A long-running domestic saga

HMRC enquiries and assessments into domicile can be costly and time-consuming for the taxpayer. Dominic Lawrance and Hugh Gunson report on how to deal with them

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HMRC's interest in challenging taxpayers on their claims to being foreign domiciled has intensified in recent years. This trend shows no signs of abating, despite the deemed domicile rules introduced in April 2017, which many thought might have taken the heat out of the issue of actual domicile. This article explores the particular challenges posed by such disputes and offers guidance on how to navigate them.

Domicile: the basics

Compared to UK domiciliaries, UK-resident taxpayers who are non-UK domiciled, and not deemed domiciled, are subject to a generous tax regime. Such taxpayers can elect for non-UK income and gains to be taxed on the remittance basis, and inheritance tax (IHT) is broadly limited to their UK assets. The question of domicile can therefore be critical for an individual's tax position.

It is also an important concept for the law of marriage, divorce and succession. For example, for any claim to be made against the estate of a deceased person under the Inheritance (Provision for Family and Dependants) Act 1975 (the 1975 Act), the deceased must have been domiciled in England and Wales at death.

The common law principles determining domicile are longstanding and well known. Everyone acquires a 'domicile of origin' at birth, derived from the domicile of a parent (typically the father). A different domicile can subsequently be acquired, in the form of a 'domicile of choice' or a 'domicile of dependency'.

Most domicile disputes centre on the issue of whether a domicile of choice has been acquired, or whether such a domicile has been retained. For such a domicile to be acquired in a given country (or state, in the case of a federal country), the individual must reside in that country/state (as their sole or main home) and, simultaneously, intend to reside there (as their sole or main home) permanently or indefinitely. This means, essentially, until death.

A domicile of origin is never entirely lost, although it can pass into abeyance. If an individual abandons a domicile of choice, the domicile of origin will revive. Importantly, in the context of domicile disputes, any change in an individual's domicile must be proved by the person asserting that such change has occurred.

Under the microscope

Historically, HMRC was generally disinclined to challenge claims to foreign-domiciled status, at least in taxpayers' lifetimes. However, the last few years have seen a major change of stance. The number of domicile enquiries has risen dramatically, as has the amount of HMRC attention devoted to them.

Various factors have contributed to this, including a general clampdown by HMRC on all matters considered 'offshore', pressure on HMRC to close the supposed 'tax gap', and a perception that, historically, a significant number of long-term UK residents claiming to be foreign domiciled may not, in reality, have had good claims to that status.

Those who are particularly susceptible to investigation include long-term UK residents who claim

not to have acquired a UK domicile of choice, and individuals with a UK domicile of origin who have resided abroad, allegedly acquired a domicile of choice in the country of residence, and claim that this domicile has been preserved despite a subsequent return to the UK.

The impact of deemed domicile

A statutory 'deemed domicile' was introduced for all tax purposes from 6 April 2017. This applies to two classes of individual:

- individuals who were born in the UK with a UK domicile of origin, and who are now UK resident; and
- individuals who have been UK resident for 15 or more out of the 20 preceding tax years.

However, the common law position remains important. Self-evidently, there are plenty of UK residents who are not (yet) deemed domiciled. Moreover, even for individuals who are, now, deemed domiciled for all tax purposes, there may be a large amount of tax for years prior to 2017/18 turning on the issue of common law domicile. And even where an individual is now deemed domiciled for all tax purposes, their common law domicile may continue to be important for their tax treatment in future years.

One reason for this is that a 'rebasing' relief applies in relation to personally held non-UK assets of certain non-UK domiciled but deemed domiciled individuals (which effectively wipes out the capital gains tax (CGT) that would otherwise be due on the increase in the asset's value between its acquisition and 5 April 2017). There is also a longstanding 'rebasing' relief for gains realised by offshore trusts, if 'matched' to a distribution to a beneficiary who is non-UK domiciled. And perhaps most importantly, the 'protected settlement' provisions, which prevent settlors from being taxed on an arising basis on the income and gains of offshore trusts they have created, only apply for as long as those settlors continue to be non-UK domiciled.

For these reliefs, common law domicile is (and will continue to be) crucial. In our view, the 'protected settlement' regime, in particular, will be a key battleground.

Challenging domicile: income tax/CGT

HMRC has two ways to challenge a taxpayer's domicile status for income tax and CGT purposes: either by opening an enquiry into a tax return or, where there is no ability for them to open an enquiry, by issuing a 'discovery assessment'.

The 'window' for opening an enquiry is relatively small. HMRC has one year from the filing date where the return is delivered on time and not amended; and up to 15 months from the delivery of the return if this is delivered late or from the date of amendment if amended. There are limited formal requirements: HMRC simply has to give the taxpayer notice of its intention to open an enquiry.

However, in our experience, HMRC frequently misses the boat, even when there is an existing enquiry for an earlier period. If so, in order to collect any underpaid tax, HMRC must be able to make a discovery assessment. This however requires various conditions to be satisfied:

- there must have been a discovery (a low threshold);
- that discovery must not have become 'stale' (staleness is a relatively recent, judicially developed doctrine – see, for example, *Beagles v HMRC* [2018]); and
- HMRC must be able to show that either:
  - the taxpayer deliberately misreported or failed to notify chargeability to tax, or
  - was careless in doing so (the 'conduct condition'); or
  - a reasonable HMRC officer could not have been reasonably expected, on the basis of the information made available to them, to have been aware of the facts giving rise to the tax loss when the enquiry window closed (the 'officer condition').

Even where an individual is now deemed domiciled for all tax purposes, their common law domicile may continue to be important for their tax treatment in future years.

In addition, HMRC must still be in time to make an assessment. The normal statutory limitation periods are (in each case from the end of the relevant tax year):

- four years if the taxpayer is not careless or deliberate;
- six years if the taxpayer is careless; and
- 20 years if the taxpayer has deliberately misreported or failed to notify chargeability.

However, the Finance Act (FA) 2019 introduced a new power allowing HMRC to extend the first two time limits to 12 years (even absent carelessness), where the tax loss involves an offshore matter (eg income arising from activities conducted offshore or gains derived from assets located offshore) or an offshore transfer which makes the lost tax significantly harder to identify. 'Offshore' for these purposes does not mean a tax haven. It simply means anywhere outside the UK (including high tax jurisdictions). In a domicile case, any contested liability is almost certain to involve an offshore matter or transfer.

The discovery assessment conditions can give rise to peculiarities in a domicile context. For example, if HMRC has an open enquiry for one

year but fails to open an enquiry for a subsequent year, can they issue a discovery assessment for that subsequent year, in reliance on the officer condition? HMRC may in fact have obtained during the course of the open enquiry all the information a reasonable officer would need to be aware of the (purported) tax loss in the subsequent year. However, Taxes Management Act 1970 s29(6) contains an exhaustive list of information that is regarded as made available to the hypothetical HMRC officer when assessing the officer condition. These include the tax return for that year and other documents provided in connection with an enquiry into that return, but not information HMRC may actually have in its possession from another open enquiry. The position is far from clear.

This is one example of a more general phenomenon: many of the statutory provisions relating to the assessment of tax do not work well when applied to domicile. The importance of considering whether procedural requirements have been met by HMRC in relation to any purported exercise of investigatory or collection powers is heightened where the alleged liability turns on domicile.

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Challenging domicile: IHT

Domicile can also have a dramatic impact on the IHT position, for example in relation to trusts funded with non-UK assets. IHT has a different enforcement regime, which does not include the concepts of enquiries and assessments. Aspects of the regime are similar to the income tax/CGT collection regime, but in some scenarios there is no limit on how far back HMRC can go in collecting tax, and there is never any procedural requirement for a 'discovery'.

It follows that it can take longer to get finality about the IHT position; procedural rules that can prevent the enforcement of income tax and CGT liabilities do not always provide the same protection against the collection of IHT.

Information overload

Assuming an enquiry is properly initiated, what form does it take? There is no set procedure, but a 'typical' domicile enquiry begins with quite basic questions from HMRC about the taxpayer's life. This is the very tip of the iceberg, with each response from the taxpayer generating further questions.

HMRC's questions often cover the detail of historic events (even pre-dating the taxpayer's lifetime), and request the same information multiple times in slightly different forms. HMRC often asks for supporting documentary evidence that it is unrealistic to expect the taxpayer to be able to provide. Recent examples include evidence of purchases of a particular foreign newspaper, and details of the modes of transport taken and precise itinerary for an emigration from the UK in the early 1970s.

HMRC seems to consider that every aspect of an individual's life is suitable for questioning, as it can give 'context' to the enquiry as a whole. This is obviously wrong, and at odds with HMRC guidance stressing the need for tailored requests and a focus on the relevance of requests (RDRM23080). The impression is often created that (contrary to HMRC's Charter) HMRC caseworkers do not believe statements from the taxpayer and their advisers – and so they ask for supporting documentation to prove every fact (even where, viewed objectively, such facts should be uncontroversial).

Battle stations

Navigating this requires a strategic approach, particularly given the potential for enquiries to be long-running and expensive. First, the evidence is critical; and gathering information and considering its relevance upfront can pay dividends.

Taxpayers should generally be co-operative. Obstructiveness or evasion will be unhelpful if the matter proceeds to litigation and the correspondence is reviewed in court. Co-operation also helps avoid formal information requests under FA 2008 Sch 36 para 1. However, taxpayers and their advisers should consider carefully the relevance of each HMRC request (applying the tests applicable to formal information notices). For example, is the information/documentation reasonably required for checking the taxpayer's tax position? If not, HMRC is not entitled to it and the request should be met with polite refusal.

Timing is another key issue. Information requested by HMRC frequently takes time to collate, particularly if it relates to historic events. If a deadline is unreasonable, taxpayers should say so. This is easier to do where there is no formal information notice (again highlighting the importance of avoiding them). Taxpayers can even, in appropriate circumstances, challenge the response time in an information notice on grounds of reasonableness.

There is often merit in being proactive. A taxpayer should feel able to take control of an enquiry and change its direction, particularly if it is proceeding down irrelevant lines. For example, at the appropriate stage it may be helpful to re-state the taxpayer's positive case by reference to the relevant stages of the taxpayer's life (and where the burden of proof lies). HMRC can be invited to agree or disagree with the taxpayer's analysis for each stage, with a view to narrowing the grounds of contention.

A further point to beware is that requests in a domicile enquiry may also lead to enquiries into other areas. We have seen HMRC ask detailed questions about an individual's business interests, which may have more relevance to the transfer of assets abroad rules, or lead to an enquiry as to whether foreign companies are managed and controlled in the UK (and are therefore UK tax resident). If HMRC is only explicitly challenging domicile status, the questions (and answers) should be directed at that.

Quite often, HMRC asks searching questions about family bereavements, serious health conditions and other sensitive subjects. Clearly, these can sometimes be relevant (for example, if illness/bereavement explains why a taxpayer did not leave the UK when previously anticipated). But frequently they are not, and the lack of compassion with which these questions are raised is sometimes startling.

Domicile statements: a hostage to fortune?

Many taxpayers sign domicile statements, setting out their intentions with respect to future residence, to explain the basis on which they are, or have a claim to be, non-UK domiciled. If properly considered and regularly reviewed, such statements can be helpful.

However, they are never conclusive evidence. HMRC guidance directs caseworkers to treat taxpayers' statements of intent with caution ('Mere statements are generally less important than actual conduct and may carry little weight if the statement does not correlate with actions taken': RDRM22320).

Moreover, an ill-considered domicile statement, or a statement that is not regularly reviewed, can do more harm than good. In particular, if an individual with a foreign domicile of origin declares their intention to leave the UK in a given timeframe, or on the occurrence of a particular contingency, but then does not (even for entirely legitimate reasons), HMRC will try to argue that a domicile of choice has been acquired within the UK.

This argument can (and should) be resisted. HMRC rightly does not accept that a statement of an intention to leave the UK is conclusive evidence of a foreign domicile. By parity of reasoning, HMRC should accept that if a taxpayer remains resident in the UK beyond the timeframe that was previously envisaged, that is not in itself conclusive evidence that he/she has formed an intention to remain indefinitely.

Gulliver and the status of prior rulings

Historically, many taxpayers obtained rulings/decisions as to their domicile status, particularly during the 1990s and 2000s. These are in a variety of forms (from the unqualified to the heavily caveated) and followed varying levels of enquiry.

In our experience, HMRC now cites the decision in *Gulliver v HMRC* [2017] as authority for ignoring any such ruling. In *Gulliver*, the taxpayer applied for a closure notice, in circumstances where HMRC was challenging the taxpayer's historic acquisition of a domicile of choice in Hong Kong despite having previously given a ruling accepting this. The First-tier Tribunal (FTT) found that HMRC was entitled to make these enquiries and dismissed the application.

However, *Gulliver* was not primarily concerned with the question of whether HMRC was bound by the previous ruling. It was simply a (non-binding, FTT) decision on a procedural point as to whether to grant a closure notice. The discussion of whether HMRC was bound was obiter. The FTT explicitly declined to express a view as to whether any public law remedies were available. Further, HMRC had pursued only a cursory 'risk-based approach' in its earlier enquiry and its final written decision had not even mentioned domicile.

Other taxpayers with domicile rulings would be well-advised to

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consider them on their own terms. The question is whether HMRC has created a legitimate expectation from which it would be unjust to resile, so the taxpayer has grounds for judicial review. Key issues will be the terms of the previous ruling – in particular whether it is 'clear, unambiguous and devoid of relevant qualification' (*R v IRC, ex parte MFK Underwriting Agencies Ltd* [1989]); and also the level of information previously provided to HMRC (compare the cursory review in *Gulliver* with, say, a detailed two-year enquiry).

Even so, on no view would any previous ruling bind HMRC for future periods. At most, it would bind HMRC to its decision at that prior time. It would not therefore determine a current enquiry, but it may limit its scope and aid the taxpayer significantly. For example, if HMRC is bound by a previous finding of a non-UK domicile of choice, only subsequent years are in point, and HMRC has the burden of showing a change of domicile in those years.

Keep litigation in mind

While litigation is never desirable, it is always a possibility. Correspondence may be seen by a judge and should be written accordingly. Similarly, *all* material provided to HMRC should be reviewed to a litigation standard.

Meetings and calls should be treated with similar care. Detailed notes should be taken. HMRC often suggests face-to-face meetings with taxpayers and/or their close relatives. Taxpayers can be keen to accept such offers, to put forward their case. However, HMRC has no power to compel attendance and serious thought should be given before accepting. In our experience it is rarely advisable. HMRC is likely to treat meetings as cross-examination practice, testing out potential witnesses. Assume it will take detailed or verbatim notes, and unguarded comments may be referred to subsequently. If the taxpayer or relatives do attend, they should prepare as they would for giving evidence in court.

Even if the FTT is persuaded to issue a direction, with the result that HMRC is compelled to issue a closure notice, the enquiry may not be as closed as the taxpayer wishes it to be.

Bringing matters to a close

Domicile enquiries are frequently long-running, seemingly without an end in sight. However, at any time a taxpayer can apply to the FTT for a direction that HMRC issues a closure notice to bring it to an end. In practice this is likely to be a partial closure notice, limited to the issue of the taxpayer's domicile.

The FTT must issue such a direction unless there are 'reasonable grounds' not to (which is for HMRC to prove). Broadly, it will do so if HMRC has been provided with sufficient information, with sufficient opportunity to review it, to come to an informed judgement (*Beneficial House (Birmingham) Regeneration LLP v HMRC* [2017] (para 15)). In practice, the threat of an application for a closure notice can be sufficient to persuade HMRC to expedite matters and close the enquiry, without forensic intervention.

The right time for such an application is a question of fine judgement. Making an application too early will only lead to it being rejected, putting HMRC at an advantage; although in principle it is possible to make a further application at a later stage.

It should also be borne in mind that, even if the FTT is persuaded to issue a direction, with the result that HMRC is compelled to issue a closure notice, the enquiry may not be as closed as the taxpayer wishes it to be. The result may be a determination by HMRC that the taxpayer is domiciled in the UK. If so, the taxpayer obviously faces a choice between accepting that determination and litigating the point.

Problems can also arise with the issue of the closure notice itself. In *Embiricos v HMRC* [2019], the taxpayer applied for a partial closure notice on the issue of domicile. HMRC argued that this required not only a conclusion on the question of domicile, but also amendments to the tax return to state the amount of tax payable. As a result, HMRC would have needed to obtain information as to the taxpayer's foreign income and gains which the taxpayer had (legitimately) refused to provide during the course of the enquiry.

However, the FTT rejected this argument. Domicile is a separate 'matter' capable of being the subject of a partial closure notice (and this is consistent with the purpose of the introduction of the partial closure notice regime in 2017). Accordingly HMRC was directed to issue such a notice making a determination on the domicile question only.

Conclusion for practitioners

Common law domicile has become an enquiry hotspot in recent years, and this trend can be expected to continue despite the introduction of the deemed domicile rules in 2017 (particularly given the benefits of the 'protected settlement' regime). Without careful management, such enquiries have the potential to be long-running and involve the provision to HMRC of vast amounts of irrelevant material going back many years. There are however various ways for taxpayers to take the initiative. These include: checking whether HMRC has complied with the relevant procedural formalities; considering carefully the relevance of each HMRC request; seeking closure when appropriate; and always keeping in mind the possibility of litigation. ■

Beagles v HMRC
[2018] UKUT 380 (TCC)
Beneficial House (Birmingham) Regeneration LLP & anor v HMRC
[2017] UKFTT 801 (TC)
Embiricos v HMRC
[2019] UKFTT 236 (TC)
Gulliver v HMRC
[2017] UKFTT 222 (TC)
R v IRC, ex parte MFK Underwriting Agencies Ltd & ors
[1989] STC 873