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UK TAX RESIDENCE LATEST DEVELOPMENTS

The Court of Appeal Decision in *Grace* earlier this month is the latest twist in a high profile tax case on the law of Residence.

Lyle Grace (a British Airways Pilot who worked on long haul flights from Gatwick and Heathrow, owned a house here but also claimed to be a South African Resident); has won the right to a re-hearing of his case in the First Tier Tax Tribunal (formerly called the Special Commissioners).

The significance of Tax Residence at this time is critical in light of the many Entrepreneurs, Executives and High Net Worth Individuals who are considering leaving the UK because of the new 50% tax rate on incomes above £150,000.

This is the first case on Tax Residence to be considered by the Court of Appeal in over 40 years and is highly informative.

Two key issues were addressed by the Judge Lord Justice Lloyd:

- Whether Lyle Grace had sufficiently broken his connections with the UK in 1997 (the year he claimed to have taken up Residence in South Africa) and established them in South Africa. This is a concept of establishing a "*Distinct Break*" and is a crucial one.
- The other issue was whether, as HMRC contended his regular return to the UK to pilot long haul flights for British Airways were not for "some temporary purpose only"; but were for a regular and permanent purpose, sufficient to constitute Residence.

Those thinking of leaving the UK will note that retaining an employment in the UK and entering the Country regularly, may swing the scales towards Residence.

Good organisation and planning of any continuing employment or business ties with the UK are therefore essential elements. Anyone wanting to succeed in keeping out of the UK tax net will need to pay careful attention to how this is structured.

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The other issue emerging from the case is what steps are necessary to constitute the "*Distinct Break*" in the pattern of a taxpayer's life?

Clearly, retaining "available accommodation" is probably (of itself) fatal, whatever the case. HMRC see this as completely pivotal and in my own experience treat this as a single and over-arching factor from which they will not back down.

Retaining an employment/directorship/management role in the UK and coming here to carry out the duties of that role, may also be fatal.

Lord Justice Lloyd has effectively sent those questions back to the First Tier Tribunal and specifically Dr Nuala Brice, so we don't know the exact outcome as yet.

The Pilots' cases emerged from a large scale HMRC Enquiry into British Airways' payroll. In all, some several hundred Pilots' cases were taken under Enquiry. Most were settled by payments to HMRC.

Lyle Grace probably should have considered this route since the costs of three Court cases and now a fourth must probably come close to all the outstanding tax and interest owed.

The other fascinating insight into both *Shepherd* and *Grace* and indeed all the recent tax cases, is that although all the Taxpayers claim to be Tax Resident in another country, they clearly have not been able to satisfy the Residence rules in that other Country, be it Cyprus or South Africa, or anywhere else.

One planning solution for those leaving the UK is not perhaps to head to Tax Havens such as Monaco, Bahamas or Gibraltar, but instead take up Residence in Countries that have Double Taxation Treaties with the UK. Obviously, if the Country in question has a tax rate equal to the UK's new Income Tax rate of 50% or higher, then there is no benefit!

However, it is surprising how many Countries, now have lower income tax rates than the UK!

Also, many Countries have different tax treatments of income and capital gains e.g. Belgium and Switzerland that broadly have no Capital Gains taxation on "*Private Capital*".

In addition, there are special regimes that exempt foreign sourced income and capital gains. Take Spain offering 24% flat rate on Spanish income for six years and Portugal offering 20% on Portuguese income for ten years.

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It is essential to obtain detailed integrated expert tax advice. UK advice that addresses the "*Distinct Break*" and continuing connections, and Foreign advice that ensures that the Client clearly qualifies or understands what they have to do to qualify as Tax Resident, in their chosen Country.

The relevance of being Tax Resident in a Double Tax Treaty Country is that the Treaty will usually contain an Article (usually Article 3). So, if a taxpayer is Tax Resident under the general laws of **BOTH** Countries; The Treaty will award taxing rights based on the tests laid out in the Article, known as the "*Tie-Breaker*" Clause.

If Lyle Grace had been Tax Resident in South Africa, then Article 4 of the UK/South Africa Treaty would have been used to determine his tax status. Clearly, the number of days he spent in South Africa were not sufficient to make him Tax Resident there, under South African tax laws.

Conclusion

In my view (and with every sympathy for Lyle Grace having to undergo a fourth hearing), there is a clear way forward to avoid similar problems for Clients in the future. That is to take advice on the "*Distinct Break*" and to ensure that the Client has the protection of a good Double Taxation Treaty and being certain they **are** Tax Resident, in their new Country.

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