



Paying a Fairer Share: The TUC Response

**A Response to the Treasury Consultation on Residence and
Domicile, February 2008**

Introduction

The TUC welcomes the opportunity to comment on the Government's proposals for changes to the domicile and residence tax regime in the UK. The TUC represents nearly 6.5 million workers in 58 unions.

The Treasury published its consultation document '*Paying a fairer share: a consultation on residence and domicile*' in December 2007. Paragraph 4.1 of the consultation document says:

The Government welcomes views on how the measures outlined in Chapter 2 will be implemented and on whether further measures (such as the approaches set out in Chapter 3) could be introduced without putting at risk the UK's competitiveness by undermining the UK's attractiveness to the internationally mobile.

There is a problem with this approach to the consultation in that it assumes that the proposed measures outlined in Chapter 2 are acceptable, and that the only issue of concern might relate to implementation, whilst Chapter 3 is premised on the notion that the domicile rule should be retained.

The TUC does not share either opinion. As is noted in paragraph 3.1 of the consultation document:

Debate on the issues of residence and domicile broadly breaks down into two camps: those who wish to see the current rules retained unamended, and those who would like to see the special rules of the remittance basis abolished in their entirety.

The TUC is of the latter persuasion: it considers that the use of the domicile principle in determining a person's right to be taxed on a remittance basis with regard to their non-UK source income and gains is unacceptable for legal, ethical, economic and pragmatic reasons and as such should be ended. This paper presents its reasons for saying so. In doing so the invitation to suggest further, alternative, taxation measures that might be used to replace the domicile rule that might create both a fair taxation system and one that will be both internationally attractive and competitive has been accepted.

As a result this report has three parts. The first is a summary of the TUC's reasons for rejecting use of the domicile rule in taxation, with evidence being given to support the claim made that this rule is harmful in terms of both taxation lost and other matters. The second is a summary of the TUC's proposed alternative course of action and the third is a summary of the submission.

1. Reasons for rejecting use of the domicile rule and selective availability of the remittance basis in the UK taxation

There are legal, ethical, economic and pragmatic reasons for rejecting use of the domicile rule in determining access to use of the remittance basis in the determination of UK taxation liabilities of individuals.

1.1 Legal reasons for rejecting the domicile rule

It has been argued¹ that the UK's use of the domicile rule in its taxation system is an illegal breach of the Race Relations Act 1976 as amended in 2003. That amendment made it illegal to indirectly discriminate against a person by reason of their national origin.

The TUC has not sought legal opinion on this claim, but does believe that the principle that the RRA sought to embrace is violated by use of the domicile rule to determine a person's right to use the remittance basis in determining their liability to UK taxation.

It would seem that a person's domicile can fairly be described as their place of national origin and the fact that a minority within the UK's population have actual or potential social advantage as a result, based upon their right to pay less tax than those with domicile in the UK does suggest that indirect discrimination is taking place against a majority of the population of the UK. The principle that discrimination can take place against a majority has, of course, been proven in the case of sex discrimination and as such can be considered in this case as well.

For this reason, and whether or not a technical argument might be used by the Government to avoid application of this law in this case it seems wholly inappropriate that the taxation system has not embraced the principle that

¹ See 'National Origin, Equality and the UK's Domicile Law as it relates to Taxation', Tax Research LLP, 2007, [Hhttp://www.taxresearch.org.uk/Documents/UKDomicileLaw03-07.pdf](http://www.taxresearch.org.uk/Documents/UKDomicileLaw03-07.pdf) accessed 14-2-08

discrimination should play no part in its operation and as such the TUC is of the opinion that the principles enshrined in this Act should now be accepted as creating a binding obligation upon the government that the domicile rule should be removed from use in determining a person's liability to UK taxation.

1.2 Ethical reasons for rejecting the domicile rule

It has long been a principle of British law that all people should be treated as equal before the law. This is a principle to which the TUC subscribes. It forms the bedrock of the democratic principle, of human rights and of the rule of law and as such is a fundamental principle of the society in which we live.

The domicile rule breaches this principle. There are, as a result of its use, two quite distinct and separate taxation laws in operation in this country, and what is legal and illegal in each differs quite significantly. For example, a non-domiciled person may place their investments offshore and not declare their income arising upon them in the UK so long as they are not remitted to this country and face no taxation penalty as a result. A domiciled person doing exactly the same thing will have evaded tax in the UK.

There can be no ethical justification for having two, parallel legal systems in the UK access to one of which is determined solely by reason of accident of birth. For this reason the domicile rule should be abolished as the basis for determining a person's right to access the remittance basis of assessing liability to taxation in the UK.

1.3 Economic reasons for rejecting the domicile rule

There are numerous economic reasons for rejecting use of the domicile rule in determining a person's right to use the remittance basis in assessing their liability to UK taxation.

1.3.1 Taxation loss.

The TUC has argued that £4.3 billion taxation revenue is lost as a result of the use of the domicile rule in determining a person's liability to UK taxation. The calculations are explained in the appendix. After the government's proposed changes much of this potential revenue will remain unavailable to the public purse in the UK.

1.3.2 Tax compliance loss.

Whilst figures for tax evasion are in total unknown there can be no doubt that the significant publicity given to the domicile rule can only have exacerbated the feeling of unease that many in the UK have about the operation of two quite distinct taxation laws, one for those domiciled and another for those not domiciled, inside one state. These laws, do for example, provide different legality to the structures that can be created by UK resident person in tax havens. Those structures will usually be legal and provide tax savings for the non-domiciled person and will, unless declared in full, be illegal for the domiciled person. The offshore tax ‘amnesty’ offered by HM Revenue & Customs in 2007 resulted in more than 45,000 people voluntarily declaring back tax liabilities thought to amount to £900 million², but left at least as many people again subject to HM Revenue & Customs investigation on their non-compliance with offshore regulation. Some of those involved have said they were genuinely confused by the UK tax system into making error. Those that were not confused may instead have been motivated by desire to seek a tax benefit that others in the UK could legally, but they felt inequitably, secure.

We believe that the simplification to the tax system that abolition of the domicile rule would allow would be beneficial in increasing tax compliance rates.

1.3.3 Cost to the UK economy.

We believe that there would be substantial benefits to the UK economy from abolishing the domicile rule. These would arise for the following reasons:

- An unfair subsidy to employees of non-domiciled status would be removed and as such those people that are long term resident and domiciled in the UK would secure enhanced opportunity to secure key jobs on the basis of there being a level playing field in the employment market;
- Small UK businesses that are owned by UK domiciled owners would be subject to the same capital gains tax regime as those UK businesses owned by non-UK owners, so removing the competitive disadvantage they suffer at present upon sale of their enterprises;

² <http://www.ft.com/cms/s/0/cd6aadb2-a39f-11dc-b229-0000779fd2ac.html> accessed 20-2-08

- UK domiciled entrepreneurs could have the same access through the same mechanisms to foreign markets as do their competitors based in the UK who are not domiciled who can at present access those markets through tax haven controlled operations to which they can also transfer control of intellectual property and other such rights at cost to the UK exchequer and at benefit to their profitability, so distorting the level playing field in the UK small business market to the detriment of society at large and to competitiveness in general.

1.4 Cost to certainty.

Although it has been represented that domicile is a matter of legal fact this is not in fact the case. Like most legal fact, the determination of a person's domicile does in many cases rely upon interpretation and the existence of doubt as to future intentions.

This is not the basis for providing certainty in a tax system and can be the cause for considerable injustice. In the interests of fair taxation this cause of uncertainty within the tax system needs to be eliminated.

1.5 Conclusions: section 1.

Adam Smith said in 1776 that a good taxation system should be equitable, certain, convenient and efficient. The domicile rule fails these tests. Discrimination on the basis of a person's national origin is not equitable. The process of determining that status, which is not based on any clearly defined legal test, is not certain. The domicile rule is not convenient: running two parallel tax systems can never be convenient. Nor is it efficient: the domicile rule causes taxation loss to the UK.

For these reasons we have major reservations with the proposals that have been made. We do not think they are the right solution to the domicile issue and we do not think they are sustainable. Most particularly, we think there are better uses for the funds used to subsidise this group within our society and we think that equity requires a different approach.

2. An alternative approach

The TUC believes that an alternative approach to this issue is required. This is outlined as follows.

2.1 Abolition of the domicile rule

If, as we contend, use of the domicile rule in taxation is highly problematic at a number of levels, including possibly legality, then its use must be ended.

We are of the opinion for the reasons noted that this would also be of benefit to the UK economy.

As a result of this change the use of the remittance basis would cease in the determination of UK taxation liabilities of those resident in the UK except as noted in section 2.2, below.

That said, we note the government's desire that tax changes should not harm the UK's competitive environment. In addition, the TUC is committed to ensuring that a fair tax system is created in the UK, which must include fairness for those temporarily resident here. As such we make the recommendations in the following paragraphs in response to the call for opinion in section 3 of the consultation document.

2.2 A revised residence rule

The government paper recognises the need for some change to the UK's residence rules. We would suggest that these do not go far enough.

The UK currently has two residence concepts in addition to domicile. These are residence and ordinary residence. The technical differences are not an issue of concern here except to note that ordinary residence is usually acquired after the elapse of three tax years of residence in the UK.

We suggest that a new rule should, in large part accept this principle. A person who has arrived temporarily in the UK (assuming that they have not already done so in the previous ten years) should be entitled to have a four year period of temporary residence status for tax purposes in this country. During that period they should be taxed on all their UK source income and capital gains and on their non-UK income and gains on a remittance basis. They should only be liable to Inheritance Tax on their UK assets. At the end of the four tax year period they

would have a choice: they could leave the UK or they could move to being taxed on an arising basis on their world wide income and gains on a basis exactly consistent with that of any other UK resident person, none of whom would by then, with this one exception, have use of the remittance basis. Temporary residents will have a personal allowance whilst holding that tax status, so not compromising their human rights.

We believe that this proposal has the following merits:

1. The vast majority of students coming to the UK will only pay tax on their UK source income under this rule;
2. The same will be true of the very many temporary migrant employees who work in this country, amongst whom a pattern of returning to their country of origin is now being established in many cases;
3. Most commercial secondments within banks and other commercial institutions rarely exceed this time duration, so leaving them unaffected by the rule change if the person accepting appointment chooses to remit no non-UK income to this country;
4. Those who intend to stay for longer have a period in which they can adjust their affairs to suit the UK tax environment without requiring them to do so either hastily or when it is disadvantageous to do so for market reasons;
5. After a period of four tax years in the UK, the person will then be subject to the one consistent tax regime that will apply to all long term residents of this country, so providing a simple, consistent, non-discriminatory system of taxation for all who make long term commitment to the UK and expect in turn to make use of its facilities over the long term;
6. The UK tax system will be considerably simplified as a result of this change;

7. The system will be easy to communicate in plain language to all those arriving in the country, which will be a substantial advantage.
8. The rule will be difficult to abuse and require only limited anti-avoidance legislation.
9. The status of temporary residents should be relatively straightforward to monitor meaning that the move to a remittance basis could be enforced, which is vital to the acceptability of any scheme.

We would recommend that presence in the UK during the four year period be determined on the basis of use of a strict 183 day rule and an aggregate 732 day rule. This is an adaptation of the existing approach to ordinary residence.

2.3 A revised rule for recognising days in the UK

We note the planned revision to the rules on recognition of a day in the UK. We have concern about this new rule that states that a day of arrival and a day of departure are both days of residence and that a day when a person both arrives and departs might also be a day of residence.

In practice we think that to count both days of arrival and departure is likely to overstate the number of days in the UK with regard to each visit. It is likely that on the basis of hours in the UK each visit would be of one day's less duration than this rule would suggest. We therefore recommend that either a day of arrival or a day of departure always be counted as a day of residence, but not the other.

We also suggest that days when a person both arrives and departs from the UK be ignored for residence purposes or the importance of the UK's airport hubs will be undermined at cost to real employment in the UK and in its airlines.

3. Conclusions

We have made proposals in this paper that are consistent with the principles of taxation that many in the taxation professions think appropriate. The changes we recommend improve equity, fairness, efficiency and by simplifying the tax system considerably, its convenience.

We believe that the recommendations we have made preserve the UK's competitiveness and will allow it to remain a location that attracts foreign students, temporary workers and those on secondment from foreign employers. This is, we think, the core quality of competitiveness that taxation in this area should support.

We do at the same time think that this proposal will increase the international standing of the UK, remove the possibility that it can be described as a tax haven, enhance the competitiveness of its internal economy and boost its own long term residents and the businesses they own by eliminating tax impediments that have prevented them accessing markets on the basis of a level playing field.

Most importantly we believe this proposal will remove discrimination from our tax system. It will as such stop a cause for tension in our society as well as eliminating a risk of legal challenge.

But most of all, we think that the vast majority of those who come to the UK on a temporary basis will think this rule fair, comprehensible and no impediment to their engagement with our economy and society.

Appendix

The cost of the domicile rule³

Data

According to [HM Treasury](#)⁴ there are 112,000 registered non-domiciled people in the UK having an average income of about £87,500 a year and pay about £26,800 each in tax, a sum which almost coincides with a simple calculation of the liability due by anyone on that income. The total approximates to £3 billion.

This information does not, of course, suggest anything about tax lost, only about tax paid. [Table 2.5⁵ of the HMRC statistics](#) for 2006-07 provides a basis for estimating the tax lost.

Assumptions

Using data solely in that table the average income of people in the various income bands it refers to and the average tax they paid can be calculated. In the income band from £50,000 to £100,000 the average income is £66,452 and the average tax paid is £16,581. This income is obviously a lot less than that of the average non-domiciled person. But they do fall into this band as a whole, on average. That locates them for the purpose of this analysis.

Claiming non-domicile status is, of course, of no benefit if you have no income or gains arising out of the UK. So, it logically follows that those who claim this status must have higher income than that which they declare in the UK. The data disclosed by the Treasury clearly refers to the income these people declare in the UK. Since their average income is already £87,500 it's reasonable to assume two things.

The first is that their real income is going to be, on average, in excess of £100,000.

The second is that because of their ability to use the domicile rule they don't on average appear in the data relating to those falling into the £50,000 - £100,000 income bracket as published by HMRC in their table 2.5. In other words, statistically they do not significantly distort the data for those who declare income in that band and above and as such it is statistically acceptable to base an analysis on that data set and to extrapolate it to calculate tax lost without having to allow for the presence of non-domiciled people in that data set.

I stress these are important assumptions. I also stress that I think that they are fair.

Calculations

There were 507,000 people in the UK who declared income above £100,000 in

³ Based on [H<http://www.taxresearch.org.uk/Blog/2007/09/06/the-domicile-rule-costs-£4.3-billion/H>](http://www.taxresearch.org.uk/Blog/2007/09/06/the-domicile-rule-costs-£4.3-billion/H) accessed 7-12-07

⁴ Data reported at <http://www.taxresearch.org.uk/Blog/2007/07/12/jane-kennedy-adding-nothing-to-the-domicile-debate/> accessed 7-12-07

⁵ [H\[http://www.hmrc.gov.uk/stats/income_tax/table2-5.xls\]\(http://www.hmrc.gov.uk/stats/income_tax/table2-5.xls\)](http://www.hmrc.gov.uk/stats/income_tax/table2-5.xls) accessed 7-12-07

2006 - 07. Data on them might look like this based on Table 2.5:

Band start point £	Mid point £	Average £	Tax each £	Tax rate	Number 000	Weighted Average £
100,000	150,000	133,693	41,509	31.0%	371	97,830
200,000	350,000	287,273	98,182	34.2%	110	62,327
500,000	750,000	689,474	244,737	35.5%	19	25,838
1,000,000		2,242,857	807,143	36.0%	7	30,966
					507	216,963

The average tax rate in this group is about 33%. To be more precise is to add spurious accuracy. The weighted average of their income is £216,963. So, the average tax payable might be £71,598. If UK tax rates were applied as set out in law the tax payable would be more: it is assumed tax reliefs and planning takes place to reduce the sum paid.

Given that all 112,000 people who are non-domiciled should on the basis of the assumptions made fall into this income bracket, but do not at present, we can extrapolate this liability to suggest that if those non-domiciled people did declare their likely average worldwide incomes here (assuming they are distributed in the same way as those of UK domiciled people, which seems if anything an assumption likely to underestimate their actual liability) then their total tax liability would be £8.019 billion a year. But we have been told that the tax paid by non-domiciled people in the UK is just £3 billion. This suggests there is just over £5 billion of tax unpaid as a result. Logically this has to be true.

Allowing for those who'd leave

But logic is not, of course everything. It's been argued that some non-domiciled people will leave if the domicile rule goes. However, since many work in the City of London that's unlikely. There is nowhere else for these people to go to get the experience they want assuming they cannot or do not want to go the United States. They will stay.

So will all US citizens now here. They pay US tax on their worldwide income anyway.

And all those who are not domiciled here but who are in the UK because it's a great place to do business will stay. As will all those who would pay more tax if they lived just about anywhere else in the world that charges resident people to tax on their worldwide income and also provides a decent environment in which a person would want to live. But, assuming 20% of all non-domiciled people decide to go as a result of a rule change to allow for the argument of those who say this would happen then the total tax paid by this group would go down to £6.4 billion. That still leaves an apparent gain of £3.4 billion from getting rid of the domicile rule.

Inheritance Tax and Capital Gains Tax

But there are two further taxes that must be considered. One is Inheritance Tax. Non-domicile people are older than average when they make their claim for this status. And they do die. Those that do will, if the domicile rule is abolished, fall

within the net of this tax. Most do not now. Suppose just 2,000 non-domiciled people a year will die here. Their estates are highly likely to be chargeable to Inheritance Tax. 37,000 estates are chargeable on average a year now. If these estates just paid the same as each of these on average the tax yield would go up by £215 million. A much higher yield is likely.

And also consider capital gains tax. In 2006-07 the total yield from this tax was £3.8 billion. This would have been very largely paid by people earning more than £100,000 a year: they have the cash to invest in assets that result in chargeable gains. If the population chargeable to this tax went up by 80% of 112,000 then the yield would increase by 17.7%, or about £670 million. In combination with Inheritance Tax that is £785 million extra tax a year.

The non-declared non-domicileds

Add to that the fact that 112,000 is the number currently claiming to be non-domicile. As has become clear as a result of the recent UK 'tax amnesty' quite a number of those who have not declared their offshore income have not done so assuming they were non-domiciled but without having told the Revenue of that fact. 60,000 people have so far come forward under that scheme. Suppose 20% of them use this defence then 12,000 extra people will fall into the net if the domicile rule goes. To be cautious suppose they aren't as wealthy as those who have declared their non-domiciled status and only, on average, have extra tax of £20,000 of income a year to declare (I gather that this is not uncommon amongst those making declaration). That's £8,000 of tax each. That's £96 million extra income tax. And another £90 million of potential capital gains too, which is reasonable because non-domiciled people find these very easy to avoid at present.

£4.3 billion

So now we have (within reasonable grounds of estimation) almost £1 billion of extra tax to compensate for the losses from those who leave. That brings the extra income arising from the abolition of this rule to a sum in excess of £4.3 billion calculated with caution throughout.