SUMMARY

• Being a UK resident with non-domiciled status simply means that one does not intend to remain indefinitely. The tax system requires residents to be taxed on their foreign income. Non-doms resident in the UK elect to be taxed on either the arising basis (their worldwide income is taxed automatically) or the remittance basis (they are only taxed on worldwide income if they bring it to the UK). 2008 reforms mean that after 7 years of UK residence, non-doms who choose to be taxed in the latter way must pay a yearly fee of £30,000 (rising to £50,000 after more years of residence).

• Ed Miliband has claimed that there are 116,000 non-doms, ignoring those of the UK’s 400,000 international students and 6 million foreign-born workers who did not have to file a self-assessment form and those who did file it but did not tick the non-dom box. It is estimated that something like 1 million are not permanent residents, so are by definition non-doms.

• The rules introduced by Labour (and supported by the Tories) in 2008 ended up only hurting less wealthy non-doms and did nothing to really wealthy ones: electing to be taxed on a remittance basis benefits only those with very high foreign incomes.

• While most countries tax worldwide income of residents, a significant number including the UK have exemptions for certain people (mostly foreigners) so that they only pay taxes on local income.

• There is a substantial literature showing that tax systems are very important in deciding where top talent goes. It tells us that punitive changes to the UK tax system could discourage the most valuable potential immigrants from footballers to inventors.

• Changing how we determine someone’s domicile is likely to have unintended consequences. First, making it easier to acquire a new domicile might reduce inheritance tax receipts, as UK domiciled residents of foreign countries currently pay UK death duties on their worldwide estates. Second, changes to the concept of domicile would have repercussions in other areas of law, such as matrimonial matters and determining the validity of wills.
• The ethical justifications for Ed Miliband’s view that it is immoral that non-doms do not pay tax on their foreign income are deeply contentious. There is no principled moral case for taxing more than local income.

WHAT IS A NON-DOM?

What do an international student from Kenya, an Indian doctor working for the NHS and Roman Abramovich have in common? They are all non-doms. Being a UK resident with non-domiciled status simply means that one does not intend to remain indefinitely.

The UK Income Tax system requires all residents in this country to pay taxes not only on their UK income but also on their foreign income. However, people who are not domiciled in this country can choose to be taxed on their foreign income on either the arising basis or the remittance basis. The former means that they pay taxes on their worldwide income – their position is the same as those who are domiciled in the UK – and the latter means that they only pay taxes on their foreign income if they bring it to the UK.

This very attractive “remittance basis” was rendered far less so by a change to the law in 2008. After seven years of UK residence non-doms who wanted to choose the remittance basis had to pay an annual charge of £30,000. After a few more years of residence this now increases to £50,000, and to £90,000 after 17 years of residence.

HOW MANY NON-DOMS ARE THERE?

Ed Miliband claims there 116,000 non-doms. That’s not quite accurate.

That figure represents those who have both filed a self-assessment form and ticked the non-dom box. It leaves out those who did not have to file a self-assessment form and those who did file it but did not tick the non-dom box.

Almost all international students and all foreign workers who do not have indefinite leave to remain are non-doms. This is because they would typically intend to go back home after their studies or work (that intention partly results from the difficulty of getting visas for non-EU citizens). There are over 400,000 non-UK students and over 6 million foreign-born workers in this country. A fair proportion

1 Subject to certain minor exemptions: e.g. the first £2k of foreign unremitted income is not taxed.
4 http://www.migrationobservatory.ox.ac.uk/sites/files/migobs/Briefing%20-%20Migrants%20in%20the%20UK%20Labour%20Market_0.pdf
of them would have permanently settled in the UK but some would not. Hence, there are a substantial number of non-doms in this country—a conservative guess might be one million.

Being a non-dom in itself does not bring any tax advantage: one must elect to be taxed on the remittance basis. If one is taxed on the arising basis then one is treated in the same way as a UK domiciled person. In the year 2012-13 there were over 110,000 non-doms (who had ticked the non-dom box on their self assessment form), of those only about 46,000 elected to be taxed on the remittance basis.

**IS IT ONLY THE RICH WHO BENEFIT FROM NON-DOM STATUS?**

Quite simply, no. Among short-term residents, both rich and poor non-doms benefit from the system. Non-dom rules mean that the Indian NHS doctor who has just arrived in this country does not pay UK taxes on the interest from her Indian savings account.

However, after 7 years one needs to pay a fixed fee of £30,000 to be taxed on the remittance basis. Assuming a tax rate of 45%, this would only be worth it if one had foreign income of £66,000 or above. If our Indian NHS doctor has about £1,000 of foreign income she is better off sticking with the arising basis. Whereas it is still worth it for a wealthy Canadian hedge fund manager whose foreign investments bring in £200,000 a year.

So, paradoxically, the rules introduced by Labour (and supported by the Tories) in 2008 ended up only costing the relatively worse-off non-doms. It essentially established a form of regressive taxation for non-doms.

**IS THE UK ONE OF THE ONLY COUNTRIES THAT HAVE THE NON-DOM RULE?**

An oft-quoted claim is that the UK’s non-dom system is virtually unique in the world. This is not true. Out of 221 tax jurisdictions that have some form of personal income tax, 35 only tax local income (regardless of residence, domicile or citizenship). The rest tax the worldwide income of residents (and in the case of the US and Eritrea, of citizens who are not residents).

Ernst & Young has compiled a database of the tax systems of each country in the world. A cursory look at it will confirm that the UK position is hardly unique (although various countries do vary in the tests they use). For example, Cuba (not

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5 [http://www.ft.com/cms/s/0/648441b0-c29f-11e4-a59c-00144feab7de.html?siteedition=uk#axzz3WfLcDoIQ](http://www.ft.com/cms/s/0/648441b0-c29f-11e4-a59c-00144feab7de.html?siteedition=uk#axzz3WfLcDoIQ)


exactly a bastion of capitalism) only taxes non-citizen residents on their local income⁸.

In fact, several former British colonies have exactly the same system as the UK, for example Ireland⁹, Malta¹⁰ and Jamaica¹¹. This is not surprising since those countries inherited their laws and their tax system from Britain.

Australia does things slightly differently. All those on temporary visas are only taxed on their local income. It does not matter how long one has resided in Australia for, just that one has a temporary and not a permanent visa¹².

Similar exemptions also exist in non common law jurisdiction. For example, in Belgian certain foreign workers are treated as non-residents and so only pay taxes on their local income¹³.

Japan¹⁴ and China¹⁵ taxes those who have been resident for less than 5 years as non-permanent residents and taxes them only on their local income. In Chile, it is 3 years¹⁶.

**ED MILIBAND IS NOT PROPOSING ANYTHING NEW**

That people who are only here temporarily should not pay taxes on their worldwide income seems to be a correct principle and one that is widely accepted throughout the world. Indeed, it is one which Ed Miliband himself accepts. Changing that rule would indeed be bad for business. The prospect of having to pay tax on worldwide income if one moves to the UK could put one off from doing so.

Miliband’s complaint is that there are people who “are permanently settled here” who have non-dom status. But this is a non sequitur. If those individuals are indeed permanently settled here then they intend to remain here permanently and so are legally domiciled in this country.

It seems all the opposition leader wants to do is to tighten the eligibility requirements and not abolish the status.

It is also not clear whether the problem of long-term non-doms is due to the rules themselves or to lax enforcement. In a recent case a High Court Judge commented

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that with a few exceptions “HMRC had never won a case on domicile against a living taxpayer and that they rarely take on such cases.”

**CHANGING THE RULES COULD HAVE NEGATIVE CONSEQUENCES**

The law of domicile takes a two-step approach. Firstly it determines a person’s initial domicile (“domicile of origin”), typically by applying a somewhat arbitrary rule such as saying that a child gets the domicile of his father. Secondly, the law decides whether the domicile has changed. This requires proving on a balance of probabilities that the person intends to remain in the UK permanently (a “domicile of choice”).

The problem is that any attempt to change the second stage by lowering the threshold for acquiring a domicile of choice cuts both ways. It will mean that foreigners coming to the UK would be more likely to be found to have UK domicile. But it will also mean that it will be easier for UK domiciled individuals to lose their UK domicile. This may have a damaging effect on tax revenue, since inheritance tax depends on domicile. If one is a UK domiciled person then that person pays UK death duties on their worldwide estate, even if that person is no longer resident in the UK.

A more successful area of reform might be to change the first stage so that more people are deemed to have an initial UK domicile (if they grew up here, for instance). However, such a change is unlikely to affect the Roman Abramoviches of this world. It would only apply to UK citizens who, because their fathers lived abroad, are not UK domiciled even though they were born here and have lived all their lives here.

One suggestion of reform, which has been made by the First Report of the Private International Law Committee in 1954, was to replace the domicile of origin by a rebuttable presumption that one is domiciled in the place one currently resides. It would then be open to the person to argue that he did not intend to live indefinitely in that country. A Private Member’s Bill to implement that reform was introduced to the House of Lords in 1958 but was defeated. This reform may be worth reconsidering.

It should also be noted that the concept of domicile is used beyond tax law. It is also used to establish the jurisdiction of the courts in certain matters (particularly matrimonial matters) and to determine the validity of wills. Any change in the law of domicile will have to bear in mind the impact this will have in those areas.

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18 http://www.ft.com/cms/s/0/290d9f62-c0f3-11e4-876d-00144feab7de.html?siteedition=uk#axzz3WILcDoIQ
19 Cmd. 9068, 1954
It seems that Labour’s proposal is to have a rule similar to that of Japan whereby after a number of years residing in the UK the person is taxed on their worldwide income. The problem with that rule is that it is a crude instrument. Say the length of time is five years. This would mean that an international student who studied as an undergraduate and a postgraduate in the UK would also be caught by those rules. Such a rule would also allow UK-domiciled individuals to reduce their UK taxes by simply leaving the country. Whereas currently in order to avoid inheritance tax, they must not only leave the UK but also lose their UK domicile (which is not easy to do).

A large literature, from the 1980s see e.g. Simula & Trannoy (2009) finds that tax systems should respond to the potential mobility of top income earners. While Brits may not be indifferent between London and Paris or New York, lots of foreigners are. Kleven, Landais, Saez & Schultz (2013) found a “very large elasticity of migration” when Denmark changed tax rules on foreign high earners. These are not just oligarchs and billionaires whose money we can use but foreign-born or foreign-domiciled inventors too. Akcigit, Baslandze & Stantcheva (2015) write:

> This paper studies the effect of top tax rates on inventors’ mobility since 1977. We put special emphasis on “superstar” inventors, those with the most and most valuable patents. We use panel data on inventors from the United States and European Patent Offices to track inventors’ locations over time and combine it with international effective top tax rate data. We construct a detailed set of proxies for inventors’ counterfactual incomes in each possible destination country including, among others, measures of patent quality and technological fit with each potential destination. We find that superstar top 1% inventors are significantly affected by top tax rates when deciding where to locate.

> The elasticity of the number of domestic inventors to the net-of-tax rate is relatively small, between 0.04 and 0.06, while the elasticity of the number of foreign inventors is much larger, around 1.3. The elasticities to top net-of-tax rates decline as one moves down the quality distribution of inventors. Inventors who work in multinational companies are more likely to take advantage of tax differentials. On the other hand, if the company of an inventor has a higher share of its research activity in a given country, the inventor is less sensitive to the tax rate in that country.

Kleven, Landais & Saez (2011) found that superstar football players were also highly responsive to tax changes.

In sum there is compelling evidence to expect a migration response from a serious attempt to get hold of more non-doms’ foreign incomes.

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Ed Miliband said that it was immoral that non-doms do not pay taxes on their foreign income. He said:

“We all use the same roads. We are all protected by our police and armed forces. Even those who go private often rely on the NHS. It is what I call the common good. We use these same services therefore we all owe obligations to help fund them according to our ability to do so.”

I want to argue that there is no reason why the government should tax foreign income – even in the case of UK domiciled people.

Residence

One justification for taxing might be residence. However, residence is both under-inclusive and over-inclusive. It is under-inclusive because we (along with every country in the world) do tax non-residents on their UK income. It is over-inclusive because it would require even temporary residents to pay taxes on their worldwide income, something that even Ed Miliband recognises we should not do.

Ed Miliband suggests that temporary residents should not have to pay taxes on their foreign income “because they will be paying their taxes in their place of permanent residence.” But this is again both under-inclusive and over-inclusive. Under-inclusive, because their home jurisdiction may not be taxing that income, over-inclusive, because long-term/permanent residents in the UK will also be paying taxes in the countries where that income is generated.

In any event, saying that residence justifies taxation confuses two issues: whether it is legitimate to subject a person to taxes and what part of her assets/income can be taxed. To see the point, consider the often-made claim that residence means consent to the laws of the state. This might very well be true but it does not establish that any individual law is morally right simply by virtue of the fact that those subject to it have consented to the laws in general.

Benefits

Perhaps Ed Miliband was trying to justify taxation of foreign income based on the fact that those who are resident benefit from the infrastructure of the UK. Again, the problem is that this applies to temporary residents as well.

In any event, it seems that this sort of argument can only justify local taxation. It is thanks to the UK’s infrastructure that one can get a job here or invest in UK companies. So part of the income one makes is attributable to the infrastructure that the UK government has put in place. Hence, so the argument goes, it is legitimate for the UK government to take a proportion of it. However, this argument does

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26 Ibid.
not apply to foreign income since the opportunities to make foreign income are unrelated to UK infrastructure.

**Property as a convention**

One of the most influential defences of taxation in recent times is Liam Murphy and Thomas Nagel’s *The Myth of Ownership* (Oxford University Press: 2002). Broadly their argument is that taxes should not be seen as a prima facie taking away of someone’s private property (which taking might be justifiable). Rather the institution of private property is a creation of the State and taxes come with property as part of a package deal. So if one is taxed at 40% one should not see it as the State taking away 40% of one’s income but instead as the State giving you (indirectly) 60% of the nominal sum. Seen this way there is nothing objectionable about taxes. Their argument finds merit in the fact that property is not a natural institution but a creation of the State.

However, this argument does not seem to apply to foreign income. Going back to the Indian NHS doctor with her investments in an Indian bank account. That Indian income is not the product of the UK legal system but of the Indian legal system. So India has the right to tax it (and indeed does) but not the UK.

**Pragmatism**

In the end, there seems to be no principled moral argument for taxing foreign income. However, there is a pragmatic argument. If foreign income were not taxed then everyone with some savings would invest them abroad in low tax jurisdictions. There is likely to be less investment in the UK.

As it is there is already a solution to this problem. These are a set of anti avoidance rules called the “transfer of assets abroad rules” [28]. These are rather complex but broadly they mean that if income generated in the UK is invested abroad (and the main purpose of investing them abroad is tax mitigation) then the income they generate will be deemed to have arisen in the UK, and so is subject to UK tax.

**Conclusion**

The UK is not unique in recognising that not all residents should pay taxes on their worldwide income. The way it decides which ones should not is by using the law of domicile.

Most non-doms are not rich people but foreign workers and students. It would be wrong to tax those people on their foreign income and no one wants to do that. Furthermore, the recent reforms introducing the annual charge of £30,000 after seven years of residence in order to be taxed on the remittance basis has ended up hurting relatively less wealthy non-doms and has done very little to the very wealthy ones.

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The Coalition’s decision to increase this amount to £50,000 has made the situation even worse.

While there are legitimate concerns about the current operation of the law of domicile, the solution is to tinker with it rather than to abolish it. A potential area of reform might be to create a presumption of domicile after a few years of residence in the UK. Furthermore, abolishing it will have negative fiscal consequences in matters relating to inheritance tax and it will adversely affect other areas of the law (such as matters of succession). It might also lead to capital flight and make the UK less attractive for potential immigrants.

Ed Miliband is right to call for reforms of those rules but we must not throw the baby out with the bathwater.

In any event, there is no moral justification for taxing the foreign income of UK resident. The ideal situation would be for no foreign income to be taxed subject to the operation of the transfer of assets abroad rules.

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