determined under the General Test place of residence (Condition A) and day count (Condition B) tests.

An irremediable mistake?

What is wrong?

There are only two things wrong with the intra-UK residence tests: their structure and content.

Their structure is wrong because they consist of two interlocking tests that require anybody who wishes to determine their intra-UK residence to look in two separate pieces of largely non-fiscal legislation and then work out how they interact. This will become more complicated if the Northern Ireland assembly is granted similar powers and more complicated still if equivalent provisions are made for England.

Their content is wrong because we now have two tests of residence in UK fiscal law, both of which are based on imprecise, indeed, indefinable concepts, but on different ones. The professional bodies criticised the government's decision to adopt soft concepts incapable of precise definition in the UK SRT. Having chosen to ignore that criticism, there was even less reason for the government to have used the similarly imprecise, but different, concepts of a 'place of residence' and 'living in' a place of residence in the definitions of a constituent country taxpayer. For the intra-UK residence tests apply only to those who are UK resident under the UK SRT and so they will, by definition, meet the soft criteria by reference to which the latter test applies.

How might it be repaired?

What is needed is a single test to allocate fiscal residence among the constituent countries of the UK concentrated in one place in UK fiscal legislation and based on a simple arithmetical day-counting formula. A day-counting test based on SA 1998 s 80D(3)(b) and s 80(F) should suffice, coupled with an exceptional circumstances exception and a transit exception in respect of each constituent country of the UK.

The need for the professional bodies to act

It is fair to say that, when SA 1998 was enacted – and even when it was amended in 2012 – the professional bodies did not realise the potential future significance of the definition of a Scottish taxpayer so the position largely went by default. What is disappointing, however, is that the Chartered Institute of Taxation seems to have been one of only three professional bodies to submit comments on the draft guidance on Scottish taxpayer status. Even these bodies confined their comments to the detail of the guidance rather than taking the opportunity to consider the adequacy of the legislative tests of intra-UK residence.

It is clear that the taxation systems of the constituent countries of the UK are likely to diverge increasingly in the future, making intra-UK residence increasingly important. If, as a profession, we do not give more active attention to the issue, we shall find ourselves, by default, with a statutory test of intra-UK residence that is permanently dysfunctional.