

The Taxing Wealth Report 2024

Every politician's guide to
"How to pay for it".

The reform of income tax, capital gains tax and
inheritance tax:

Abolishing the domicile rule for tax purposes

Brief Summary

This note proposes that the use of the domicile rule for taxation purposes should be ended.

It is suggested that a temporary residence rule should be created in place of the domicile rule for those who come to the UK for a period of less than seven years.

The proposal is made to prevent people being able to secure a tax advantage based solely on their domicile being outside the UK and their ability to afford the fee to do so.

The proposal

To cease providing tax advantages to those who are tax resident in the UK but who can claim to be not domiciled in this country.

¹ This note forms a part of 'The Taxing Wealth Report 2024' published by Finance for the Future LLP, which is UK LLP number OC329502, registered at 33 Kingsley Walk, Ely, Cambridgeshire, CB6 3BZ. See <https://www.financeforthefuture.com/taxing-wealth/>. This note was written by Richard Murphy FAcSS FCA FAIA (Hon), Professor of Accounting Practice, Sheffield University Management School, who is a director of Finance for the Future LLP. © Finance for the Future LLP 2023

The Taxing Wealth Report 2024 is a joint project between:

Finance for the Future

and



Sheffield
University
Management
School.

	To provide a temporary residence rule in place of the domicile rule for those who come to the UK for a period of less than seven years.
Reason for the proposal	<ol style="list-style-type: none"> 1. To prevent people being able to secure a tax advantage based solely on their domicile being outside the UK and their ability to afford the fee to do so. 2. To improve the horizontal equity of the UK tax system by preventing the abuse that the use of domicile status for taxation purposes has permitted. 3. To increase vertical tax equity. 4. To reduce the incentive to avoid tax. 5. To reduce the tax spillover effects that the domicile rule has created, particularly with regard to the use of offshore tax arrangements. 6. To raise additional tax revenues in a more progressive fashion.
Estimated tax that might be raised as a result of the recommendation made	Academics at Warwick University and the LSE have estimated that abolition of the domicile rule for taxation purposes might raise £3.2 billion a year in additional tax revenue for the UK and this estimate is accepted here.
Ease of implementation	The changes proposed will be relatively easy to implement because the alternative basis of taxation is already well known. No technical difficulties should arise.
Likely difficulties that might result from implementation	There is likely to be significant opposition to these changes but that is the only difficulty that should be anticipated. They have broadly based political appeal.
Likely time required to implement the change	Capable of being delivered in any Finance Bill i.e. in a matter of months. However, at least twelve months' notice of the change might, be beneficial as this will require some people to change their tax arrangements

	and it is generally considered appropriate to allow time for them to do so.
Consultation period required.	It is likely that at least a year’s notice of these changes would be required. The consultation period could be somewhat shorter.

Background

The UK’s concept of domicile is a legal, not a taxation, creation and has existed for centuries.

In essence, a person’s domicile is their natural home. This is best interpreted as being the place to which they will return and live when they are best able to do so. The concept of domicile recognises the fact that there may be good reasons why this might be impossible, and that does not mean that a person’s domicile changes as a result.

For most people, their domicile is acquired at birth from the father. If they do not have a known father then they acquire their mother’s domicile at birth. This is called their domicile of origin.

A person needs not retain this domicile of origin for life. They can adopt a domicile of choice, although doing so is by no means straightforward. Changing domicile basically requires that a person indicates by their actions, rather than by statements made in words, that they have severed all, or almost all, of their connections with the place in which they were previously domiciled. So, for example, by making it clear through their actions that they have abandoned any intention to live in their previous country of domicile, a person can adopt a domicile choice in another place, including the United Kingdom.

Changing taxation law with regard to domicile will not change this element of more general UK law. The question of a person’s domicile, which is quite independent of their nationality, citizenship, residence or ethnicity, has significance beyond taxation.

The taxation significance of domicile

A person’s domicile is relevant for taxation purposes because a country like the UK has to know whether or not it has the right to charge tax upon a person who might have income or gains, or who makes gifts, in this country.

Broadly speaking, two concepts are used to determine this. One, which is common to all tax jurisdictions, is the concept of tax residence. The rules with regard to tax residence vary from state to state, and are complex within the UK. That being said, HMRC notes on its website that²:

You may be resident under the automatic UK tests if:

- you spent 183 or more days in the UK in the tax year
- your only home was in the UK for 91 days or more in a row - and you visited or stayed in it for at least 30 days of the tax year
- you worked full-time in the UK for any period of 365 days and at least one day of that period was in the tax year you're checking

You may also be resident under the sufficient ties test³ if you spent a number of days in the UK and you have additional ties to the UK, like work or family.

These rules are broadly internationally consistent, and the UK has double tax treaties with many countries to make sure that their operation is fair and disputes can be resolved so that a person is not unfairly double taxed.

The second concept used in the UK is domicile. If a person can claim to be non-domiciled in the UK, then their income is considered to arise in two ways, broadly speaking. Income and gains and assets located in the UK are all considered to be subject to relevant UK taxes relating to these issues if the person in question is also tax resident in this country.

The big issue of concern is that if a person is not domiciled in the UK, but is resident here, then they can elect for their income and capital gains arising outside the UK to be taxed on what is described as a 'remittance basis'. The gift of assets located outside the country is also, broadly speaking, outside the scope of inheritance tax.

The remittance basis is complex, and unless a taxpayer is very diligent and has good tax advisors, is inherently risky as a basis for tax. What it suggests is that any source of income or gain arising outside the UK is only taxable here if remitted to the country. What that then means, by implication, is that income and gains earned outside the UK and left outside the UK are outside the scope of UK tax if owned by a non-domiciled person.

² <https://www.gov.uk/tax-foreign-income/residence>

³ <https://www.gov.uk/hmrc-internal-manuals/residence-domicile-and-remittance-basis/rdrm11500>

The potential for abuse within the domicile rule

Use of the UK's domicile rule grew considerably as worldwide financial liberalisation increased in the 1980s, and its abuse was subject to significant comment from that decade onwards.

The potential for abuse was obvious because if a person did not have to declare their income and gains, and so their wealth, outside the UK then the opportunity for those who could live in the UK, but claim to be non-domiciled, to make use of tax havens and other such arrangements to hide income from tax authorities around the world was very high. This has had a significant impact on the growth of illicit funds in London, and the rise in the number of oligarchs located in the UK.

On a smaller scale, the opportunity to abuse the domicile rule for those who were second and even third generation immigrants clearly opened up the opportunity for significant disparities in the tax bills paid by some people who were long-term resident in the UK, and whose situations were otherwise similar, creating obvious horizontal and vertical tax inequalities as a result. These differences were a natural course for resentment.

Gordon Brown promised that he would tackle this issue before he was elected to office as Chancellor of the Exchequer in 1997, but largely failed to do so.

More recent legislation, largely from the Conservative party, has been more progressive. The right to use the domicile rule for taxation purposes has been severely restricted.

First, since 2008 anyone not domiciled and who had more than £2,000 per annum of income arising outside the UK had to decide whether they wished to use the domicile rule or not⁴. Those who chose to do so have been subject to steadily more progressive charges for exercising that option. The current charges are either⁵:

- £30,000 if a person has been here for at least 7 of the previous 9 tax years
- £60,000 for being here for at least 12 of the previous 14 tax years

What this means is that anyone now wishing to make use of the domicile rule has, after a relatively short time period in the UK, to calculate the trade-off between making payment of the fee for doing so and paying tax on their actual income and gains arising on a worldwide basis. They can also only use the rule for a relatively short time period before being deemed to be domiciled in the UK whether they like it or not. This is not now a status that

⁴ <https://commonslibrary.parliament.uk/research-briefings/cbp-8099/>

⁵ <https://www.gov.uk/tax-foreign-income/non-domiciled-residents>

can go on indefinitely.

Despite this, continued existence of the domicile rule is an anomaly found in the tax legislation of only a very few countries around the world (Ireland and Italy being other notable countries where something similar exists). The discrimination that it promotes on the basis of a person's national origin rightly offends current sensibilities. The domicile rule needs to be abolished, and to be replaced by an improved temporary residence rule for those who relocate to the UK for short periods of time, but with no favour being shown to those who might move to this country for periods of longer than, say, seven years.

Recommendation

That the domicile rule cease to have any relevance for taxation purposes in the UK.

All persons tax resident in the UK should be subject to the same taxation rules unless they apply for temporary residence status, which would not apply for a period of longer than seven years after their time of arrival in the country .

Revenue consequences

It has been estimated by academics at Warwick University and the LSE that abolition of the UK domicile rule might raise £3.2 billion in additional tax revenue per annum⁶. This estimate was based on an analysis of the tax returns of those claiming the status. The estimate has to be treated with caution because a temporary residence rule for those coming to the UK for short time periods, such as secondees or students, might reduce the tax raised. However, given the widespread recognition of this estimate it is used here as the best available estimate of the current likely taxation revenue arising as a consequence of abolishing the domicile rule, which abolition is long overdue.

⁶ <https://www.lse.ac.uk/News/Latest-news-from-LSE/2022/i-September-22/Abolishing-the-non-dom-regime-would-raise-more-than-3.2-billion-each-year-finds-new-report>