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# Temporary non-residence: the anti-avoidance rules


**Speed read**

**Anti-avoidance rules prevent a formerly UK-resident taxpayer from taking advantage of a short period of non-residence to realise income or gains outside the UK and, as a result, escape UK taxation on the receipt. These rules are most commonly seen in the context of capital gains tax, but they also have application to certain receipts subject to income tax. The scenarios are wide-ranging and include, for example, close company distributions, chargeable event gains and lump sum pension distributions.**



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## The purpose and development of the temporary non-residence rules

The temporary non-residence rules (TNR) have been with us in one form or another for the last 20 years, although their scope has extended over the years. The purpose of this article is to provide a general overview of the rules and summary of the present position, rather than a comprehensive review. There are particular nuances in the application of the TNR rules, particularly where they interact with applicable double tax treaty provisions on residence and double tax treaty relief. Each case should be considered in the light of its specific fact pattern.

The reasoning behind the TNR legislation is straightforward. In the absence of such a measure, a UK-resident taxpayer could avoid the UK tax charge on relevant income or gains by leaving the country for a short period and crystallising the income/gains whilst non-resident (typically in a suitably benign tax jurisdiction).

To address this once much-exploited loophole, a countermeasure for CGT purposes was first introduced for disposals taking place after 16 March 1998. Subsequent changes to the legislation, notably in 2008 and in 2013, updated the original provisions to make them consistent with wider changes to the residence and domicile legislation, and also to introduce new provisions extending the scope. Similar rules now also apply to various income payments.

The rules discussed in this article apply only to individuals. They have no application to entities such as trusts or companies, which face separate migration charges on ceasing to be UK-resident. The commentary below deals solely with the rules applicable for individuals who left the UK on or after 6 April 2013.

## When the TNR rules apply

Each of the TNR provisions requires that the taxpayer in question is defined as 'temporarily non-resident' within the meaning of FA 2013 Sch 45 para 110. Para 110 states:

'An individual is to be regarded as "temporarily non-resident" if—

(a) the individual has sole UK residence for a residence period,

(b) immediately following that period (referred to as "period A"), one or more residence periods occur for which the individual does not have sole UK residence,

(c) at least 4 out of the 7 tax years immediately preceding the year of departure were either—

(i) a tax year for which the individual had sole UK residence, or

(ii) a split year that included a residence period for which the individual had sole UK residence, and

(d) the temporary period of non-residence is 5 years or less.'

In simple terms, the relevant provisions are in point if the taxpayer has been UK-resident in at least four of the seven years prior to the date of 'departure' (i.e. the beginning of 'period A'), and becomes UK-resident again within five years of that date.

> The TNR rules are intricate and wide-ranging .... They should always form part of any discussions concerning migration tax planning for individuals, either on departure from or return to the UK

Note that the five-year period starts from the date of departure and ends exactly five years after that date. It is not linked to the tax year end, so if the 'split year' rules apply in the year of departure, the five-year period will end at the corresponding point in the tax year five years later (see example 1).

UK residence status is determined by the application of the statutory residence test (SRT). The SRT rules are applied rigidly, with the outcome depending on the taxpayer's precise circumstances (i.e. day count, application of automatic overseas or automatic residence tests, sufficient ties tests, etc.).

Determining the date of 'departure' requires some care. For split year treatment to apply in the year of departure, the taxpayer's circumstances in the year of departure and the following year must meet the precise requirements of one of the three relevant cases applicable to departing individuals. It is often the case that the date of departure will not be the date of physical departure, but will instead fall on the previous 6 April or the following 6 April.

The reference to 'sole' UK residence in para 110 is deliberate. A taxpayer may be 'dual' resident, being resident

### Example 1: Arnold

Arnold is UK-domiciled and was UK-resident for several years until he took up a new employment in Saudi Arabia. He left the UK on 14 January 2017, and has been treated as non-resident from that date because he met the requirements of case 1 of the split year rules in the statutory residence test, including satisfying the full-time overseas working criteria for the third automatic overseas test for both 2016/17 and 2017/18.

Arnold made the following disposals of assets held on 14 January 2017:

- In December 2018, he sells UK residential property making a gain of £25,000
- In December 2019, he sold UK shares realising a loss of £10,000
- June 2020, he sold overseas shares making a gain of £50,000

If Arnold remains non-resident until on or after 15 January 2022, the TNR rules do not apply. There will be no UK tax on the gains, or relief for the capital loss.

If Arnold resumes UK residence on or before 14 January 2022, the TNR rules will apply. If he resumes UK residence during the current tax year (on, say, 31 December 2021), the two gains will fall to be taxed in the current tax year, and will be taxable at the 2021/22 CGT rates, assuming he owned the assets before his departure. Relief will be available for the loss on the UK shares, which can be offset against the 2021/22 capital gain. The gain on the UK residential property may have been partly or fully taxed in December 2018 under the NRCGT rules. If so, the NRCGT gain will be deducted from the 2021/22 taxable gain.

in the UK under the SRT and, at the same time, resident in an overseas tax jurisdiction under its domestic rules. Even if this taxpayer is 'treaty' resident overseas for all or part of the period under the terms of the 'tiebreaker' clause in the relevant double tax treaty with the UK, they would still be within the scope of the TNR rules.

That said, where treaty residence is a factor, the application of the rules can give some surprising results (see example 2, which is taken from HMRC's guidance at RDRM12650).

## CGT

### Scope of the CGT legislation

The relevant legislation is TCGA 1992 ss 1M and 1N.

Capital gains arising during the period of TNR are caught by the legislation. The legislation covers all gains on UK or overseas assets held at the date of departure that are realised during the period of TNR, including attributed gains under TCGA 1992 s 3 (formerly s 13).

For CGT purposes, a specific exception applies to exclude gains arising on assets acquired after the date of departure from the UK. Gains on such assets will not be taxed under this legislation, except where the asset is acquired after the date of departure through a no gain/no loss transaction such as an inter-spouse transfer, or by means of a 'rolled over' transaction (for example, roll-over relief under TCGA 1992 s 152). Assets created by or arising under a settlement after the date of departure would also not be excepted from the charge.

This legislation does not apply if the gain falls to be taxed in the UK anyway under the general CGT provisions.

### How the CGT rules operate

The taxable gain arising during the TNR period is treated as being realised in the tax year of return to the UK, and is taxed at the CGT rates and under the CGT rules applicable in that year. The application of this treatment may have had some small benefit for taxpayers in the past, where the CGT rates have fallen (for example, the reduced rates for non-residential property that applied from 2016/17 onwards). It seems unlikely that this will be the case in the near future, with taxation moving upwards due to the government deficit.

### Example 2: Max

Max has had sole residence in the UK for the previous ten years. On 22 February 2015, he moves to Poland and is considered resident there from this point, as well as retaining his UK residence up to the end of the tax year. From 22 February to 5 April 2015, he is treaty non-UK resident.

For the purpose of this example, Max does not satisfy the conditions for split year treatment in 2014/15. Max is not solely UK-resident from 22 February 2015, but he will remain UK-resident for the tax year.

As this is not a split year, period A (as defined in FA 2013 Sch 45 para 110) will end at the end of the 2013/14, because that is the end of the last tax year in which Max was solely UK-resident. His year of departure for the purpose of applying the temporary non-resident provisions is therefore 2013/14, even though he actually physically left the UK on 22 February 2015. The next residence period begins on 6 April 2014, and Max will begin to be regarded as temporarily non-resident from this point.

### CGT: other points to be aware of

- **Losses:** Capital losses arising during the TNR period are treated as arising in the tax year of return. They can therefore be offset against gains arising on or after that date and against gains accruing during the TNR period, even if the disposal of the asset on which the gain arose took place prior to the loss-making disposal.
- **Non-resident CGT (NRCGT):** If the asset is UK property, UK CGT arises under the NRCGT rules in the year of disposal. If an NRCGT gain arises during the TNR period, to prevent double taxation, the NRCGT gain (which in most cases will be lower, due to the NRCGT rebasing provisions) is deducted from the 'TNR' gain taxable in the year of return.
- **Business asset disposal relief (BADR):** If BADR qualifying shares (or other BADR qualifying business assets for that matter) are disposed of during the TNR period, it may be prudent to make a protective claim for relief, even where the vendor considers they are unlikely to return within the five-year period. The time limit for a BADR claim, which is 12 months from the filing date for the tax year in which the gains arises, is rigidly applied, so if the vendor's circumstances change and they return early, there is no facility to make a late claim.
- **Trust gains (s 86):** Trust gains arising on settlor-interested trusts and taxable on the settlor under TCGA 1992 s 86 fall with the scope of the TNR rules.
- **Trust gains (s 87):** Capital payments to non-resident beneficiaries are disregarded for the purposes of matching gains potentially taxable under TCGA 1992 s 87 against capital payments to beneficiaries. This rule also applies where a formerly UK-resident beneficiary receives capital payments after they have left the UK. If the beneficiary returns to the UK within the TNR

period, the capital payment is deemed to have been made in the year of return, and is then matched to historic gains or, if the capital payments exceed the gains, against future trust gains.
- **Double tax relief:** The temporary non-residence rules may mean that a gain is taxed in another country in the year that it arises and then in the UK for the year of return. If tax has been paid on the gain in another country, in principle it should be possible to claim relief for double taxation.

### Remittance basis: capital gains and income tax

- **Gains realised during the TNR period:** Assuming the proceeds have not been remitted to the UK, the remittance basis can be claimed in the year of return, enabling tax on the gain to be deferred until the proceeds are remitted to the UK (or eliminated completely if the proceeds are never remitted).
- **Gains remitted during the TNR period:** If a previously unremitted gain on which the remittance basis has been claimed is remitted to the UK during a period of non-residence, ordinarily there would be no UK tax charge. However, if the remittance falls in a TNR period, the gain will be treated as having been remitted in the year of return.
- **Income remitted during the TNR period:** 'Relevant foreign income' (i.e. income from non-UK sources that is chargeable to tax under any of the provisions listed at ITTOIA 2005 s 830) arising in a tax year of UK residence where the remittance basis has been claimed which is then remitted to the UK during a TNR period is treated as having been remitted in the period of return (ITTOIA 2005 s 832A).

### Income tax

#### Pension drawdowns and other pension-related benefits

Certain pension-related lump sum payments fall within the scope of the TNR anti-avoidance provisions. These are listed in HMRC's *Residence, Domicile and Remittance Basis Manual* (at RDRM12680) and include the following:
- withdrawals under a flexible income drawdown fund from a UK or foreign pension fund (HMRC's *Employment Income Manual* at EIM74050 gives a detailed overview of these rules);
- certain lump sum payments from employer-financed retirement benefit schemes (EFRBS);
- 'relevant' steps involving the payment of lump sum benefits that are caught by the disguised remuneration rules; and
- certain lump sum payments that might otherwise be protected from charge by a provision in the relevant double tax agreement.

Payments caught within the TNR would be subject to UK taxation in the year of return, and income tax would be charged at the marginal rate applicable in the year of return.

#### Gains taxed as income

Chargeable event gains on life assurance policies arising on encashment of life policies are generally caught by the TNR rules under ITTOIA 2005 s 465B and treated as arising in the year of return. However, the TNR rules do not apply where the encashment is caused by the death of the life assured. (Note that, in many cases, the amount of the taxable gain may be reduced by periods of non-residence, depending on the fact pattern and, for pre-April 2013 disposals, whether the policy was held with an overseas insurer).

Similarly, offshore income gains realised during the TNR period (and taxable as income under the non-reporting fund rules) are within the scope of the TNR rules, and would be taxable in year of return (under SI 2009/3001).

#### Close company distributions

Payments from close companies to 'material participators' are generally caught by the TNR rules. A 'material participator' is a person who, on their own or together with their 'associates' (as defined by CTA 2010 s 448), controls, directly or indirectly, more than 5% of the ordinary share capital of the company or, either solely or together with their associates, is entitled to more than 5% of the share capital on a winding up.

Income distributions from a UK company received by a non-resident shareholder fall within the 'disregarded income' rules at ITA 2007 s 811. This rule limits the UK income tax charge to the amount of tax or notional tax already suffered (unless personal allowances are claimed).

Where such payments are made during a TNR period to a shareholder, ITA 2007 s 812A deals with the interaction between the two provisions. If the shareholder has been a material participator at any time during the year of departure or at any time in the three years preceding the year of departure, the effect of s 812A is to increase the individual's 'relevant' investment income in the year of return to include the income received during the TNR period. Dividends paid from profits arising after departure from the UK are excluded from the TNR charge.

Distributions from a UK close company to a material participator during a TNR period are taxed in the year of return if the UK tax charge is limited by the application of a provision in a double tax agreement (ITTOIA 2005 s 401C).

Dividends and other distributions from overseas companies to overseas taxpayers would not normally be taxable in the UK. However, if a shareholder receives a distribution in a TNR period and was either a material participator in the year of departure or in the three preceding years, the TNR rules will apply to tax the dividend in the year of return. This rule applies if the overseas company making the distribution would have been a close company if it had been UK resident (ITTOIA 2005 s 408). Only dividends out of profits arising whilst the shareholder was UK-resident would be caught by the TNR charge.

Finally, loans to participators in a close company which are written off during a TNR period are treated as having been written off in the year of return, and the charge under ITTOIA 2005 s 415, arises at that point (ITTOIA 2005 s 420A). There is no equivalent provision in respect of the employment income charge that could otherwise arise where a loan to a non-participator director or employee is written off.

### Conclusion

The TNR rules are, by necessity, intricate and wide-ranging in order to avoid the UK tax authorities suffering tax loss on mobile individuals. However, they can easily be overlooked, and they should always form part of any discussions concerning migration tax planning for individuals, either on departure from or return to the UK. ■