

**A CRITICAL AND COMPARATIVE ANALYSIS OF THE EXPRESSION  
“ORDINARILY RESIDENT” AS A CRITERION FOR DETERMINING THE PLACE  
OF RESIDENCE OF AN INDIVIDUAL IN THE CONTEXT OF INCOME TAX  
LEGISLATION IN SOUTH AFRICA AND CERTAIN OTHER JURISDICTIONS.**

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***“Se vogliamo che tutto rimanga come è, bisogna che tutto cambi!”<sup>1</sup>***  
(Everything must change, so that everything can stay the same.)

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<sup>1</sup> G Tomasi di Lampedusa *Il Gattopardo* (1958), 29.

## **DECLARATION**

I, John Andrew Hardie do hereby declare that, unless specifically referenced, this dissertation consists of my own work and has not been submitted to any other university in full or in partial fulfilment of the academic requirement of any other degree or qualification

Signed:

Date:

## **ABSTRACT**

*The nexus between a natural person's income and their liability to tax in South Africa on their income, regardless of the location of its source, subject to statutory relief and international agreements, is the individual's status as an income tax resident in South Africa.*

*The criterion for determining the place of residence of an individual in the context of income tax can be uncertain and difficult to determine due to the case law approach imposed by the definition of the term 'resident' in the Income Tax Act.*

*Through an analysis of the legislation, case law and guidelines, primarily in South Africa and the United Kingdom, the dissertation queries whether the current legislation and case law in South Africa is adequate to deal with the determination of the place of residence of an individual in the context of income tax legislation in South Africa and if a new statutory definition of residence should be considered.*

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# CHAPTER ONE

## BACKGROUND TO THE STUDY

### 1.1 Introduction

The world has become increasingly globalised and taxpayers can live and derive income in multiple jurisdictions, at times achieving fiscal and competitive advantage through international tax planning through their choice of tax residence. However, a change in a natural person's tax residence or a failure to change their tax residence can quickly become a competitive disadvantage if the tax residence rules are breached due to a misinterpretation of the legislation. The failure to terminate a natural person's tax residence in South Africa can be highly prejudicial and give rise to what has been termed a "modern Midas complaint that everything he touches turns into tax"<sup>2</sup>.

In South Africa, Section 1 of the Income Tax Act defines a resident as a natural person who is ordinarily resident in the Republic and who meets an objective physical presence test. The expression "ordinarily resident" as a criterion for determining the place of residence of an individual in South Africa is both subjective and complex, requiring a case law approach in its determination.

The retention of an individual's South African tax residence appears easier than the termination of their South African tax residence. Residence appears to have an adhesive nature and is harder for a resident to terminate their residence than it is to retain it.

The international mobility of South African residents has increased in recent years as a result of the exponential growth in South Africa's globalisation (see Graph 1), a relaxation of exchange controls<sup>3</sup> and an expanding market into the continent of Africa.

The degree to which the South African economy has become globalised in recent years, reflected in Graph 1, reflects how internationally mobile the South African

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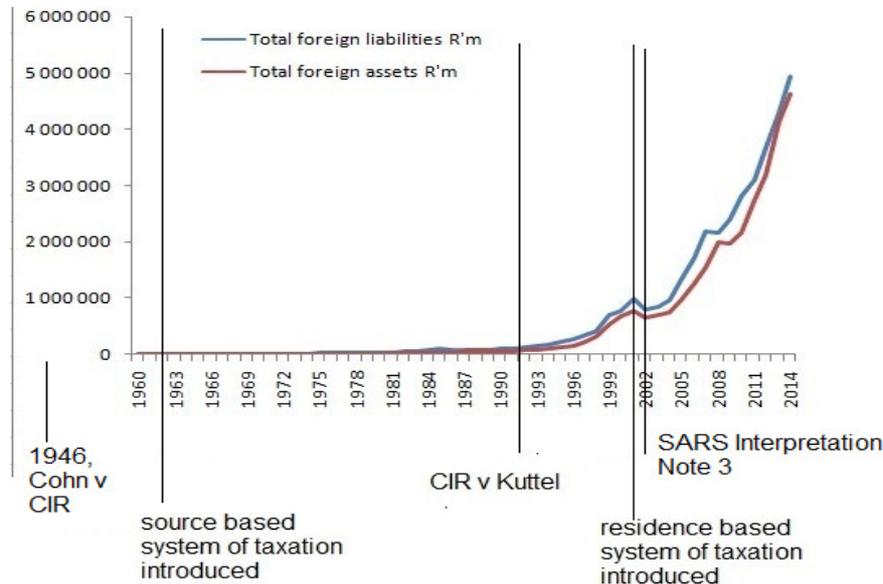
<sup>2</sup>D Kruger *Broomberg on Tax Strategy* 5<sup>th</sup> ed (2012) 1.

<sup>3</sup> South African Exchange Control Regulations as promulgated by Government Notice R.1111 of 1 December 1961 and amended up to Government Notice No. R 9 in Government Gazette No. 33926 of 14 January 2011.

society has become and how important certainty on an individual's tax residence has become, in particular on the cessation of their tax residence.

There are numerous measures of globalisation and the Organisation for Economic Co-operation and Development (OECD) maintains that capital movements, foreign direct investments and international trade are key measures of globalisation<sup>4</sup>. It is submitted that the degree to which South Africa has become globalised is reflected by the exponential growth in its international trade since 1960, reflected in the graph below. Against this graph, the dates of the introduction of the residence basis of taxation, source basis of taxation, the South African Revenue Services (SARS) Interpretation note<sup>5</sup> (Interpretation Note 3) dealing with an individual's status as ordinarily resident in South Africa and key court cases<sup>6</sup>, have been plotted, providing a timeline of the developments in tax law dealing with an individual's tax residence in South Africa, against the backdrop of the growth in globalisation in South African.

GRAPH 17: Developments in tax law as regards tax residence



<sup>4</sup>OECD *Measuring Globalisation: OECD Economic Globalisation Indicators* (2010).

<sup>5</sup> SARS Interpretation Note 3, February 2002.

<sup>6</sup>*Cohen v Commissioner for Inland Revenue* 13 SATC 362 and *Commissioner for Inland Revenue v Kuttel*, 54 SATC 298.

<sup>7</sup>Economic data obtained from the South African Reserve Bank 'Economic and financial data for South Africa' available at <http://www.resbank.co.za/webindicators/EconFinDataForSA.aspx>, accessed 7 September 2016.

## 1.2 Research problem, question and objectives

Determining the place of residence on an individual in the context of income tax legislation in South Africa is subjective and uncertain due to the case law approach imposed by the definition of the term 'resident' in Section 1 of the Income Tax Act.

Fundamental to this is the determination, with certainty, of an individual's status as 'ordinarily resident' in South Africa.

Legal certainty is necessary to avoid tax prejudice, tax avoidance, and a lack of efficiency and effectiveness in the tax system<sup>8</sup>.

The dissertation explores the criteria in South Africa of determining an individual's tax residence, through an analysis of the questions: Does the common law approach in determining if an individual is ordinarily resident in South Africa provide sufficient certainty on an individual's residence in South Africa, in particular on termination of their residence; and if the introduction of a statutory residence test in South Africa would provide greater legal certainty on an individual's residence in South Africa?

In order to answer these questions, the following objectives were undertaken:

- To critically evaluate if there is adequate legal and tax certainty regarding the expression "ordinarily resident" as a criterion for determining the place of residence of an individual in the context of Income tax legislation both in South Africa and the United Kingdom
- To review the developments in legislation and leading tax cases regarding the place of residence of an individual in the context of Income tax legislation both in South Africa and the United Kingdom
- To examine and critique the concept of 'ordinarily resident' in South Africa
- To review leading cases dealing with the concept of 'ordinarily resident' in South Africa and the United Kingdom, with, for comparative purposes, a

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<sup>8</sup>Her Majesty Revenue and Customs *Statutory Definition of Tax Residence: A Consultation* (2011).

review of certain leading cases in Rhodesia, prior to Independence, Canada and Australia

- To critique the current statutory residence test in the United Kingdom
- To recommend the introduction of a statutory residence test in South Africa, based on the statutory residence test in the United Kingdom.

### **1.3 Outline of the dissertation**

The dissertation chapters will reflect the stated objectives.

- Chapter one provides the background to the study along with the research question and objectives.
- Chapter two will examine the nature and complexity of legal certainty
- Chapter three will provide an overview of the development of tax residence in South Africa.
- Chapter four will examine and critique the concept of 'ordinarily resident' and review relevant selected case law from various jurisdictions.
- Chapter five examines the uncertainty regarding the concept of 'ordinarily resident'.
- Chapter six deals with foreign precedents in relation to tax residence and in particular statutory residence tests that exist in several jurisdictions.
- Chapter seven will conclude the dissertation by considering a residence test for South Africa.

## CHAPTER TWO

### LEGAL AND TAX CERTAINTY

#### 2.1 Introduction to legal and tax certainty

In a constitutional democracy, legal certainty is an important objective and it is desirable that before anyone commits themselves to a course of action, that they are able to know in advance what legal consequences will flow from their actions<sup>9</sup>.

However, legal certainty is a complex concept and although important, it is almost impossible to achieve as the economy, society and technology are dynamic.

Despite the challenges, legal certainty remains an important objective and should be strived for through an ongoing review and update of the legislation. Legislation needs to continuously be reviewed, updated and amended in line with changes in the economy, society and technology, so that everything else can remain the same.

The doctrine of precedent, which imposes a general duty on the courts to follow legal rulings from previous judicial decision, generally assists in providing a degree of legal certainty through the provision of a set of rules based on previous judgements.

The doctrine of precedent, referred to as *stare decisis et non quieta movere* (to stand by decisions and not disturb settled points) seeks to ensure that individuals are able to arrange their affairs according to a predictable set of rules<sup>10</sup>.

Whereas a body of case law and the doctrine of precedent promotes legal certainty, its effectiveness may be limited in circumstances where there have been fundamental changes in society, the economy and technology; and where the courts have not provided clear or specific principles applicable to all situations.

In dealing with the expression “ordinarily resident” as a criterion for determining the place of residence on an individual in the context of the Income Tax legislation in South Africa, the existing body of case law and the doctrine of precedent may not

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<sup>9</sup>*Black-Clawson International Ltd v Papierwerke Waldhof-Aschaffenburg AG* [1975] AC 591 (HL) at 638 per Lord Diplock.

<sup>10</sup> K O’ Regan, Change v certainty: precedent under the Constitution, April 2001, page 31

contribute adequately, as for example, the *locus classicus* judgements in *Cohen v Commissioner for Inland Revenue* 13 SATC 362 and *Commissioner for Inland Revenue v Kuttel* 54 SATC 298 which established principles regarding an individual's place of tax residence in South Africa, are seventy and twenty four years old, respectively, and do not provide specific principles applicable to all situations and all taxpayers.

A failure to achieve legal certainty in taxation can give rise to tax prejudice, a breakdown of a tax system aimed at creating certainty, efficiency and ease of compliance and discourages investment in the local economy as investors seek certainty and predictability<sup>11</sup>.

In 1776 Adam Smith<sup>12</sup> wrote about the importance of certainty in taxation, where certainty of taxation was held to be one of the four maxims (cannons) of taxation<sup>13</sup>, fundamental to any good system of taxation. This view was endorsed by the OECD over two hundred years later as still being applicable in the modern age<sup>14</sup>.

## **2.2 How tax certainty may be achieved**

It is submitted that tax certainty is compromised when principles of taxation are not defined by the legislator and legislation does not keep up to date with changes in the economy, society and technology.

To this end, whilst limiting the inherent risk of changing tax legislation, sunset clauses and experimental legislation may provide a key to the legislator when introducing change in a measured way.

It is also submitted that by considering similar successful foreign legislation, especially in matters dealing with international taxation where many similarities exist, the legislator may improve the existing legislation whilst limiting the risks associated with a change in legislation.

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<sup>11</sup>Her Majesty Revenue and Customs *Statutory Definition of Tax Residence: A Consultation* (2011).

<sup>12</sup>A Smith *An Inquiry into the Nature and Causes of the Wealth of Nations* (1776).

<sup>13</sup>*ibid*.

<sup>14</sup> OECD. Committee on Fiscal Affairs 'Electronic commerce: taxation framework conditions' available at <http://www.oecd.org/tax/consumption/1923256.pdf> accessed 26 July 2016.

The risk and concern to the legislator of providing statutory definitions and amending legislation to provide tax certainty, is that in the pursuit of tax certainty, opportunities may be created by endlessly creative entrepreneurs<sup>15</sup> to avoid or postpone their tax liability.

In trying to achieve an objective of tax certainty, whilst minimising the risk and loss to the Fiscus, the legislator faces a Morton's Fork<sup>16</sup>. The pursuit of certainty can give rise to a loss of tax revenue from loopholes and technicalities created by the tax legislation, whereas on the other hand, the lack of tax certainty can give rise to tax prejudice, a breakdown of a tax system aimed at efficiency and ease of compliance and a deterrent to local investment<sup>17</sup>, which too ultimately results in a loss of tax revenue. Therein lies the Morton's Fork.

### **2.3 Katz Commission**

The Katz Commission of Inquiry<sup>18</sup> researched and reported on certain aspects of the tax structure of South Africa including the possibility of introducing a statutory definition of a resident. In its report in 1997 it was held in para 5.1 that:

“The Commission is not in favour of attempting a detailed definition of a phenomenon that can have as many variables as international commerce and investment in the hands of endlessly creative entrepreneurs”.

In its assessment of a definition of a tax resident, the Commission decided that it was willing to trade off tax certainty to prevent tax avoidance, to ensure that what

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<sup>15</sup> MM Katz *Fifth Interim Report of the Commission of Inquiry into certain Aspects of the Tax Structure of South Africa: Basing the South African Income Tax System on the Source or Residence Principle Options and Recommendations* (1997) (Katz Commission).

<sup>16</sup> "John Morton's method of levying forced loans by arguing that those who were obviously rich could afford to pay and those who lived frugally must have savings". (Morton was Archbishop of Canterbury and minister to Henry VII) - JA Simpson and ESC Weiner *The Oxford English Dictionary* 2<sup>nd</sup> ed. (1989) Vol X, page 1106.

<sup>17</sup> Her Majesty Revenue and Customs 'Statutory definition of tax residence: a consultation' (2011).

<sup>18</sup> Katz *Fifth Interim Report of the Commission of Inquiry into certain Aspects of the Tax Structure of South Africa: Basing the South African Income Tax System on the Source or Residence Principle - Options and Recommendations* (1997).

should be taxed in economic terms was taxed and not rendered tax free as a result of liberal legislative drafting.

In contrast to this approach, the Income Tax Codification Committee of Great Britain<sup>19</sup>, which presented its report eighty years ago, held:

“We are fully conscious of the complexities which surround this question and of the advantages which, from the point of view of a taxing authority, lie in the absence of a statutory definition (of residence). We are, however, of opinion that the present state of affairs, under which an enquirer can only be told that the question whether he is resident or not is a question of fact for the Commissioners, but that by the study of the effect of a large body of case law he may be able to make an intelligent forecast of their decision, is intolerable and should not be allowed to continue.”<sup>20</sup>

Deviating from the recommendation of the Katz Commission may require the creation of a residency test which would be both clear and flexible enough to cover a wide variety of situations.

These objectives were of fundamental importance when drafting the statutory residence test in the United Kingdom in 2013 and therefore the design, implementation and effect of the introduction of the statutory residence test in the United Kingdom provides a useful insight into the possible introduction of a statutory residence test in South Africa.

The next chapter will review the development of tax residence in South Africa.

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<sup>19</sup> Great Britain. Treasury Income Tax Codification Committee *Report Vol 1: Report and Appendices* (1936) available at <http://dspace.gipe.ac.in/xmlui/handle/10973/23635> accessed 6 September 2016.

<sup>20</sup> Great Britain. Treasury Income Tax Codification Committee *Report Vol 1: Report and Appendices* (1936) available at <http://dspace.gipe.ac.in/xmlui/handle/10973/23635> accessed 6 September 2016, 37, para 59.

## CHAPTER THREE

### TAX RESIDENCE IN SOUTH AFRICA

#### 3.1 Introduction

The determination of the place of residence of an individual in South Africa, in the context of income tax legislation, subject to statutory relief and international agreements, determines the individual's liability to tax in South Africa, as in a residence based tax system, an individual's liability to tax, on an annual basis, on ceasing to be a resident and upon death, is determined with reference to their status as a resident.

The connecting factor between the State and an individual's liability to tax in South Africa, regardless of the location of its source, subject to statutory relief and international agreements, is the residence of the individual<sup>21</sup>.

*Silke on South African Income Tax* hold that "a critical ingredient of any tax system is the 'connecting factor' or nexus which endows the State with the power to levy tax and accords the State fiscal jurisdiction<sup>22</sup>.

Determining an individual's residence is both important to the State and the individual.

Despite the importance of the concept of a resident, it is an area of law internationally disputed, which was summarised in a judgement eighty years ago, where the Income Tax Codification Committee<sup>23</sup> held:

It may be asserted with confidence that no one subject which arises in the application of the Income Tax Acts has been more prolific of dispute than the question of the meaning of residence.

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<sup>21</sup> M Honiball & L Olivier *International Tax, A South African Perspective* 5<sup>th</sup> ed (2003), 14.

<sup>22</sup> A de Koker & A Koekemoer *Silke on South African Income Tax* (2016), (loose leaf, 1990- updated) para 1.8.

<sup>23</sup> Great Britain. Treasury Income Tax Codification Committee *Report Vol 1: Report and Appendices* (1936) available at <http://dspace.gipe.ac.in/xmlui/handle/10973/23635> accessed 6 September 2016, 34, para 54.

Despite the importance of an individual's tax residence in South Africa, the term resident is only defined by the Income Tax Act<sup>24</sup> by referring to the expression 'ordinarily resident', an expression which is not defined by the Income Tax Act.

The meaning of the expression 'ordinarily resident' has been left to the courts to decide in South Africa.

## **3.2 The law**

### **3.2.1 Background**

From 1962 to 2001, with some amendments to the source rules in 1977, the South African tax system was a source based system of taxation, where only income from South African sources were taxed.

In January 2001 the South African tax system became a residence based system of taxation and South African residents, ordinarily resident in South Africa, were taxed, with certain exemptions and subject to statutory relief and international agreements, on their income, regardless of the location of its source.

The change from a sourced based system of taxation to a residence based system of taxation was only introduced after three commissions of enquiry, namely the Franzsen Commission in 1969 (DG Franzsen ;*Taxation in South Africa : First Report of the Commission of Enquiry into Fiscal and Monetary Policy in South Africa*) the Margo Commission in 1986 (C Margo *Report of the Commission of Inquiry into the Tax Structure of the Republic of South Africa*) and the Katz Commission in 1997, extensive research and seven drafts<sup>25</sup> of the Revenue Amendment Bill of 2000.

The Revenue Amendment Act, Act 59 of 2000, promulgated on the 9<sup>th</sup> November 2000 amended Section 1 of the Income Tax Act to introduce and define the expression 'resident', replacing what was formerly referred to as 'person'.

### **3.2.2 The current law: defining a resident**

Section 1 of the Income Tax Act defines a resident as a natural person:

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<sup>24</sup>Income Tax Act No 58 of 1962 (hereafter referred to as the Income Tax Act).

<sup>25</sup> L Olivier 'Residence based taxation' (2001)14 *Tydskrif vir die Suid-Afrikaanse Reg*, 20.

- who is ordinarily resident in the Republic or
- who was physically present in South Africa for periods exceeding 91 days during the year of assessment, and who were physically present in South Africa for more than 91 days during each of the five years of assessment preceding such year of assessment and who were present in South Africa for periods exceeding 915 days in total during those five preceding years of assessment (physical presence test).

These two tests are mutually exclusive and the physical presence test does not exclude a natural person from being a resident if the individual is ordinarily resident.

The physical presence test is an objective test easily supported by the facts, but the determination if an individual is ordinarily resident is both subjective and complex.

The Income Tax Act does not define the expression ordinarily resident and there is no statutory residence test in South Africa.

The termination of an individual's place of residence in the context of income tax legislation in South Africa has become an important tax planning opportunity and tax threat, as the individual's status as a resident affects their liability to tax on an annual basis, on death and on the termination of their South African residence.

In addition to this, capital gains tax, subject to certain exemptions, is payable on the individual's assets, regardless of the location of its source, on the termination of their residence.

From a simple mathematical perspective, the benefits of an individual terminating their South African residence, under reasonably typical circumstances, where the emigrant's local assets are disposed of and sent offshore on emigration, appears to be a financially sound tax decision, as capital gains tax, subject to certain limited exceptions, is levied on the termination of the individual's residence, thereafter, no further tax will be payable by the individual in South Africa, other than tax on South African sourced income.

On ceasing to be a tax resident in South Africa, and assuming no assets are retained in South Africa, the individual will also have no liability to estate duty in South Africa.

The logic of this proposition is that the tax cost of terminating a natural persons residence in South Africa, is the capital gains tax levied on the termination of their South African tax residence, at a maximum tax rate of 16.4%; whereas the benefit to the individual is that they will have no further liability to tax in South Africa, potentially mitigating income tax up to forty one percent and estate duty up to twenty percent.

Simple mathematics, however, may not provide the correct answer in these circumstances and the view that terminating tax residence on emigration, paying the deemed capital gains tax of up to 16.4% and paying no further tax in South Africa, may not be the optimal tax strategy. It is submitted that what is required is a careful analysis of the net present values of the cash flows generated from the emigrant's assets, regardless of their location, based on say the life expectancy tables, an analysis of the tax system in the emigrant's new country of residence and the double tax agreements between South Africa and their new country of residence.

Fundamental to this analysis, however, is the meaning of the expression 'ordinarily resident', an expression which cannot be objectively determined and relied on whilst planning the natural person's emigration tax strategy.

This chapter has discussed how a person's residence for tax purposes has been determined in South Africa as well as how a resident has been defined. This chapter has also highlighted the problems that arise in terms of defining residence which involves an examination of the concept of 'ordinarily resident'. The next chapter will examine the concept of 'ordinarily resident' in detail with reference to relevant case law.

## CHAPTER FOUR ORDINARILY RESIDENT

### 4.1 The Explanatory Memorandum

The Explanatory Memorandum on the Revenue Laws Amendments Bill, 2000<sup>26</sup>, held that:

“The Courts have interpreted “ordinarily resident” to mean the place where a person has his or her place of permanent residence. If a person is outside the Republic and has the intention to return to the Republic to make it his or her permanent home, such person will, therefore, be regarded as a resident regardless of the period of time spent outside the Republic. The majority of countries use similar bases which, although effectively the same test, are referred to as “domicile, habitual abode, and permanent home”. A person will, therefore, become a resident and be taxed on his or her income, regardless of the location of its source, by virtue of him or her being ordinarily resident from the date that such person so becomes ordinarily resident, until such person ceases to be ordinarily resident in the Republic”.

### 4.2 Judicial decisions in South Africa

The two important judicial decisions in South Africa where the meaning<sup>27</sup> of the expression ‘ordinarily resident’ were addressed, were the Supreme Court of Appeal cases of *Cohen v Commissioner for Inland Revenue*<sup>28</sup> (“*Cohen*”) and *Commissioner for Inland Revenue v Kuttel*<sup>29</sup> (“*Kuttel*”). The two judicial decisions are authoritative in this regard and *Kuttel* has become the *locus classicus* in South Africa in dealing with the meaning of the expression ‘ordinarily resident’ as it expanded on the judgement in *Cohen*.

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<sup>26</sup> The Explanatory Memorandum on the Revenue Laws Amendments Bill, 2000, 3-5

<sup>27</sup> Stark, Arendse & Renaud “The Cohen and Kuttel stories: Is the place where I hang my hat still relevant to determine my residence for tax purposes?” (2015) 19 *Southern African Business Review* 2.

<sup>28</sup> [1946] 13 SATC 362 (1946 AD 174).

<sup>29</sup> [1992] 54 SATC 298 (1992 (3) SA 242 (A)).

#### 4.2.1 *Cohen v Commissioner for Inland Revenue* 13 SATC 362

The taxpayer (“Cohen”) was domiciled in South Africa; he was a director of O.K. Bazaars Limited and in the course of his duties, regularly travelled internationally. In June 1940 he was sent to the United States to assist with buying products for the South African company. He obtained a nine month permit to travel, which was later extended by a further twelve months. He was joined in the United States by his family and they established a home in New York. Whilst overseas, he rented out his family home in South Africa. From June 1940 to 30<sup>th</sup> June 1942, neither Cohen nor his family returned to South Africa.

Cohen maintained that he was exempt from certain taxes in South Africa whilst in the United States, on the basis that whilst in the United States he was no longer ordinarily resident in South Africa. He argued that since income tax is an annual tax, the facts relating to each year of assessment must be examined separately in order to determine if he was ordinarily resident during that year of assessment.

The *ratio decidendi* of the judgement were as follows:

Schreiner JA<sup>30</sup> held that although tax is an annual tax, it does not mean that a taxpayer’s actions in that year alone determine his status as ordinarily resident and in establishing if a taxpayer is ordinarily resident, regard should be given to his mode of life, not only during the tax year in question, but his mode of life before and after the tax year in question.

Schreiner JA<sup>31</sup> held that based on English case law, taxpayers’ physical presence was not required to establish ordinarily residence.

It was held<sup>32</sup> that an individual’s ordinarily residence would be “the country to which he would naturally and as a matter of course return from his wanderings”. It was confirmed that a person is ordinarily resident where he has his usual or principal residence i.e. what may be described as his real home.

It was further held that:

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<sup>30</sup>*Cohen v Commissioner* 13 SATC 362 at 372 and 373.

<sup>31</sup>*Cohen v Commissioner* 13 SATC 362 at 362.

<sup>32</sup>*Cohen v Commissioner* 13 SATC 362 at 185.

- a natural person can be resident in more than one country but he can only be ordinarily resident in one country<sup>33</sup>;
- a natural person's domicile is not the same as the place where they are ordinarily resident<sup>34</sup>.

Cohen was held to be ordinarily resident in South Africa on the basis of the legal principles set out above and the fact that the court was of the opinion that he had not managed to prove that he was not ordinarily resident in the light of the facts that:

- his trip to the United States was of a temporary nature as evidenced by his temporary travel permits;
- he had entered into a medium term lease of a flat in South Africa (for five years) and had only sub-let it whilst he was out of the country;
- in the course of his duties as a director of O.K. Bazaars Limited, he regularly travelled internationally, but always returned to South Africa.

#### **4.2.2 *Commissioner for Inland Revenue v Kuttel* 54 SATC 298**

The taxpayer (Kuttel) emigrated to the United States, not only taking up residence in the United States but was also granted permanent residence in the United States. As a consequence of his decision to emigrate to the United States, he sold a large number of his assets in South Africa and invested the proceeds in Eskom stock in order to maximise the income which he could remit from South Africa. He lived and worked in the United States, becoming a member of the community as evidenced by his membership of a local church, the opening of a United States bank account, registration with the United States social security, the acquisition of a car, an office and a home in the United States. Despite this, he travelled internationally, including numerous trips to South Africa where he pursued both business and sporting interests. He retained a home in South Africa, primarily as a hedge against fluctuations in the exchange rate and spent considerable periods of time in South Africa. The property was not rented out and held to provide him with accommodation when he returned to South Africa. During the period from September 1983 to

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<sup>33</sup>*Cohen v Commissioner* 13 SATC 362 at 371.

<sup>34</sup>*Cohen v Commissioner* 13 SATC 362 at 371.

February 1986, Kuttel spent nearly one third of his time in South Africa and made nine trips to South Africa. The main purpose of the trips were domestic and business in nature, including the education of his children, the building of a yacht, attending his brother's funeral and supervising various investments and businesses in South Africa.

The Commissioner for Inland Revenue taxed Kuttel on his interest and dividend income earned during the 1984 to 1986 tax years and Kuttel objected to this on the basis that they were not taxable, as he held that he was not ordinarily resident in South Africa.

On appeal, it was held that:

- There is a difference between the terms resident and ordinarily resident, the latter being narrower. This view was supported by the fact that Section 9A of the Income Tax Act defined the expression resident, which would have been unnecessary if there was no difference between the terms<sup>35</sup>. The importance of this being that a natural person may have more than one residence, but can only be ordinarily resident in one place at a time;
- Lord Denning MR<sup>36</sup> was cited where he held that the meaning of the expression "ordinarily resident" means a place where a person is "habitually and normally resident ... apart from temporary or occasional absences of long or short duration"
- The court adopted the judgement in *Cohen v Commissioner for Inland Revenue*<sup>37</sup> that a person is ordinarily resident where he has his usual or principal residence, i.e. what may be described as his real home;
- Based on the facts, Kuttel was not ordinarily resident in South Africa and the Commissioner for Inland Revenue did not provide any evidence which indicated that Kuttel had not set up his usual or principal residence in the United States<sup>38</sup>;
- It was held that the fact that Kuttel kept a home in South Africa did not detract from the fact that his usual or principal home was in the United States. Sound

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<sup>35</sup> *Commissioner for Inland Revenue v Kuttel* 54 SATC 298 at 304-5.

<sup>36</sup> *Shah v Barnet London Borough Council and Other Appeals* [1983] 1 All ER 226 (HL) at 234 b-c. 45.

<sup>37</sup> *Cohen v Commissioner* 13 SATC 362 at 185.

<sup>38</sup> *Commissioner for Inland Revenue v Kuttel* 54 SATC 298 at 306.

financial reasons for retaining the residence in South Africa supported the retention of the property<sup>39</sup>;

- Each of the nine trips to South Africa in the period in question were examined and not found to have indicated that Kuttel was naturally and as a matter of course returning from his wanderings. Goldstone JA held that these trips to South Africa “were not for purposes which one would normally associate with a ‘return home’”<sup>40</sup>.

The court held that Kuttel was not ordinarily resident in South Africa during the period in question.

#### **4.2.3** *ITC 1170* (34 SATC 76 (C), 1971)

In a Cape Special Court ruling in 1971, the *ratio decidendi* set out on page 78 of the judgement, held that the question whether a taxpayer may be regarded as being ordinarily resident in a particular place at a particular time is one of degree, and one is entitled to look at the taxpayer’s mode of life beyond the period under consideration<sup>41</sup>.

On page 79 of the judgement, it was held that “it is not possible to lay down any hard and fast rule with regard to a time of absence which should be regarded as temporary. ....the word 'temporary' can mean 'lasting for a limited time' (see the Shorter Oxford English Dictionary), and it can also mean 'not permanent' (see *Principal Immigration Officer v Mithal* 1946 CPD at 573)”

#### **4.2.4** *Robinson v COT* 1917 TPD 542, 32 SATC 41

In a Transvaal Provincial Division case in 1917, it was held that the physical presence of the taxpayer and the maintenance of a home are decisive factors in determining an individual’s residence.

Bristowe, J held:

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<sup>39</sup> *Commissioner for Inland Revenue v Kuttel* 54 SATC 298 at 306.

<sup>40</sup> *Commissioner for Inland Revenue v Kuttel*, 54 SATC 298 at 306.

<sup>41</sup> SARS Interpretation Note 3, February 2002, 3.

“Residence means a man's home or one of his homes for the time being. If a man sets up an establishment and lives there at intervals he is resident in that country. The result is the same whether the establishment is for a defined period or whether the intention expressed or to be implied from the circumstances is to prolong the arrangement for a period exceeding the limit (whatever that may be) of casual visitation. In the case of physical presence without an establishment, a similar test must be applied”.

The Interpretation Note 3 holds that this decision is important as it deals with a taxpayer's physical presence and the maintenance of a home<sup>42</sup>.

### **4.3 Summary of the principles established by the South African courts**

- 4.3.1** A natural person is ordinarily resident where he has his usual or principal residence, what may be described as his real home<sup>43</sup>;
- 4.3.2** A natural person is “ordinarily resident in the country to which he naturally and as a matter of course returns from his wanderings”<sup>44</sup>;
- 4.3.3** There is a difference between a natural person's residence (or their domicile) and the place where he is ordinarily resident. A natural person may have more than one residence, but can only be ordinarily resident in one place at a time<sup>4546</sup>;
- 4.3.4** Temporary or occasional visits back to South Africa, of long or short duration, do not necessarily indicate that the individual is ordinarily resident in South Africa<sup>47</sup>. What is required is an analysis of each trip back to South Africa to determine their real purpose and establish if the trips were associated with a return home<sup>48</sup>;
- 4.3.5** A natural person's physical presence is not required to establish ordinary residence in South Africa<sup>49</sup>;

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<sup>42</sup> SARS Interpretation Note 3, February 2002, 3-4.

<sup>43</sup> *Cohen v Commissioner* 13 SATC 362 page 185.

<sup>44</sup> *Cohen v Commissioner* 13 SATC 362 page 185.

<sup>45</sup> *Commissioner for Inland Revenue v Kuttel* 54 SATC 298 at 304-5.

<sup>46</sup> *Cohen v Commissioner* 13 SATC 362 at 371.

<sup>47</sup> *Shah v Barnet London Borough Council and Other Appeals* [1983] 1 All ER 226 (HL) at 234 b–c. 45.

<sup>48</sup> *Commissioner for Inland Revenue v Kuttel* 54 SATC 298 at 306.

<sup>49</sup> *Cohen v Commissioner* 13 SATC 362 at 362.

**4.3.6** The fact that a natural person retains a home in South Africa does not necessarily mean that they are ordinarily resident in South Africa<sup>50</sup>;

**4.3.7** Although tax is an annual tax, it does not mean that a natural person's actions in the tax year alone will determine their status as ordinarily resident, what is required is an assessment of the individual's mode of life, not only during the tax year, but before and after the tax year in question<sup>51</sup>.

#### **4.4 Interpretation Note 3**

SARS issued an interpretation note dealing with a natural person's status as ordinarily resident.

The guide sets out two requirements for an individual to be regarded as ordinarily resident, namely that the individual has to have an intention to become or cease to become ordinarily resident and the individual has to be able to demonstrate the steps taken which would indicate this intention.

The interpretation note sets out eleven factors which SARS is of the opinion may confirm the individual's intention<sup>52</sup>:

- most fixed and settled place of residence;
- habitual abode i.e. present habits and mode of life;
- place of business and personal interests;
- status of the individual in the country i.e. immigration, work permit periods and conditions;
- location of personal belongings;
- nationality;
- family and social relationships (schools, churches, etc.);
- political, cultural or other activities;
- application for permanent residence;
- period abroad; purpose and nature of visits;

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<sup>50</sup> *Commissioner for Inland Revenue v Kuttel* 54 SATC 298 at 306.

<sup>51</sup> *Cohen v Commissioner* 13 SATC 362 at 372 and 373.

<sup>52</sup> SARS Interpretation Note 3, February 2002, 5.

- frequency of visits

#### 4.5 Tabular representation of the ‘ordinarily resident’ principles in South Africa

With a view to providing an objective guide to establish if an individual is ‘ordinarily resident’ in South Africa, through the construction of a list of events and factors, based on the Explanatory Memorandum in the Revenue Laws Amendment Bill of 2000, judicial decisions in South Africa and the SARS practice note; the theoretical objective guide may look as follows:

Table 1: Ordinarily resident events and factors

EVENT/FACTOR	ORDINARILY RESIDENT	
	YES	NO
Belongings retained in South Africa	1	
Business interests in South Africa	2	
Cell phone usage and bills pointing to a presence in South Africa	3	4
Children being educated in South Africa		4
Employment based in South Africa	5	
Family and social relationships in South Africa	6	
Home in South Africa	7	8
Nationality in another country		8,9& 10
Overseas on business	10	11
Permanent Residence in another Country		12
Marriage to a South African and the establishment of a home in South Africa	13	
Personal post being sent to South Africa	14	
Physical presence in South Africa	15	16
Private medical aid or medical insurance in South Africa	17	

Regular visits with extensive time to South Africa	18	19
Work full time overseas	20	21

## KEY

1. SARS Interpretation Note 3, February 2002, Page 5
2. SARS Interpretation Note 3, February 2002, Page 5
3. Assumption, based on the case law and SARS Interpretation Note 3, February 2002, Page 5
4. *Commissioner for Inland Revenue v Kuttel* 54 SATC 298
5. Assumption, based on a judgement in the United Kingdom, *Grace v The Commissioners for Her Majesty's Revenue and Customs*, [2011] UKFTT 36 (TC)
6. SARS Interpretation Note 3, February 2002, Page 5 and a judgement in the United Kingdom, *R (on the application of Davies and another) (Appellants) v The Commissioners for Her Majesty's Revenue and Customs (Respondent) and R (on the application of Gaines-Cooper) (Appellant) v The Commissioners for Her Majesty's Revenue and Customs (Respondent)*[2011] UKSC 47
7. SARS Interpretation Note 3, February 2002, Page 5
8. *Commissioner for Inland Revenue v Kuttel*, 54 SATC 298, pages 306
9. SARS Interpretation Note 3, February 2002, Page 5
10. *Cohen v Commissioner*, 13 SATC 362
11. SARS Interpretation Note 3, February 2002, Page 5
12. SARS Interpretation Note 3, February 2002, Page 5
13. *ITC 961 (1061)* SATC 648
14. Assumption, based on the SARS Interpretation Note 3, February 2002, Page 5
15. SARS Interpretation Note 3, February 2002, Page 5
16. *Commissioner for Inland Revenue v Kuttel* 54 SATC 298
17. Assumption, based on the SARS Interpretation Note 3, February 2002, Page 5

18. SARS Interpretation Note 3, February 2002, Page 5

19. *Commissioner for Inland Revenue v Kuttel* 54 SATC 298

20. *Cohen v Commissioner* 13 SATC 362

21. SARS Interpretation Note 3, February 2002, Page 5.

The table, however, serves limited purpose and offers limited clarity on an individual's status as ordinarily resident, as the case law is based on the degree to which each factor determines residence, and is subjective rather than objective in nature. Judicial decisions do not provided clear or specific principles applicable to all situations and it is therefore not possible to create a definitive guide to an individual's South African tax residence based on judicial decisions and the SARS Interpretation Note 3.

In South Africa, only a statutory residence test, replacing the reliance on judicial decisions would create certainty through the introduction of an objective test.

Despite the above mentioned factors and events developed to establish what constitutes 'ordinarily resident', uncertainty exists as regard an individual's status as 'ordinarily resident'. The next chapter explores these uncertainties in more detail.

## CHAPTER FIVE

### UNCERTAINTY REGARDING THE EXPRESSION 'ORDINARILY RESIDENT'

#### 5.1 Reasons for uncertainty

It is submitted that there is a lack of certainty in South Africa regarding an individual's status as ordinarily resident. This is as a result of:

- The absence of a statutory definition of the expression ordinarily resident;
- The reliance on judicial decisions to interpret, on a case by case basis, the meaning of the individual's status as ordinarily resident;
- Inconsistencies between the judicial decisions and SARS practice, for example, in the *Kuttel* case, it was held that retaining a home in South Africa did not prove that the taxpayer was still ordinarily resident, whereas the Interpretation Note 3 highlighted the importance of the case of *Robinson v COT* 1917 TPD 542, 32 SATC 41, which dealt with the fact that the maintenance of a home is a decisive factor in determining an individual's residence;
- There is uncertainty if a taxpayer can rely on the Interpretation Note 3 on the basis of it not being a binding class ruling in terms of Section 78 of the Tax Administration Act<sup>53</sup> and is not legally binding or intended as a definitive and binding guide and has not been updated since 2002. In the United Kingdom, prior to the introduction of a Statutory Residence Test, individuals and the courts questioned their ability to rely on written guidance issued by the HMRC<sup>54</sup> and it was held that possibly only 'an ordinarily sophisticated taxpayer'<sup>55</sup> could rely on the written guidance;
- The two most important judicial decisions dealing with the definition of the expression "ordinarily resident"<sup>56</sup> are the *Cohen* case, a judgement handed down nearly seventy years ago and the *Kuttel* case, a judgement handed down nearly

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<sup>53</sup> Tax Administration Act 28 of 2011.

<sup>54</sup> J Freedman & J Vella "Revenue guidance: The limits of discretion and legitimate expectations" (2012) 128 *Law Quarterly Review*, 192.

<sup>55</sup> *R (on the application of Davies and another) (Appellants) v The Commissioners for Her Majesty's Revenue and Customs (Respondent) and R (on the application of Gaines-Cooper) (Appellant) v The Commissioners for Her Majesty's Revenue and Customs (Respondent)* [2011] UKSC 47 (hereafter *R v The Commissioner HMRC*)

<sup>56</sup> Stark, Arendse & Renaud "The Cohen and Kuttel stories: Is the place where I hang my hat still relevant to determine my residence for tax purposes?" (2015) 19 *Southern African Business Review* 2.

twenty four years ago. Given the changes in the South African economy, society and technology over this period, it is submitted that these cases are outdated;

- An additional limitation to a case law approach in determining a natural person's residence is that judicial decisions do not provide specific principles applicable to all taxpayers<sup>57</sup>.

Stark, Arendse & Renaud<sup>58</sup> maintain that the meaning of the expression ordinarily resident in South Africa in relation to a natural person, has become both vague and uncertain and is in need of modernising.

Given that the South African constitution acknowledges the usefulness of foreign law, and the necessity of examining foreign precedents when drafting legislation in South Africa, the next chapter will examine a range of precedents from the United Kingdom, Rhodesia (pre Independence cases) and Canada. The next chapter will also investigate the similarities and differences between the principles surrounding residence in the United Kingdom and South Africa. A critique of the statutory residence test developed in the United Kingdom in 2013 will be provided and the chapter finishes with consideration of statutory residence tests in the jurisdictions of Australia, New Zealand and the United States.

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<sup>57</sup> HM Treasury *Statutory Definition of Tax Residence and Reform of Ordinary Residence: A Summary of Responses to the June 2012 Consultation* (2012), 53.

<sup>58</sup> Stark, Arendse & Renaud "The Cohen and Kuttel stories: Is the place where I hang my hat still relevant to determine my residence for tax purposes?" (2015) 19 *Southern African Business Review*, 22.

## CHAPTER SIX

### FOREIGN PRECEDENTS AND LEGISLATION

#### 6.1 Introduction

The Constitution<sup>59</sup> allows South African courts to use foreign judicial decisions when formulating a judgement, enabling them to benefit from global precedents and judicial decisions handed down over centuries, however, the interpretation of foreign judicial decisions are regarded as persuasive, not binding<sup>60</sup>.

In *State v Makwanyane*<sup>61</sup> it was held that ‘we can derive assistance from public international law and foreign case law, but we are in no way bound to follow it.’

#### 6.2 The use of foreign tax precedents and legislation

##### 6.2.1 The influence of legislation and judicial decisions from the United Kingdom

The influence of legislation and judicial decisions from the United Kingdom is evident in South African legislation and judicial decisions and examples of these include:

- In South African judicial decisions such as *Cohen* and *Kuttel*, reference was made to cases in the United Kingdom;
- The SARS interpretation notes and practice notes make reference, from time to time, to cases in the United Kingdom. An example of this was Interpretation note 6 (Issue 2)<sup>62</sup> dealing with corporate residence, where SARS was guided by judicial decisions in the United Kingdom when drafting the interpretation note, in particular in relation to the judgement in *Smallwood v CRC*<sup>63</sup> and in the SARS Interpretation Note 3<sup>64</sup>, dealing with the definition of a natural person’s residence,

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<sup>59</sup> The Constitution of the Republic of South Africa, 1996, Section 39(1).

<sup>60</sup> R Rohatgi *Basic International Taxation* (2005) Vol 1, page 59.

<sup>61</sup> *State v Makwanyane and Another* (CCT3/94) [1995] ZACC 3.

<sup>62</sup> SARS Draft Interpretation Note 6 (issue 2), April 2015 and Interpretation Note 6 (issue 2), November 2015.

<sup>63</sup> *HMRC v Smallwood* (2010) EWCA Civ 778.

<sup>64</sup> SARS Interpretation Note 3, February 2002.

legislation from the United Kingdom, the IR20 issued by Her Majesty's Customs and Excise ("HMRC")<sup>65</sup> and English case law such as *Levene v Inland Revenue Commissioner* (1928) ALL ER Rep 746 (HL) and *Shah v Barnet London Borough Council and Other Appeals*<sup>66</sup> were referred to and

- The South African legal system has some of its origins in the British legal system which has resulted in an interrelationship between the two legal systems.

Stark, Arendse & Renaud<sup>67</sup> maintain that:

"The UK residence rules and jurisprudence are at the root of the South African principles regarding the tax residence of an individual and, as was seen in the cases discussed above<sup>68</sup>, South African courts in interpreting 'residence' and 'ordinarily resident' referred extensively to judicial decisions of the English courts for guidance. Hence it is significant for the purposes of this study to follow the evolution of the UK residency rules".

## 6.2.2 The influence of foreign legislation

Historically, when contemplating the introduction of new tax legislation in South Africa, foreign legislation is considered, for example, the research undertaken prior to the introduction of the capital gains tax legislation in South Africa involved a survey of the legislation of over forty countries.<sup>69</sup> Another example of this was the evaluation of numerous other jurisdiction's value added tax ("VAT") legislation prior to the introduction of VAT<sup>70</sup> in South Africa. As a result of the comparative international research, New Zealand VAT legislation was ostensibly used when drafting the South African VAT legislation.

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<sup>65</sup> HMRC 'Residents and non-residents: Liability to tax in the United Kingdom' (IR20) available at <https://www.britishcouncil.org/new/PageFiles/8535/ir20.pdf> accessed 2 August 2016.

<sup>66</sup> *Shah v Barnet London Borough Council and Other Appeals* (1983) 1 ALL ER 226 (HL) at 234 b-c.

<sup>67</sup> Stark, Arendse & Renaud "The Cohen and Kuttel stories: Is the place where I hang my hat still relevant to determine my residence for tax purposes?" (2015) 19 *South African Business Review*, 19.

<sup>68</sup> [1946] 13 SATC 362 (1946 AD 174) and [1992] 54 SATC 298, (1992 (3) SA 242 (A)).

<sup>69</sup> 'Capital Gains Tax in South Africa' (24 January 2001) available at <http://www.ftomasek.com/NationalTreasury.pdf> Accessed 2 May 2016.

<sup>70</sup> Value Added Tax Act 89 of 1991.

In contrast to this experience, it has been held that South African conditions are unique and the optimal tax system for South Africa is not to be found in the tax system of another country, but rather in South Africa<sup>71</sup>.

It is submitted that this view, in relation to the definition of the expression ordinarily resident, does not take into account the benefits which could be obtained from developing the knowledge, experience and outcomes from other countries who have addressed the same objectives in relation to an individual's place of residence in the context of income tax legislation.

The SARS legislative research and development team<sup>72</sup> maintain that no specific country's legislation is followed when developing South African tax legislation, however, comparative research on the tax law of countries such as Australia, Canada, New Zealand, the United Kingdom and the United States are considered. The SARS Legal Counsel hold that final South African legislation is based on proposals made during the legislative process and public comments received on draft legislation during the Parliamentary process.

It is submitted that the statutory residence test introduced in the United Kingdom in 2013, not only provides an insight into legislation which aims at defining an individual's place of residence, but it also offers insight into the process and research considered prior to its introduction; and the consequences of its introduction. The statutory residence test provides a possible foundation for a statutory residence test in South Africa, a test, which may need to be adapted to take into account the unique South African conditions.

### **6.3 Judicial decisions in Rhodesia<sup>73</sup>**

#### **6.3.1 *H v COT* 23 SATC 292 (1960)**

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<sup>71</sup> R Krever 'A Capital Gains Tax for South Africa: Draft notes for a presentation to the Portfolio Committee on Finance and the Select Committee on Finance' (2001) available at <http://www.ftomasek.com/RickKreverDraft.html> accessed 2 May 2016.

<sup>72</sup> In an email to the author from SARS Legal Counsel on the 17<sup>th</sup> August 2016, Mr S Stoffels.

<sup>73</sup> Now Zimbabwe.

In a judgement delivered in 1960, the taxpayer sold his private dwelling in Salisbury, and bought one at Somerset West in South Africa, where he kept his furniture and belongings and where he lived for the greater part of every year.

On page 296 of the judgement it was held that:

“His real home in the popular sense was in Somerset West, where his permanent place of abode was, where his belongings were stored which he left for temporary absences and to which he regularly returned after such absences. That he resided at Somerset West was conceded by counsel for the Commissioner; if there is a difference between 'residence' and 'ordinary residence', as Ramsbottom J. indicated in *Biro's case*, *supra*, and appears from the judgment of Rowlatt J. in *Levene's case*, 13 T.C. at 493 (though the speech of the Lord Chancellor at 507 of the same report expresses doubt on the point), it might well be considered that the taxpayer was 'ordinarily resident' at Somerset West”.

In Interpretation Note 3<sup>74</sup>, SARS concluded from this case that:

An individual is resident in the place where his permanent abode is, where his belongings are stored and where he left only for temporary absences.<sup>75</sup>

### 6.3.2 *ITC 961 (1961) SATC 648*

It was held in the judgement on page 649 that:

“The question of whether an individual is resident for income tax purposes is ultimately a question of fact, to be decided on the particular circumstances of each case”.

It was further stated on page 650 of the judgement, that a woman who marries a man who is ordinarily resident in a particular country, and sets up home with her

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<sup>74</sup>SARS Interpretation Note 3, February 2002.

<sup>75</sup> SARS Interpretation Note 3, February 2002, 3.

husband in that country, cannot be said to be ordinarily resident in some other country, even if before her marriage she was ordinarily resident in that other country.<sup>76</sup>

“...to my mind the fact of marriage to a man domiciled and permanently resident in England in the circumstances disclosed in the evidence alters the whole situation. I do not say that the fact of marriage alone would necessarily prevent a wife retaining her premarital residence, for it is possible to envisage circumstances where there might be no change. But where she is living in the country of her husband's domicile and permanent residence at the time of marriage, and sets up a home with him in that country after marriage, particularly when there is no decision or even discussion about that home being temporary pending the couple's departure for the wife's country of origin, I feel that it is almost impossible to say that the wife has a settled and certain residence in another country”.

### 6.3.3 *Soldier v COT* 1943 SR 130

It was held that the individuals residence must be settled and certain and not temporary and casual<sup>77</sup>.

On page 133 of the judgement, it was held that:

“In the present case it is established that the appellant came here simply as a soldier... his service in the Colony has been prolonged. When the year of assessment expired he had been here nine months. He has now been here over two years. It is undesirable, indeed it is impossible, to attempt to suggest how long a period of physical presence in the Colony would turn a purely temporary sojourn into "ordinary residence" within the meaning of the section. So much must depend upon the other indications in the circumstances of each case”.

## 6.4 Judicial decisions in Canada

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*Thompson v Minister of Natural Revenue* (1944) 2 DTC 812 (SCC)

The taxpayer had a dispute with the village tax authority in Canada over his personal property tax and decided to leave Canada and moved to Bermuda, where he rented a house, obtained a passport for ten years, signed an affidavit declaring that he had moved to Bermuda to establish his home and domicile and declared that his intention was to live there indefinitely. Despite these manifestations, he only spent 6 days in Bermuda in 1926; 8 days in 1928 and 6 days in 1933. He did not own any property in Bermuda or have a bank account there.

The case was decided on the question of whether the taxpayer was residing or ordinarily resident in Canada during such year.

It was held in paragraph 23, that:

“the terms "residing" and "ordinarily resident" in section 9(a) of the Income War Tax Act have no technical or special meaning and that the question whether in any year a person was "residing or ordinarily resident in Canada" within the meaning of the section is a question of fact”.

It was held that the taxpayer had not terminated his Canadian tax residence.

## **6.5 Judicial decisions in the United Kingdom, prior to the introduction of the Statutory Residence Test in 2013**

### *6.5.1 Levene v IRC* (1928) AC 217

For centuries this was the *locus classicus* on the place of residence of an individual in the United Kingdom.

The *ratio decidendi* in the appeal court ruling in March 1928, was that although a person can have only one domicile at a time, he may simultaneously reside in more than one place, or in more than one country<sup>78</sup>:

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<sup>78</sup>*Levene v IRC* (1928) AC 217 at para 505.

The taxpayer was initially ordinarily resident in the United Kingdom but changed his way of life and moved abroad for seven months a year, spending the remaining five months a year in the United Kingdom.

Whilst in the United Kingdom he stayed in hotels (as he did whilst he was abroad) and engaged himself in religious and social activities.

The court held that he was ordinarily resident in the United Kingdom, a decision which relied on the definition of “reside” in the Oxford English Dictionary, namely “....to have one’s settled or usual abode”.

The *ratio decidendi* of the court was that your residence terminates when you cease to have a settled or usual abode in the United Kingdom.

It was held that to ordinarily reside in a place requires an individual to live in that place with some degree of continuity and permanence, apart from accidental or temporary absences<sup>79</sup>.

Viscount Sumner also addressed the lack of certainty and a taxpayer’s ability to arrange their affairs in a manner which mitigated tax, he stated:

“It is trite law that His Majesty’s subjects are free, if they can, to make their own arrangements, so that their cases may fall outside the scope of the taxing Acts. They incur no legal penalties and, strictly speaking, no moral censure if, having considered the lines drawn by the Legislature for the imposition of taxes, they make it their business to walk outside them.

It seems to follow from this and from other general considerations that the subject ought to be told in statutory and plain terms, when he is chargeable and when he is not. The words “resident in the United Kingdom, whether “ordinarily,” or otherwise, and the words “leaving the United Kingdom for the purpose only of occasional residence abroad,” simple as they look, guide the

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<sup>79</sup>*Levene v IRC* (1928) AC 217 at para 746.

subject remarkably little as to the limits, within which he must pay and beyond which he is free. This is likely to be a subject of grievance and to provoke a sense of injustice”.

6.5.2 *Shah v Barnet London Borough Council and Other Appeals* [1983]1 ALL ER 226 (HL)

It was held that “ordinarily resident” referred

“to a man’s abode in a particular place or country which he has adopted voluntarily, and for settled purposes, as part of the regular order of his life or the time being, whether of short or of long duration”.

The *ratio decidendi* of the court was that a person must be habitually and normally resident in the United Kingdom, apart from temporary or occasional absences of long or short duration in order to be regarded as ordinarily resident in the United Kingdom<sup>80</sup>.

6.5.3 *IRC v Lysaght* (1928) AC 234, 13 TC 511<sup>81</sup>

It was held that the question of residence or ordinary residence is one of degree, to be established by the facts and that there was no technical or special meaning attached to the words.

On page 535 of the judgement it was held:

"It would appear that the element of choice is regarded by the Court of Appeal as a factor of great, if not of final, consequence in determining residence.

In my opinion this reasoning is not sound. A man might well be compelled to reside here completely against his will".

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<sup>80</sup>*Shah v Barnet London Borough Council and Other Appeals* (1983)1 All ER 226 (HL), para 234 b to c.

<sup>81</sup>*IRC v Lysaght* (1928) AC 234, 13 TC 511 at 249.

On page 536 of the judgement it was held:

"I have reluctantly come to the conclusion that it is now settled by authority that the question of residence or ordinary residence is one of degree, that there is no technical or special meaning attached to either expression for the purposes of the Income Tax Act, and accordingly a decision of the Commissioners on the question is a finding of fact."

*6.5.4 Reid v IRC (1926) 10 TC 673, 1926 S.L.T. 365*

It was held on page 368 of the judgement that

"I am not sure that there is anything impossible in a person 'ordinarily residing' in two places, although no doubt he cannot be physically present in more than one place at the same time".

*6.5.5 Inland Revenue Commissioners v Combe (1932) 17 TC 405*

The concept of a 'distinct break' was first dealt with in this case. It was held that a taxpayer's residence is terminated when there is a distinct break in the taxpayer's residence as a result of his residence abroad being more than temporary or occasional.

*6.5.6 Reed v Clark [1986] CHD 1886*

The concept of a distinct break was considered and the *ratio decidendi* was that what was required to terminate an individual's place of residence was that "the pattern of the taxpayer's life"<sup>82</sup> be distinctly broken.

*6.5.7 R v The Commissioners for Her Majesty's Revenue and Customs (Gaines-Cooper)*<sup>83</sup>

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<sup>82</sup>*Reed v Clark* [1986] CHD Ch 1, 18.

<sup>83</sup>*R (on the application of Davies and another) (Appellants) v The Commissioners for Her Majesty's Revenue and Customs (Respondent) and R (on the application of Gaines-Cooper) (Appellant) v*

Dealing with the concept of a distinct break, it was held that to terminate residency in the United Kingdom, what was required was a distinct break, one which results in a distinct break in the pattern of the taxpayer's life in the United Kingdom, but which does not require the "severance of social and family ties". What is required is a "substantial *loosening* of social and family ties".

#### 6.5.8 *Shepherd v IRC* 2006 STC 1821

Mr Shepherd was a commercial pilot, flying internationally from the United Kingdom. Whilst working and prior to his retirement, he stayed in his home in the United Kingdom and lived a settled life in the United Kingdom with his wife, family and friends.

In April 2000 he retired and moved to Cyprus. He had rented a flat in Cyprus two years prior to his retirement and after he retired, purchased a flat in Cyprus. Mr Shepherd claimed that he ceased to be a resident in the United Kingdom when he started renting the flat in Cyprus, two years prior to his retirement, on the basis that he had a home in Cyprus and had spent less than ninety days per year in the United Kingdom. The court ruled that his presence in the United Kingdom, even though for a limited period, was substantial and continuous and there was no distinct break.

It was held that what was meant by "residence" and "to reside" was "to dwell permanently or for a considerable period of time and to have a settled or usual abode, to live in or at a particular place".

The court ruled that residence is a question of fact and the following factors need to be taken into account:

- the duration of an individual's presence in the United Kingdom,

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*The Commissioners for Her Majesty's Revenue and Customs (Respondent)* [2011] UKSC 47, at para 20.

- the regularity and frequency of visits,
- the birth, family and business ties, the nature of visits and the connections with this country,
- the availability of living accommodation in the United Kingdom

The court stated that the reduced presence in the United Kingdom of an individual whose absences were caused by his employment did not necessarily mean that the individual was not residing in the United Kingdom.

It was also stated that the fact that an individual had a home elsewhere was of no consequence.

*6.5.9 R (on the application of Davies and another) (Appellants) v The Commissioners for Her Majesty's Revenue and Customs (Respondent) and R (on the application of Gaines-Cooper) (Appellant) v The Commissioners for Her Majesty's Revenue and Customs (Respondent)*[2011] UKSC 47(hereafter referred to as *Gains-Cooper case*).

The court applied the law rather than the Revenue Guidance, IR20<sup>84</sup> and held that the natural and ordinary meaning of an individual's residence should be adopted, by looking into the facts of the case and the taxpayers life in detail, instead of simply counting the number of days he spent out of the country, as set out in the Revenue Guide, IT20.

Based on the fact that the taxpayer was born in the United Kingdom, that his wife and son continued to live in the United Kingdom, that he had business interests in the United Kingdom and he travelled there regularly, the court held that there was sufficient evidence to disregard the Revenue Guidance, IR20, and regard him as a resident in the United Kingdom.

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<sup>84</sup>HMRC 'Residents and non-residents: Liability to tax in the United Kingdom' (IR20) available at <https://www.britishcouncil.org/new/PageFiles/8535/ir20.pdf> accessed 2 August 2016.

On appeal the court supported the earlier decision and held that the taxpayer was a resident in the United Kingdom, but the court went further to say that the actual wording of the Revenue Guidance was vague and gave rise to conflicts between HMRC and taxpayers.

The case was taken to the Supreme Court and Gaines-Cooper's appeals were dismissed.

In the Supreme Court it was held that the Revenue Guide IR20, contained sufficient information for 'an ordinarily sophisticated taxpayer' to come to the same conclusions as the HMRC, in that there was a need to establish a distinct break with the United Kingdom in order to become non-resident, which the taxpayer had not done. Gaines-Cooper was a Seychelles-based billionaire and 'an ordinarily sophisticated taxpayer' who had not established a distinct break with the United Kingdom.

*6.5.10 Grace v The Commissioners for Her Majesty's Revenue and Customs*  
[2011] UKFTT 36 (TC)

It was argued by HMRC that residence has an 'adhesive' nature and was harder for a resident to terminate their residence than it is for someone who has not previously been a resident to prove that they have not become a resident.

It was held that a sufficient break in the pattern of the taxpayer's life needed to be demonstrated to prove the termination of his residency.

Despite the taxpayer owning a home in South Africa, spending half his year in South Africa (the other half in the United Kingdom) and him regarding himself as a resident in South Africa, it was held by the court that he remained a resident in the United Kingdom on the basis that when he was in the United Kingdom he stayed at his own home, where he had a settled mode of life.

The ruling that he had not broken the pattern of his life in the United Kingdom was supported by his choice of employment in the United Kingdom as a pilot, based in the United Kingdom.

The court placed less emphasis was on how he spent his leisure time, in contrast to the findings in the *Gaines-Cooper case*.

## **6.6 Summary of the judicial principles established in the United Kingdom, prior to the introduction of the statutory residence test in 2013**

- 6.6.1 Whereas a person can only have one domicile at a time, he may reside in more than one country<sup>85</sup>;
- 6.6.2 An individual ceases to be a resident when he ceases to have a settled or usual abode in the United Kingdom<sup>86</sup>;
- 6.6.3 To ordinarily reside in a place requires an individual to live in that place with some degree of continuity and permanence, apart from accidental or temporary absences<sup>87</sup>;
- 6.6.4 Ordinary residence is one of degree, to be established by an assessment of the facts. There is no technical or special meaning attached to the words<sup>88</sup>;
- 6.6.5 Ordinary residence is terminated when there is a distinct break in the taxpayer's residence<sup>89</sup>, the distinct break being a distinct break in "the pattern of the taxpayer's life"<sup>90</sup>. but this does not require the "severance of social and family ties", but rather a "substantial loosening of social and family ties"<sup>91</sup>
- 6.6.6 Residence is a question of fact and the following factors need to be taken into account<sup>92</sup>:
  - 6.6.6.1 The duration of an individual's presence in the United Kingdom,
  - 6.6.6.2 The regularity and frequency of visits,
  - 6.6.6.3 The birth, family and business ties, the nature of visits and the connections with this country and
  - 6.6.6.4 The availability of living accommodation in the United Kingdom;

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<sup>85</sup>*Levene v IRC* (1928) AC 217 at para 505.

<sup>86</sup>*Levene v IRC* (1928) AC 217.

<sup>87</sup>*Levene v IRC* (1928) AC 217 at para 746.

<sup>88</sup>*IRC v Lysaght* (1928) AC 234, 13 TC 511 at 249.

<sup>89</sup>*Inland Revenue Commissioners v Combe* (1932) 17 TC 405.

<sup>90</sup>*Reed v Clark* [1986] Ch 1, 18.

<sup>91</sup>*R v the Commissioner HMRC* at para 20.

<sup>92</sup>*Shepherd v IRC* 2006 STC 1821

- 6.6.7 A reduced presence in the United Kingdom due to employment commitments does not necessarily mean that the individual was not a resident in the United Kingdom<sup>93</sup>;
- 6.6.8 The fact that an individual has a home elsewhere does not necessarily mean that the individual is not a resident in the United Kingdom<sup>94</sup>;
- 6.6.9 Other than for ‘an ordinarily sophisticated taxpayer’, the wording of the Revenue Guidance may be regarded as vague and may give rise to conflicts between HMRC and taxpayers, accordingly the Revenue Guidance may not be relied on in all circumstances<sup>95</sup>;
- 6.6.10 Residence has an ‘adhesive’ nature and is harder for a resident to terminate their residence than it is for someone who has not previously been a resident to prove that they have not become a resident<sup>96</sup>.

## **6.7 Comparison between principles established in the United Kingdom and South Africa**

### **6.7.1 Similarities between the judicial principles established**

- 6.7.1.1** In South Africa, a natural person is regarded as ordinarily resident where he has his usual or principal residence, i.e. what may be described as his real home<sup>97</sup>. In the United Kingdom, an individual is regarded as a resident where he has a settled or usual home<sup>98</sup>;
- 6.7.1.2** In South Africa a natural person may have more than one residence, but can only be ordinarily resident in one place at a time<sup>99 100</sup>. In the United Kingdom it has been established that whereas a person can only have one domicile at a time, he may reside in more than one country<sup>101</sup>;
- 6.7.1.3** In South Africa, temporary or occasional visits back to South Africa, of long or short duration, do not necessarily indicate that the individual is ordinarily

<sup>93</sup> *Shepherd v IRC* 2006 STC 1821

<sup>94</sup> *Shepherd v IRC* 2006 STC 1821.

<sup>95</sup> *R v The Commissioner HMRC*.

<sup>96</sup> *Grace v the Commissioners for Her Majesty's Revenue and Customs* [2011] UKFTT 36 (TC).

<sup>97</sup> *Cohen v Commissioner* 13 SATC 362 185.

<sup>98</sup> *Levene v IRC* (1928) AC 217.

<sup>99</sup> *Commissioner for Inland Revenue v Kuttel* 54 SATC 298, at 304-5.

<sup>100</sup> *Cohen v Commissioner* 13 SATC 362 at 371.

<sup>101</sup> *Levene v IRC* (1928) AC 217 at para 505.

resident in South Africa<sup>102</sup>. What is required is an analysis of each trip back to South Africa to establish if they were for purposes which would normally be associated with a return home<sup>103</sup>. In the United Kingdom it has been held that ordinarily resident in a place requires an individual to live in that place with some degree of continuity and permanence, apart from accidental or temporary absences<sup>104</sup>, ordinary residence is one of degree, to be established by an assessment of the facts<sup>105</sup> including the following facts<sup>106</sup>:

- 6.7.1.3.1 The duration of an individual's presence in the United Kingdom
- 6.7.1.3.2 The regularity and frequency of visits
- 6.7.1.3.3 The birth, family and business ties, the nature of visits and the connections with this country and
- 6.7.1.3.4 The availability of living accommodation in the United Kingdom;

## **6.7.2 Judicial principles established by the courts in the United Kingdom which have not been directly considered by the courts in South Africa**

A number of key judicial principles established by the courts in South Africa which deal with the expression 'ordinarily resident' have either been adapted from judicial decisions in the United Kingdom or are similar in nature to the judicial principles established by the courts in the United Kingdom. However, the following principles addressed by the courts in the United Kingdom have not been specifically considered by the South African courts, namely:

- 6.7.2.1 In the United Kingdom, it has been held that a natural person's ordinary residence is terminated when there is a distinct break in "the pattern of the taxpayer's life"<sup>107</sup>. but this does not require the "severance of social and family ties", but rather a "substantial *loosening* of social and family ties"<sup>108</sup>

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<sup>102</sup>*Shah v Barnet London Borough Council and Other Appeals* [1983] 1 All ER 226 (HL) at 234 b–c. 45.

<sup>103</sup>*Commissioner for Inland Revenue v Kuttel* 54 SATC 298, at 306.

<sup>104</sup>*Levene v IRC* (1928) AC 217 at para 746.

<sup>105</sup>*IRC v Lysaght* (1928) AC 234, 13 TC 511 at 249.

<sup>106</sup>*Shepherd v IRC* 2006 STC 1821.

<sup>107</sup>*Reed v Clark* [1986] Ch 1, 18.

<sup>108</sup>*R v The Commissioner HMRC* at para 20.

- 6.7.2.2** In the United Kingdom, it has been held that the fact that an individual has a home elsewhere does not necessarily mean that the individual was not a resident in the United Kingdom<sup>109</sup>;
- 6.7.2.3** In the United Kingdom, it was held that other than for ‘an ordinarily sophisticated taxpayer’ the wording of the Revenue Guidance (and in the South African context, the SARS Interpretation Note 3) may be regarded as vague and may give rise to conflicts between HMRC and taxpayers, accordingly the Revenue Guidance may not be relied on in all circumstances<sup>110</sup>;
- 6.7.2.4** In the United Kingdom it was argued that the concept of residence has an ‘adhesive’ nature and is harder for a resident to terminate their residence than it is for someone who has not previously been a resident to prove that they have not become a resident<sup>111</sup>.

### **6.7.3 Reasons why there are limited judicial decisions in South Africa dealing with the concept of ordinarily resident**

There are considerably more judicial decisions in the United Kingdom dealing with the expression ‘ordinarily resident’ than in South Africa, with the last reported case in South Africa being nearly twenty four years ago<sup>112</sup>.

The reasons for the limited number of judicial decisions may be because many South Africans are unfamiliar with the consequences of the termination of their ordinary residence and terminate their residence without due consideration of what should be reported to SARS and the compliance required.

This may be compounded possibly by ineffective policing by SARS in this specific area and unclear disclosure requirements. The termination of an individual’s place of residence is currently not addressed in an individual’s tax return, but requires reporting directly to the SARS office<sup>113</sup>. In addition to this, the psychology of

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<sup>109</sup> *Shepherd v IRC* 2006 STC 1821.

<sup>110</sup> *R v The Commissioner HMRC*.

<sup>111</sup> *Grace v The Commissioners for Her Majesty’s Revenue and Customs* [2011] UKFTT 36 (TC).

<sup>112</sup> *Commissioner for Inland Revenue v Kuttel* 54 SATC 29.

<sup>113</sup> Email from SARS 6 July 2016 stating that “Kindly be advised that due to changes in our Policies and Procedures, changes to individual profile must done at the branch office. Documents required are: 1. Certified ID/Passport copy of taxpayer 2. Proof of residence (to show TP residing overseas) 3. Valid signed Power of Attorney 4. Certified ID copy of whom the Power of Attorney is granted to 5. A SPOA (if changes are being done by a subordinate) and 6. Certified ID copy of subordinate”.

emigration may give rise to a change in attitude of taxpayers towards their tax compliance and liability to tax in South Africa as they leave South Africa for a new country.

## **6.8 The statutory residence test in the United Kingdom**

### **6.8.1 Background**

Prior to its introduction in 2013, there was no statutory definition of the expression ordinarily resident in the United Kingdom and an individual's place of residence was determined by numerous judicial decisions and guidance issued by HMRC.

The legislation dealing with an individual's place of residence was based on the needs of an Edwardian society and failed to adapt to an evolved internationally mobile society a hundred years later.

The numerous judicial decisions which developed as a result of legal uncertainty regarding the place of residence of an individual in the context of income tax legislation in the United Kingdom, compounded the uncertainty, partly due to the volume of judicial decisions and partly due to the judicial decisions not providing specific principles applicable to all taxpayers<sup>114</sup>.

The Income Tax Codification Committee<sup>115</sup> concluded in 1936, nearly eighty years prior to the introduction of the statutory residence test, that the system of interpreting a natural person's tax residence by means of judicial decisions, was 'intolerable'

"We are, however, of opinion that the present state of affairs, under which an enquirer can only be told that the question whether he is resident or not is a question of fact for the Commissioners," but that by the study of the effect of a large body of case law he may be able to make an intelligent forecast of their decision, is intolerable and should not be allowed to continue."<sup>116</sup>

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<sup>114</sup> HM Treasury *Statutory Definition of Tax Residence and Reform of Ordinary Residence: A Summary of Responses to the June 2012 Consultation* (2012), 53.

<sup>115</sup> Great Britain. Treasury Income Tax Codification Committee *Report Vol 1: Report and Appendices* (1936) available at <http://dspace.gipe.ac.in/xmlui/handle/10973/23635> accessed 6 September 2016.

<sup>116</sup> Great Britain. Treasury Income Tax Codification Committee *Report Vol 1: Report and Appendices* (1936) available at <http://dspace.gipe.ac.in/xmlui/handle/10973/23635> accessed 6 September 2016, 37, para 59.

In June 2011, Her Majesty's Treasury (Treasury) issued a consultation paper on a proposed statutory residence test which they proposed would replace the existing income tax legislation on the place of residence of an individual.

The rationale given for the proposed introduction of a statutory residence test was<sup>117</sup>:

- Tax residence is fundamentally important as it determines an individual's tax liability in the United Kingdom;
- The courts have in the past not provided clear or specific principles on an individual's tax residence which would be applicable to all taxpayers;
- The rules setting out an individual's tax residence are vague, complicated and perceived to be subjective;
- The lack of certainty regarding an individual's tax residence is unsatisfactory and undermines the objective of developing a tax system which is more certain, efficient and easy to comply with;
- It is a deterrent to individuals and businesses considering investing in the United Kingdom and undermines the Government commitment to making the tax system more supportive of growth.

In setting out their proposal, the Treasury committed to the following objectives<sup>118</sup>:

- To make the test transparent, objective and simple to use;
- To give all existing and potential taxpayers a clear view of their tax liability;
- To create a more conducive environment for investors;
- To enhance the United Kingdom's reputation as a good place to do business;
- To ensure that individuals with close connections with the United Kingdom pay their fair share of tax;
- To ensure that the new residence test does not give rise to unfair outcomes or opportunities for tax avoidance;

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<sup>117</sup> HM Treasury *Statutory Definition of Tax Residence and Reform of Ordinary Residence: A Summary of Responses to the June 2012 Consultation* (2011), 3 to 6.

<sup>118</sup> HM Treasury *Statutory Definition of Tax Residence and Reform of Ordinary Residence: A Summary of Responses to the June 2012 Consultation* (2011), 3 to 6.

The consultation paper set a clear path forward, with timelines, objectives, processes and milestones.

The detailed draft proposal from the Treasury was analysed by numerous organisations, academics and members of the public and one hundred and seventeen submissions were made by professional institutes, banks and industry, including the Association of Chartered Certified Accountants, Barclays, Deloitte, the Chartered Institute of Taxation<sup>119</sup> and similar bodies. These proposals, mainly dealing with the clarification of definitions and day counting issues, were considered when preparing the final statutory residence test set out in the Finance Act, 2013<sup>120</sup>.

## **6.8.2 Outline of the statutory residence test<sup>121</sup>**

The test sets out two initial tests which establish if an individual is a resident or not.

### **6.8.2.1 Automatic non residence test**

An individual is not regarded as a resident if:

- They stayed in the United Kingdom for fewer than sixteen days during the tax year or
- They stayed in the United Kingdom for fewer than forty six days during the tax year, provided they have not been resident for any of the previous three tax years or
- They worked full-time overseas (more than thirty five hours per week) during the tax year without any significant breaks, spending less than ninety one days during the year, and no more than thirty days can be spent working in the United Kingdom.

### **6.8.2.2 Automatic residence test**

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<sup>119</sup>HM Treasury *Statutory Definition of Tax Residence and Reform of Ordinary Residence: A Summary of Responses to the June 2012 Consultation* (2011).

<sup>120</sup> Schedule 45 to the Finance Act 2013.

<sup>121</sup> Schedule 45 to the Finance Act 2013, 512 to 579.

An individual, who does not meet the automatic non-resident tests criteria, is regarded as a resident if they:

- Stayed in the United Kingdom for one hundred and eighty three days or more during the tax year or
- stayed in the United Kingdom for more than ninety one days during the tax year, whilst owning a home in the United Kingdom and living in the home for at least thirty days during the tax year or
- worked full-time work in the United Kingdom for a period of at least three hundred and sixty five days with no significant break, straddled over two tax years.

These two tests deal with the vast majority of cases.

### **6.8.2.3 Those individuals who are not dealt with by the automatic non residence test and automatic residence test**

The exceptions to these cases, are dealt with in terms of the 'Sufficient United Kingdom Ties' test. This test provides a transparent, objective and simple test to determine this group of individual's tax residence in the United Kingdom.

The Sufficient United Kingdom Ties test has five significant ties which determine an individual's tax residence in the United Kingdom, these five ties are:

- If the individual has a resident spouse or minor children in the United Kingdom;
- If the individual has and uses accommodation in the United Kingdom (excluding a residence which is rented out or short term hotel or family accommodation) during the tax year;
- If the individual works forty or more days during the tax year;
- If the individual spends more than ninety days in the United Kingdom during either of the two previous tax years;
- If the individual spends more time in the United Kingdom during the tax year than in any other country.

The individual's residence is then determined according to the following table:

Table 2: Individual's residence: United Kingdom

Number of days spent in the United Kingdom	If the individual was previously resident in the United Kingdom	If the individual was previously not resident in the United Kingdom
Less than 16 days	Automatically not resident	Automatically not resident
16 days to 45 days	Resident if 4 UK ties (or more)	Automatically not resident
46 days to 90 days	Resident if 3 UK ties (or more)	Resident if 4 UK ties
91 days to 120 days	Resident if 2 UK ties (or more)	Resident if 3 UK ties (or more)
121 days to 182 days	Resident if 1 UK tie (or more)	Resident if 2 UK ties (or more)
183 or more days	Automatically resident	Automatically resident

The test provides a quantitative objective test which can be supported by facts in determining an individual's tax residence.

### 6.8.3 Criticism of the statutory residence test since its introduction in 2013

Viewed superficially, the statutory residence test appears objective and clear, capable of determining, with reasonable ease, an individual's tax residence in the United Kingdom based on a set of facts. However, as quickly as the test can generate a result, albeit through an analysis of the law, an app or the HMRC online tool which tests your residency online<sup>122</sup>, the accuracy of the result depends on the interpretation of the key concepts and definitions and there are a number of key concepts and definitions set out in the Act<sup>123</sup>. These include definitions of:

- Work;
- Home;
- Days spent;
- Days spent in a period;
- Location of work;
- Significant break;
- United Kingdom ties;

<sup>122</sup><http://tools.hmrc.gov.uk/rift/investigate/SRT+-+Combined/en-GB/Attribute~interview Complete~global~global/qs%24s40%40Interviews Screens xint%24global%24global?user=guest> accessed 9 September 2016.

<sup>123</sup> Schedule 45 to the Finance Act 2013, part 2, pages 519 to 527.

- Work ties;
- Family ties;
- Accommodation ties;
- Ninety day tie.

It is not a simple mathematical day counting test and it is dependent on the definitions and key concepts.

There has also been criticism of the way marriage has been dealt with by the statutory residence test as an individual's residence can be determined by marriage. For example, if the individual's new spouse spent time in the United Kingdom prior to their marriage, then a statutory residence family tie is created, potentially making the individual a tax resident in the United Kingdom simply through marriage.

From a tax perspective, this may necessitate an analysis, prior to an individual's marriage, of their future spouse's previous residential history and residence status under statutory residence test.

The legislation has also been criticized for being too strict regarding the number of days spent in the United Kingdom<sup>124</sup>.

Despite the criticism of the test, it is a highly objective test and an improvement on the former common law approach. The task of drafting an objective statutory residence test, based on the subjective concept of residence, was challenging, but despite the challenges, it has not given rise to any case law since its introduction<sup>125</sup>.

## **6.9 Overview of the statutory residence test in Australia, New Zealand and the United States**

### **6.9.1 Australia**

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<sup>124</sup>JS Schwarz & NB Booth *Residence, Domicile & UK Taxation*, 15<sup>th</sup> ed (2011) at v.

<sup>125</sup>A search on Balii.org on the 1 October 2016 revealed no cases in the United Kingdom on the on an individual's place of residence in the context of Income Tax legislation in the United Kingdom since the introduction of the statutory residence test.

In Australia there is a primary 'reside' test and three additional statutory residence tests<sup>126</sup>. If a natural person is not regarded as a resident based on the 'reside' test, then they may still be regarded as a resident based on the three additional statutory residence tests. If a natural person fails any of the four tests, they are regarded as an Australian tax resident.

The word 'reside' is not defined by the Australian Income Tax Act of 2007 and its meaning is determined using a similar case law approach<sup>127</sup> used in South African when dealing with the expression ordinarily resident.

The 'reside' test has the same weakness as the ordinarily resident test in South Africa, however, where the residency tests differs from the South African residency test, is that the Australian residency test then determines the natural person's residency with reference to three further tests based on a domicile test, a 183 day test (similar to the South African physical presence test) and a superannuation test.

The domicile test establishes that an individual domiciled in Australia is regarded as an Australian tax resident, the 183day test deems anyone physically present in Australia for 183 days or more to be an Australian tax resident and the superannuation test ensures that Australian government employees working in Australian posts overseas remain Australian tax residents.

The four tests do not provide a completely objective standard as the statutory residence test does in the United Kingdom. The Australian residency test appears to provide a stricter test than the South African test, one which, it is submitted, appears to be biased in favour of the Australian Tax Authority.

### **6.9.2 New Zealand**

In New Zealand, the definition of a tax resident involves two tax residency tests. A183day physical presence test, very similar to the Australian test noted above, and

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<sup>126</sup> Australian Income Tax Assessment Act, 1936, s 6 defines resident.

<sup>127</sup> *FCT v Applegate* (1979) 9 ATR 899 and *Re The Engineering Manager and FCT* [2014] AATA 969.

a permanent place of abode test which regards you as a New Zealand tax resident if you have a permanent place of abode' in New Zealand.

The permanent place of abode test, which looks at an individual's enduring relationship with New Zealand rather than the individual's ownership or access to a home in New Zealand, like the ordinarily resident test in South Africa and the 'reside' test in Australia, is determined using a case law approach.

For this reason, in the absence of a wholly objective statutory residence test which provides an objective standard to determine tax residency, it is submitted that the New Zealand test does not offer the same degree of legal certainty as the statutory residence test in the United Kingdom and therefore less appropriate to be introduced in South Africa.

### **6.9.3 United States**

In the United States, tax residency is dealt with on both a state and a federal level. On a federal level, the United States Internal Revenue Code (Code)<sup>128</sup> regards all residents and citizens of the United States as tax residents, residency being determined by citizenship, residence, a green card test and a substantial presence test.

The green card test determines that if an individual is, at any stage during the tax year, a lawful permanent resident of the United States under the United States Immigration law<sup>129</sup>, then the individual will be regarded as tax resident in the United States.

The substantial presence test establishes that, with certain exceptions, if an individual is physically present in the United States for at least 31 days during the current calendar year; and 183 days during the three years straddling the year in question, then the individual will be regarded as a tax resident in the United States.

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<sup>128</sup> Internal Revenue Code (IRC) (Title 26, USC).

<sup>129</sup> Immigration and Nationality Act, 1952.

Termination of a natural person's tax residence<sup>130</sup> in the United States is based on citizenship, income and procedural criteria.

The definition of a tax resident in the United States is based on an objective standard closely linked to the United States immigration laws and for this reason it may not be an ideal model to base a statutory residence test on in South Africa.

This dissertation concludes with a proposed statutory residence test for South Africa which is presented in the next chapter, Chapter seven.

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<sup>130</sup> Internal Revenue Code sections 877 and 877A.

## CHAPTER SEVEN

### CONCLUSION

It has been submitted in the dissertation that the expression ordinarily resident gives rise to sufficient legal uncertainty that it warrants amending the existing legislation to provide for an objective statutory residence test.

Drafting legislation which will provide an objective standard test dealing with a concept which is inherently subjective, may be difficult.

Due to the similarities in the case law approach (in determining if an individual is ordinarily resident) between the courts in South Africa and those in the United Kingdom; and the successful formulation and implementation of a statutory residence test in the United Kingdom, it is submitted that the statutory residence test in the United Kingdom provides a useful framework for a statutory residence test in South Africa.

Despite the similarities between the United Kingdom and South Africa, the two countries economies and societies are fundamentally different.

The economy in the United Kingdom is substantially bigger than the South Africa economy, with a gross domestic product (GDP) of GBP 2.85 trillion, compared to a GDP in South Africa of only GBP 313 billion.

Whereas the size of the population of the two countries are similar, with sixty four<sup>131</sup> million people living in the United Kingdom and fifty four million people living in South Africa, the GDP per capita in the United Kingdom is US\$ 43 734<sup>132</sup> and is only US\$ 5 691 in South Africa<sup>133</sup>.

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<sup>131</sup>CIA *World Factbook* available at <https://www.cia.gov/library/publications/the-world-factbook/geos/uk.html>, accessed 8 September 2016.

<sup>132</sup> World Bank 'GDP per capita (current US\$)' available at <http://data.worldbank.org/indicator/NY.GDP.PCAP.CD> accessed 8 September 2016.

<sup>133</sup>World Bank 'GDP per capita (current US\$)' available at <http://data.worldbank.org/indicator/NY.GDP.PCAP.CD> accessed 8 September 2016.

The World Economic Forum publishes an annual global competitive report where components of target country economies are analysed and ranked<sup>134</sup>, providing a useful comparison between South Africa and the United Kingdom.

In the most recent Global Competitiveness Report<sup>135</sup>, the United Kingdom was ranked tenth, whereas South Africa was ranked forty ninth in the world.

South Africa ranked poorly in the fields of health and primary care, being ranked one hundred and twenty sixth, compared to the United Kingdom which was ranked eighteenth; in higher education South Africa was ranked eighty third, whereas the United Kingdom was ranked eighteenth; in the area of business sophistication, innovation and infrastructure, South Africa was ranked substantially lower than the United Kingdom.

Despite the vast differences, none of these factors tend to indicate that the statutory residence test in the United Kingdom would not work in South Africa, in fact, to the contrary; the data tends to indicate that due to the low rankings and relatively poor fundamentals in South Africa's global competitiveness and economy, that there may be a greater shift of residence and movement of capital from South Africa to other countries, than there would be in the United Kingdom. This shift indicates a need for better defined income tax residence tests as a change in residence may be more prevalent in South Africa.

The statutory residence test in the United Kingdom brought about an objective quantitative approach to the determination of a natural person's place of residence, a test which has been praised by practitioners<sup>136</sup> and academics<sup>137</sup> in the United Kingdom for providing certainty on an individual's place of residence in the context of income tax legislation. The statutory residence test has reduced litigation, with no reported court cases on an individual's place of residence since the introduction of the statutory residence test in 2013.

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<sup>134</sup>Called the *Global Competitiveness Report*.

<sup>135</sup>World Economic Forum *Global Competitiveness Report 2015-2016* available at <http://reports.weforum.org/global-competitiveness-report-2015-2016/the-global-competitiveness-index-2015-2016/>, accessed 8 September 2016.

<sup>136</sup> S Phelps 'UK statutory residence test' (2012) available at <https://www.blplaw.com/expert-legal-insights/articles/uk-statutory-residence-test> accessed on 17 August 2016.

<sup>137</sup>L Crompton & C Groves 'UK residency rules close to certain under proposed statutory residence test' (2012) 3 *Irish Tax Review* 104-107.

It is submitted that through an analysis of the macro and micro-economic implications of introducing a new statutory residence test in South Africa, a consultative process and comparative research into the statutory residence test in the United Kingdom, a statutory residence test should be introduced in South Africa. This test will provide a greater degree of certainty regarding an individual's place of residence, whilst limiting income tax prejudice, promoting tax collection efficiency, simplify and compliance; and promoting investment in the South African economy.

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