THE ADVANCED DIPLOMA IN INTERNATIONAL TAXATION

December 2021

MODULE 2.09 – UNITED KINGDOM OPTION

SUGGESTED SOLUTIONS

PART A

Question 1

To: Mr Singh
From: Tax Advice LLP
Date: December 2021
Subject: Proposed acquisitions – UK CFC and Digital Services Tax implications

You recently raised certain questions with respect to the UK controlled foreign companies (CFC) implications of Panda plc's proposed acquisitions and the wider impact of the UK's Digital Services Tax (DST) should the group's projected revenues materialise. This memo sets out the tax analysis of each.

Part 1: UK CFCs

A CFC is defined in s.371AA TIOPA 2010 as a company which is not resident in the UK and which is controlled by a UK resident person or persons. "Control" can take a number of forms and we will consider these as they apply to the proposed acquisitions in question.

If a company is a CFC, there are several "gateways" which must be considered, each of which pertains to different types of profit. Any profits passing through these gateways will be apportioned to all chargeable companies, being UK companies with at least a 25% interest in the ordinary shares of the CFC. Apportioned profits will be subject to UK corporation tax in the chargeable companies accordingly. There are five statutory exemptions which may apply to a CFC and, if applicable, that CFC's profits will be exempt from apportionment under the UK CFC rules.

Polar Inc

Polar Inc is incorporated and resident in Bermuda and we understand that Panda plc will acquire 100% of its shares. Polar Inc will therefore constitute a CFC of Panda plc.

Polar Inc does not qualify for the excluded territories exemption as Bermuda is not an excluded territory; the company paid no tax in 2020 so does not qualify for the tax exemption; it has profits in excess of low profits exemption de minimis; and we do not have sufficient information to establish whether the low profit margin exemption is in point.

As such, prima facie, Polar Inc's profits must be assessed for the CFC gateways. Polar Inc does not appear to have non-trading finance profits or trading finance profits, and the captive insurance and solo consolidation gateways are not in point. The key gateway to be considered is therefore the Chapter 4 gateway, profits attributable to UK activities.

There are a number of safe harbours set out in s.371CA TIOPA 2010. If any of these are met, no profits of Polar Inc will pass through the gateway. The safe harbours include the CFC having no UK managed assets or risks, or having the capability to ensure that the business is commercially effective if that UK management were to cease. Polar Inc has no staff in Bermuda and management of the financial and commercial decisions takes place in the UK. It is fair to say that Polar Inc could not operate effectively in the absence of the UK management.

The other key safe harbour for Polar Inc is the motive test, which requires that the CFC does not hold assets or bear risks under an arrangement which has a main purpose of reducing or eliminating a UK tax liability. It is unclear whether there is a commercial motive for Polar Inc's IP holding structure, but the directors acknowledge that it is "aggressive" from a tax perspective so it is reasonable to assume that at least one of the main purposes of the structure is to reduce its UK tax liability.

The safe harbours therefore do not apply and so we must consider the extent to which Polar Inc's profits pass through the gateway. The approach is set out in s.371DB TIOPA 2010 and broadly relies upon the identification of the "significant people functions" to establish the extent to which the business of the CFC is actually carried on from the UK. The subsequent sections of the legislation set out specific exclusions for certain profits. However, for Polar Inc, it appears that all of the profits are attributable to the significant people functions of the UK-based directors. As a result, following acquisition by Panda plc, all of the £10m profits of Polar Inc will likely be subject to apportionment and taxed in the UK.

However, there may be scope to benefit from the exempt period exemption. This is set out in s371JD and is intended to provide CFCs coming under UK control with a 12-month "grace" period, within which they can reorganise their activities so that a UK CFC charge does not arise going forward. For Polar Inc, the key condition which will determine the availability of this exemption is the "subsequent period condition", which requires that there is at least one accounting period after the exempt period in question where the CFC rules apply but no CFC charge arises in respect of Polar Inc.

In effect, this requires a restructuring of Polar Inc's activities such that one of the other statutory exemptions applies or no profits pass through the CFC gateways. The directors of Polar Inc have expressed that they are willing to reorganise the business, which may involve redomiciling to an excluded territory for CFC purposes or reducing reliance on UK significant people functions, and this should be considered in order to mitigate a CFC charge in the exempt period and periods thereafter.

Sun Ltd

Sun Ltd is resident in Mauritius and we understand that Panda plc will acquire 100% of its shares. Sun Ltd will therefore be a CFC of Panda plc.

However, based on the information available, Sun Ltd may qualify for the tax exemption set out in Chapter 14 TIOPA 2010. Per s.371NB TIOPA 2010, this applies where the local (in this case, Mauritius) tax amount is at least 75% of the corresponding UK tax.

Although a direct comparison of the headline corporation tax rates of Mauritius and the UK (15% versus 19%) can be indicative, the corresponding UK tax amount must be calculated. In doing so, the tax assumptions set out in Chapter 19 TIOPA 2010 must be applied and, in particular, the UK tax amount should be reduced by any available double tax relief (excluding tax paid in the CFC's residence country). So, in Sun Ltd's case, the corresponding UK tax is calculated as follows:

	£
£1,000,000 @ 19%	190,000
Less Nigeria tax paid	(40,000)
Corresponding UK tax	150,000

The corresponding UK tax is therefore £150,000, so 75% of the corresponding UK tax is £112,500. The local tax paid by Sun Ltd in Mauritius is £120,000, which is more than 75% of the corresponding UK tax. As a result, the tax exemption applies and no CFC charge arises in respect of Sun Ltd.

Kodiak SRL

Kodiak SRL is resident in Uruguay, but will only be 49% owned by Panda plc with the remaining 51% of its ordinary shares being held in Uruguay. However, "control" for the purposes of the CFC rules, per s.371RC TIOPA 2010, exists where:

- Two persons taken together control the company (in this case, Panda plc and the current Uruguayan shareholder);

- One of those persons (in this case, Panda plc) is resident in the UK and holds at least 40% of the interests, rights and powers in relation to the CFC; and

- The other person (the current Uruguayan shareholder) is not resident in the UK and holds at least 40% but not more than 55% of the interests, rights and powers of the CFC.

As these conditions are met in relation to Kodiak SRL, the company is deemed to be controlled from the UK and is therefore a CFC, so the wider CFC rules must be considered.

Based on Kodiak SRL's profit, the low profits exemption in Chapter 12 TIOPA 2010 may apply. This exemption is effectively a de minimis and applies where the CFC's accounting or taxable profits do not exceed £50,000, which is not the case for Kodiak SRL; or where the accounting or taxable profits do not exceed £500,000, of which not more than £50,000 represents non-trading income.

Kodiak SRL has taxable profit for the year of £350,000, and this excludes interest income (which constitutes non-trading income for the CFC rules) of £40,000. In total, both the combined profit of £390,000 and the non-trading income itself fall within the respective de minimis thresholds, so the low profits exemption applies and no CFC charge arises in respect of Kodiak SRL.

<u>Ursa GmbH</u>

Ursa GmbH is resident in Switzerland, but Panda plc will only be acquiring 20% of Ursa GmbH's ordinary share capital. This does not preclude Ursa GmbH from being a CFC, because the definition of legal and economic control under s.371RB requires only that "two or more persons, taken together" either:

- Have the power to secure that the affairs of the company are conducted in accordance with their wishes; or

- Would be entitled to receive more than 50% of the company's distributed income, assets on winding up, or disposal proceeds on a sale of shares.

The rules do not require that those persons are connected, only that they are resident in the UK.

So, in Ursa GmbH's case, the combination of Panda plc's 20% acquisition and the 35% owned by the unrelated UK company mean that 55% of Ursa GmbH's share capital is owned by two persons resident in the UK, which we can assume satisfies both of the s.371RB criteria above.

As such, Ursa GmbH is indeed a CFC for the purposes of the rules. However, only UK companies owning at least 25% of the CFC's ordinary share capital are chargeable companies and subject to apportionment. So, in respect of Ursa GmbH, Panda plc will not be a chargeable company and none of Ursa GmbH's profits will be apportioned to it. The unrelated UK company owning 35% of Ursa GmbH's share capital will, however, be subject to an apportionment if any of Ursa GmbH's profits pass through one of the gateways.

<u>Part 2</u>

Digital Services Tax (DST) is a new tax introduced by Finance Act 2020 (FA 2020). In a similar sense to Diverted Profits Tax, DST operates independently of corporation tax and is charged on UK digital services revenues, rather than taxable profits, at a rate of 2%.

The tax only applies where certain conditions are met. The first is that there must be a group, defined in s.57 FA 2020 to include a parent entity and each of its subsidiaries. If there are no subsidiaries, it will be a single company group, which would be the case for Panda plc if the proposed acquisitions fall through. Note that the companies referred to do not need to be resident in the UK.

The second condition comprises the two threshold conditions, which require that the group has total digital services revenues exceeding £500m and total UK digital services revenues exceeding £25m in the accounting period. If the Panda plc group succeeds in generating revenues from its online marketplace in excess of the projected £500m, then the first element of the threshold test is met. However, it will be important to ascertain whether at least £25m of the digital services revenues are attributable to Panda plc's users in the UK.

In ascertaining Panda plc's digital services revenues, there are three categories of services in scope: social media services, internet search engines and online marketplaces. The key category for Panda plc will be its online marketplace, which broadly means a service with a main purpose of facilitating the sale or hire of goods, services or other property between users and is clearly met by Panda plc's offering, but if the Polar Inc acquisition goes ahead then Polar Inc's social media platform revenues will likely also be in scope.

The revenues attributable to Panda plc's users in the UK will be those which fall within any of the five "cases" in s.41 FA 2020. The key case for Panda plc will be case 2, being online marketplace revenues arising in connection with accommodation or land in the UK. To the extent that Panda plc generates £25m in revenues in connection with users hiring holiday accommodation in the UK (or from other cases, such as those relating to online advertising revenues, which could equally apply), the threshold condition will be met and a DST charge will likely result.

Question 2

Part 1

For trading income to be treated as relevant foreign income and hence to be eligible for the remittance basis, the trade must be carried on wholly abroad. It is generally considered that a non-domiciled person cannot avoid carrying on a trade at least in part in the UK see Ogilvie v Kitton (1908) 5 TC 338. It is argued that the person carrying on a trade directs the whole commercial adventure with the consequence that the trade is carried on where the individual is based. The result is that normally trading income of non-domiciled taxpayers cannot benefit from the remittance basis. In Ms Katz case, it is clear that she is carrying on her trade partly in the UK and therefore is not entitled to the remittance basis on her trading income. Ms Katz's trading income is liable to tax on an arising basis.

Part 2

UK resident but non-domiciled taxpayers may elect to pay tax on the remittance basis.

- The election for the remittance basis is made each year on the individual's tax return.
- Where a non-domiciled individual is taxed on the remittance basis they are assessed on their UK income and chargeable capital gains on an arising basis, however they are only taxed on their foreign income and capital gains to the extent these are remitted to the UK.
- An individual may elect for the remittance basis without charge for the first 7 years of their UK tax residency. A remittance basis charge arises if the taxpayer wishes to benefit from the remittance basis in later years.
- Where an individual elects for the remittance basis they lose their personal income and capital gains tax allowance.

Investment Portfolio

Broadly, the base cost of assets comprised in the inherited portfolio, will be uplifted to their market value at the date of Ms Katz's mother's death. The income and gains generated by Ms Katz's inherited portfolio, to the extent they relate to non-UK situs assets will only be taxed if they are remitted to the UK. It will be necessary to review the portfolio to ensure that the income and gains arising on any UK shares and securities are taxed on the arising basis. An exercise might be undertaken to rebalance the portfolio to exclude UK assets. A disposal of UK assets would not qualify for the remittance basis and so would be taxed on an arising basis. Nevertheless given the recent uplift to market value, any gains arising may be relatively modest.

Planning

Ms Katz may consider transferring her inherited investment portfolio to a non-resident offshore trust to the extent it comprises foreign assets and Italian Commercial real estate. This would constitute an excluded property trust for inheritance tax purposes.

Any income and gains arising within the trust would not be subject to UK income tax or capital gains tax to the extent it was rolled up within the trust and not brought into the UK.

It is important that directly held capital, foreign income and gains are segregated, this is to avoid the application of the mixed fund rules that apply where foreign income, gains and capital are mixed. The mixed fund rules generally operate to treat remittances to the UK from being comprised of the most unfavorable category to the extent the account contains income from that source. For example if an account contains income and capital, any remittance out of that account to the UK will be deemed to be remittances of income until all income is exhausted.

In order to segregate accounts new bank accounts should be opened for each source. In particular, Ms Katz should preserve the 2 million Euros capital held in the deposit account. She should ensure that no foreign income or gains is paid into that account. This would enable Ms Katz to bring these funds to the UK tax free as pure capital. Separate accounts should be opened for each source that would attract a different effective tax rate.

Part 3

For income tax and capital gains tax, the offshore extended time limit, applies to any assessment made for tax year 2015-16 onwards. It may also apply for the tax years 2013-14 and 2014-15 if the lost tax resulted from carelessness. The 12 year extended time limit does not apply for earlier tax years.

The 12-year time limit applies only to income tax, capital gains tax and inheritance tax involving offshore matters or offshore transfers.

HMRC's compliance manual explains: Lost income tax or capital gains tax involves an offshore matter if it is charged on or by reference to:

- Income arising from a source in a territory outside the UK. For example, the person may have an interest-bearing overseas bank account.

- Assets situated or held in a territory outside the UK. For example, the person may own or dispose of land or buildings overseas.

'Assets' takes its meaning from TCGA92/S21(1) so it covers all forms of property. It includes:

- Physical assets, such as, land and buildings

- Options, debts and incorporeal property generally, and currency. Note that for these purposes currency includes sterling.

- Income or assets received in a territory outside the UK.

- Activities carried on wholly or mainly in a territory outside the UK. For example, the person may have a trade, or a branch of a trade, overseas.

- Anything having effect as if it were income, assets or activities of a kind described above.

It is clear that both Ms Katz 'foreign' trading income and foreign dividend would be treated as falling within the scope of what constitutes an offshore matter and therefore are within the extended assessment provisions. On the basis that the errors are careless rather than deliberate HMRC may raise assessments for years commencing 2013/14.

Penalties

Requirement to Correct (RTC) and Failure to Correct (FTC) penalties.

From 1 October 2018, there are 2 main factors in applying penalties for offshore matters and offshore transfers for Income Tax or Capital Gains Tax liabilities. These are:

- Whether a taxpayer was non-compliant during the tax year 2015 / 2016 and earlier tax years;

- Whether any non-compliance was disclosed on or before 30 September 2018 under RTC legislation.

Penalties for failing to make a disclosure under the RTC regime are called FTC penalties. FTC penalties are a minimum penalty of 100% of the tax not paid in relation to any offshore non-compliance. The maximum or 'standard' penalty rate is 200% but this can be reduced by the quality of the disclosure.

As Ms Katz did not disclose her non-compliance by 1 October 2018, she will be liable to FTC penalties.

For matters arising from 6 April 2016 a new penalty regime applies. HMRC may charge a penalty of more than 100% where:

- there is an inaccuracy, failure to notify or the deliberate withholding of information;
- it involves offshore matters in certain categories of ‘territory’, or an offshore transfer;
- the tax at stake is either Income Tax or Capital Gains Tax.

As well as these higher penalties for an offshore matter or offshore transfer, HMRC may also charge:

- an offshore asset moves penalty;
- an asset-based penalty.

The rate of penalty that may apply is 100% for a category 1 country, 150% for a category 2 country and 200% for a category 3 country. The category assigned to a country reflects the degree to which HMRC may access the taxpayer’s financial information.

PART B

Question 3

Part 1

Under UK domestic law, a non-UK tax resident company will have a taxable presence in the UK if its activities in the UK give rise to a permanent establishment (PE). Under section 1141 CTA 2010, Endor BV will have a UK PE if:

- It has a fixed place of business in the UK through which Endor BV's business is wholly or partly carried on; or

- An agent acting on behalf of Endor BV has and habitually exercises authority to do business on behalf of Endor BV in the UK (a "dependent agent PE").

Endor BV's sales staff working in the UK could potentially give rise to both a fixed place of business PE and a dependent agent PE.

Fixed place of business

A fixed place of business PE specifically includes a place of management, a branch and an office. In Endor BV's case, Gondor Ltd has made its offices in the UK available to the Endor BV sales staff. This constitutes a fixed place for the purposes of the UK PE rules, notwithstanding the fact that the offices may not be the exclusive province of the Endor BV sales staff. The key is that the space is at the disposal of the staff.

A fixed place of business PE also requires that the business of the non-UK company is carried on through that place, usually through the activities of some personnel. In this case, whether the Endor BV sales staff are concluding contracts is not in point, but rather whether their activities constitute the business of Endor BV itself.

There is a key exclusion contained in section 1143 CTA 2010 where activities carried on are "preparatory", meaning in anticipation of the business, or "auxiliary", meaning in support of the business. In Endor BV's case, there is a strong chance this exclusion will apply on the basis that the market research and lead generation carried on by the sales staff are preparatory to the commencement of the hyperdrive sales business in the UK.

Note that this exclusion does not apply where the activities are part of a fragmented business operation. However, this does not appear to be the case here because there are no other activities carried on by Endor BV staff in the UK which, together, would constitute a cohesive business operation, nor does the overall sales staff activity go beyond preparatory or auxiliary.

Dependent agents and international developments

The dependent agent PE must also be considered. This type of PE requires that the Endor BV staff habitually exercise authority to do business on behalf of the company. It is clear that the staff do not have authority to sign contracts on behalf of Endor BV, but they have discretion to discuss and negotiate the terms of a potential contract with prospective customers, presumably in advance of any such contract being signed by Endor BV in the Netherlands.

This might be considered very close to the line of what constitutes a PE, and indeed is similar to the "Commissionaire" arrangements that BEPS Action 7 set out to counter, where a person habitually plays the principal role leading to the conclusion of contracts that are routinely concluded without material modification. The Multilateral Instrument ("MLI") included a provision to counter such arrangements, among other artificially avoided PEs.

Notably, however, the UK elected not to implement these new PE standards through the MLI, and equally has not incorporated them into domestic law. Even if the wider commissionaire PE were included in the UK-Netherlands tax treaty, and despite section 6 of TIOPA 2010 being clear that treaty law overrides domestic law, treaty law cannot impose a charge if one does not exist under domestic law.

Overall, the presence of the Endor BV sales staff in the UK is not sufficient to create a UK taxable presence. They are unlikely to give rise to a fixed place of business PE because their activities will likely be excluded on the basis of being preparatory or auxiliary to Endor BV's business. Although the sales staff have discretion to negotiate contracts, and while this may be enough to create a PE in other countries, the absence of authority to conclude the contracts means that they are unlikely to constitute a dependent agent PE in the UK; and their activities equally should not fall within the remit of DPT.

Part 2

For UK tax purposes, a company is resident in the UK if it is incorporated in the UK, under section 14 CTA 2009, or if it is centrally managed and controlled in the UK. Endor BV is clearly not incorporated in the UK, so the key concern is inadvertently shifting the company's central management and control ("CMC") to the UK.

The CMC test is not enshrined in statute but has instead been developed over a series of common law precedents. In particular, De Beers Consolidated Mines Ltd v Howe largely established CMC as the test for residence. CMC broadly refers to the highest level of strategic control over the company, as opposed to the place where the main operations take place, albeit in many cases these may be the same.

Establishing where this CMC, or strategic control, takes place has itself been the subject of a number of cases. The De Beers case is equally notable for establishing that where directors convene for board meetings will be a key factor in determining where CMC takes place.

In Endor BV's case, the board meetings will continue to take place in the Netherlands. So, prima facie, there may be a good case for establishing that CMC remains in the Netherlands despite half the board relocating to the UK.

However, the Endor BV directors based in the UK are given the option of dialling in to the board meetings virtually. This could mean that, although the board meeting is in theory held in the Netherlands, there may only be a minority of directors in the Netherlands at the time, and perhaps a majority dialling in from the UK.

HMRC made clear in a Statement of Practice, SP 1/90, that the location of board meetings is not necessarily conclusive, and the place of CMC is a question of fact; it may be that the directors themselves do not exercise CMC, or do not do so at the board meetings, as evidenced in the more recent case of Laerstate BV v Revenue and Customs Commissioners.

This position also follows the decision in Bullock v Unit Construction Ltd where, although the directors held board meetings overseas, the real control was being exercised in the UK. It will therefore be important, in Endor BV's case, to establish the extent to which the oversight and strategic direction provided by the directors in the UK constitutes the CMC of Endor BV itself residing in the UK.

Given that half of Endor BV's directors will be relocated to the UK to provide strategic direction, there is a risk that those remaining in the Netherlands are not suitably qualified to exercise CMC – for example if they are primarily functional (finance or legal) leaders – or that they are simply "rubber-stamping" the decisions made by those in the UK. Where this is the case, HMRC may consider Endor's place of CMC, and therefore its tax residence, to be in the UK.

Equally, based on Gondor Ltd's board developing a three-step plan for Endor BV which ultimately envisions moving Endor BV's operations to the UK, HMRC may argue that Endor BV's CMC in fact resides at the parent company level, i.e. with the Gondor Ltd board. There is precedent for this position, for instance in the abovementioned Bullock v Unit Construction Ltd, and SP 1/90 distinguishes between the usual powers of a majority shareholder (e.g. to appoint a board) versus that shareholder "usurping" the functions of the subsidiary's board.

HMRC could feasibly consider Gondor Ltd's board to be guilty of such usurping, particularly if the three-step plan comes down from the level of Gondor Ltd. However, following the decisions in the various Unigate cases, the Endor BV board doing what the Gondor Ltd board recommends is not in itself proof of CMC being at the Gondor Ltd level: provided the recommendations are meaningfully deliberated upon by the Endor BV board and discretion exercised accordingly, they will be considered to retain CMC and the burden of proof in contending otherwise will be with HMRC.

Overall, the relocation of half of Endor BV's board to the UK poses a considerable risk of inadvertently migrating the company's tax residence. However, in practice this will be a question of fact based on a range of factors, so, if managed carefully and with appropriate controls in place, the risk of migration can be mitigated. If Endor BV does migrate its residence to the UK, it will be subject to corporation tax in the UK on its worldwide profits, wherever they arise.

Part 3

If Endor BV successfully migrates its tax residence to the UK, it will be dual resident in both the UK (by virtue of central management and control) and the Netherlands. In order to benefit from the UK-Netherlands double tax treaty, Endor BV's residence will need to be established through the Mutual Agreement Procedure (MAP).

This involves the tax authorities of each country attempting to determine residence by reference to a range of factors. These will include the place of incorporation (presumably the Netherlands) and its place of effective management (POEM). The POEM is generally considered to be a lower level of management than CMC and is typically concerned with the day-to-day operational management of the business.

In Endor BV's case it would appear that, following the conclusion of Gondor Ltd's three-step plan, the POEM is likely to be the UK, particularly given the migration of the company's operations to the UK. In the absence of any additional relevant factors, the MAP is likely to award tax residence to the UK.

Question 4

Woking Ltd and Falmouth Yachting Ltd

From 6 April 2012 non-domiciled, remittance basis taxpayers who bring their foreign income or gains to the UK and invest it in an eligible trading company may claim relief from the UK tax charge that would otherwise have arisen. The investment may be made in the form of money or other property derived from foreign income and gains arising in years which a person elected to be taxed on the remittance basis. There is no requirement that the remittance basis applies in the tax year in which the investment is made to benefit from the relief. Either the individual or a relevant person can make a qualifying investment.

To qualify for relief from UK tax, the following conditions must be satisfied:

- The investment is a qualifying investment made in a eligible company, within 45 days of the foreign income and gains being brought into the UK;

- A claim must be made on the individual’s tax return.

A qualifying investment (s809VC ITA 2007) may be made by:

- Acquiring newly issued shares in; or
- Making a loan (secured or unsecured) to an eligible company

From 6th April 2017, a qualifying investment can now be made by acquiring existing shares.

To constitute a qualifying investment conditions A and B must both be satisfied.

Condition A – Eligible Trading Company (s809VD(2) ITA 2007)

An eligible trading company is a private limited company that;

- Carries on at least one commercial trade; or
- Prepares to do so within five years from the date on which the funds to be invested were transferred to the UK (this is the 5 year start-up rule);

and the conduct of a commercial trade is all or substantially all it does, or it is reasonably expected to do once trading commences.

Condition B

In addition to making an investment in an eligible company, the relief is only available if:

- No relevant person has either directly or indirectly enjoyed a benefit or become entitled to enjoy a benefit; and

- There is no expectation that such a benefit will be obtained which is related, either directly or indirectly, to the making of the investment. (s809VF ITA 2007)

Benefit for these purposes includes anything (for example money, property, capital, goods or services) that is provided to a relevant person. It includes, the provision of anything that:

- Would not be provided by the company in the ordinary course of business;
- Would be provided but only on less favorable terms; or
- Would not be available at all without the making of the investment.

Woking Ltd

The acquisition of 20% of the ordinary share capital of Woking Ltd from Ms Dean an existing shareholder potentially qualifies for BIR. It is noted that this is a logistics company which would appear to be a trading company so that Condition A would be met. Regarding Condition B, there is no suggestion that Mr Schulz would obtain benefits from the company other than in the ordinary course of it business. It should be noted that dividends would be expected to meet this criterion.

Falmouth Yachting Ltd

Subscribing for the issued share capital of Falmouth Yachting Ltd also would appear to meet Condition A, as the company appears to be a trading company. However Condition B would not be met, as a key attraction of making this investment is that this investment would entitle Mr Schulz, an experienced sailor, to one week's yacht charter in the Mediterranean each year, at a greatly discounted rate. While the charter may be provided by the company to Mr Schulz in the ordinary course of business it would otherwise be provided at an arm's length rate, i.e. on less favorable terms.

UK Residential Property

BIR

The general conditions are as set out in answering the first part of this question.

To fund the investment into UK residential Property, Mr Schulz could incorporate a UK company, funded, by way of either subscription for shares or shareholder loan to acquire the properties and carry on a commercial property rental business.

It is specifically provided a commercial property rental business is a qualifying trade for the purposes of BIR. It is noted that the properties are to be renovated, however provided the renovations are completed within 12 months this would be well within the requirement to commence trading within 5 years.

ATED

An annual charge applies to UK residential Property purchased through companies. The charge depends on the market value of the property.

Chargeable amounts for 1 April 2020 to 31 March 2021

Property value	Annual charge
More than £500,000 up to £1 million	£3,700
More than £1 million up to £2 million	£7,500
More than £2 million up to £5 million	£25,200

Certain reliefs apply to ATED; these include Property Rental Businesses FA13/S133.

Relief from ATED is available where a residential property is exploited as a source of rents or other receipts in the course of a qualifying property rental business. s133(1)(a).

Where the single-dwelling interest is not currently generating receipts from the business relief will be available where steps are being taken to rent the property without delay. This may apply where a taxpayer first purchases a property but requires time to find a tenant or if there is a period of non-occupation between lettings. It might also apply if renovation work was required before letting s133(1)(b).

Qualifying property rental business

To qualify for relief the person must be carrying on a qualifying property rental business:

- The business must meet the criteria of a property rental business as defined in Chapter 2 of Part 4, CTA 2009; and

- It must be conducted on a commercial basis and with a view to a profit.

Mr Schulz's investment may therefore be structured in a way that qualifies both for BIR and ATED.

SDLT

If UK residential property is acquired through a company a higher 15% rate of SDLT applies. However a similar relief to that applying to ATED applies if the company carries on a property rental business.

FA03 s55 & Sch 4A: property rental businesses FA03 Sch 4A para 5

Where the acquisition of an interest in UK residential property is exclusively made for the purpose of exploitation as a source of rents etc in the course of a qualifying property rental business, the 15 per cent higher rate charge does not apply. Instead, SDLT will be charged at normal higher rates.

A qualifying property rental business:

- Must fall within the definition of property rental business in Chapter 2 of Part 4, CTA 2009; and

- Must be carried on, on a commercial basis and with a view to a profit.

IHT

On the assumption that a UK company is used, the inheritance tax provisions dealing with the offshore ownership of UK residential property would not apply. The investment either through subscription for shares or shareholder loan would be subject to UK inheritance tax, since these constitute UK situs assets. It is unlikely that investment in UK residential property would qualify for relief under the business property relief provisions which require there to be a trade, so therefore the investment is likely to fall within Mr Schulz's estate in the event of his death.

PART C

Question 5

The UK has long been a leading choice of holding jurisdiction for a multinational group. There are a number of elements of the UK tax regime which are attractive for multinationals, particularly when considered in a cross-border context, although there are a number of key limitations which investors should be aware of. This answer sets out the extent to which the UK is a leading holding company jurisdiction as suggested.

The domestic corporation tax rate in the UK is 19%, which is one of the lowest in the G20 with only Singapore and Switzerland having lower headline corporate tax rates. This provides an attractive initial incentive for groups looking for a holding company jurisdiction.

However, for a holding company in particular, this is further supplemented by the absence of a dividend withholding tax on distributions paid from a UK holding company to an overseas parent. This allows the tax-efficient repatriation of profit from an intermediate UK holding company.

The UK also provides for a number of dividend exemptions, including for controlled companies and distributions in respect of ordinary shares (see s.931D CTA 2009 et seq). This means that the receipt of dividends by the UK holding company itself will, in the vast majority of cases, not be subject to corporation tax in the UK.

This benefit is further compounded by the UK having the largest tax treaty network in the world. Many of these treaties provide for the reduction of any local dividend withholding tax to 5% where the UK parent holds at least 10% of the subsidiary's share capital, so profits from overseas operations can be distributed to the UK holding company with minimal tax leakage.

The advantages of the UK's strong treaty network are particularly important in light of BEPS Action Six on the Prevention of Treaty Abuse, and the introduction of the principal purpose test into the Multilateral Instrument, because it is now more important for a multinational to have substance in the relevant contracting states in order to avail of treaty benefits. Therefore, utilising the UK as a holding jurisdiction for substantive business activity provides a strong degree of comfort that the applicable treaty benefits will be available and that the group is not "treaty shopping".

The UK as a holding jurisdiction also provides considerable flexibility in how to structure overseas activities. Overseas permanent establishments of a UK company may be an attractive means of expanding into new territories, particularly when those businesses are expected to be initially loss-making, as the losses will be automatically offset against the UK company's profits and any excess can be surrendered within the wider UK group by way of group relief or carried forward to future periods.

Conversely, the branch exemption election (s.18A CTA 2009) means that a UK company can opt to exempt all of its overseas permanent establishments from the scope of UK corporation tax, thereby providing certainty as to the UK tax position in respect of overseas operations. Equally, once overseas operations are profitable, the group may wish to incorporate a permanent establishment into a subsidiary. This typically gives rise to a chargeable disposal in the UK, but the UK provides for the deferral of the gain through s.140 TCGA 1992 (or s.140C TCGA 1992, which operates slightly differently, if the permanent establishment is in the EU) provided certain conditions with respect to genuine commercial purpose are met.

Other restructuring reliefs are widely available, most notably the UK's participation exemption, known as the Substantial Shareholding Exemption (SSE). The SSE enables the UK holding company to dispose of a subsidiary (whether or not UK resident) and exempt any resulting chargeable gain from UK corporation tax provided certain conditions, including a trading condition for the subsidiary and a 10% shareholding requirement, are satisfied.

The SSE is particularly valuable for exit planning, and so too is the absence of a UK non-resident capital gains tax. This means a multinational headquartered outside of the UK can dispose of an intermediate UK holding company without incurring a UK corporation tax charge. There is an exception for property investment companies, for which the UK does apply a non-resident capital gains tax.

More generally, the UK has had a historically stable tax regime and political climate, and HMRC themselves are considered a sophisticated and collaborative tax authority. This is seen through the availability of non-statutory clearances, Advance Thin Capitalisation Agreements (ATCAs) and Advance Pricing Agreements (APAs), all of which help provide certainty for the taxpayer on the application of the UK tax rules and HMRC's acceptance of transfer pricing positions.

From a personal perspective, the UK is also attractive for non-UK domiciled directors or employees of a holding company, as they will be able to use the remittance basis of personal taxation such that they are only liable to UK tax on foreign income or gains that they remit to the UK.

The benefits of the UK as a holding company jurisdiction are well-established, but there are some notable drawbacks. Perhaps the most widely acknowledged is the impact of Brexit, which means the UK is no longer part of the single customs union so there are numerous indirect tax complexities. Many of these are administrative like the need to submit import and export declarations for customs and the increased VAT registrations that will be needed UK exporters. The direct tax consequences are more limited, and it may be the case that pure holding companies in the UK are only minimally impacted by the indirect tax changes.

In the 2021 Budget, the UK government announced that the UK tax rate would increase to 25% from 1 April 2023. This may make the UK less competitive; however, the same Budget also introduced certain incentives like the "super-deduction", albeit these may have little impact for a pure holding company in the UK.

Despite the various restructuring reliefs that are available in the UK, a company leaving the UK (for example, through migrating its residence overseas) will usually incur an exit charge. This will include the payment of outstanding tax as well as being deemed to dispose of and reacquire its chargeable assets at market value. As such, a decision to use the UK as a holding jurisdiction should not be made lightly, as the subsequent migration of that company to an alternative jurisdiction can result in considerable tax leakage.

Financing of the group will also be a key consideration for a holding company, and it might be argued that the UK has a restrictive regime in this respect. Not only will interest deductions in the UK be subject to the corporate interest restriction, but groups will also need to consider the UK anti-hybrids legislation and thin capitalisation rules.

This is indicative of the UK's wider tax regime. Although stable, it is very complex and there are a number of anti-avoidance measures in place. These include Diverted Profits Tax, the General Anti-Abuse Rule (GAAR) and the Controlled Foreign Company (CFC) rules, albeit the latter are arguably more generous than other similar provisions in many European countries.

Ultimately, however, the OECD's BEPS project and the EU's Anti-Tax Avoidance Directives (ATAD I and II) have seen many favorable holding jurisdictions bring their domestic tax systems more in line with the UK. In this respect, the UK being at the forefront of anti-avoidance developments can be seen as a positive, as there is less risk of forced reactive overhauls of the tax system and holding companies can be more comfortable that their operations will not need to be restructured in response.

Overall, the UK can be considered a leading choice of holding company jurisdiction for a multinational group. It provides both flexibility and certainty as part of a competitive wider tax regime. Although the rules are complex, made more so by Brexit, and punitive to aggressive tax arrangements, they reflect both best practice and the direction of travel for many other countries in response to BEPS.

Question 6

Part 1

The UK's anti-hybrid rules are specific anti-avoidance measures designed to prevent multinational enterprises from creating tax benefits by taking advantage of "mismatches" in the tax treatment of different entities or arrangements. The provisions detail a number of different hybrid mismatches and the conditions to trigger a counteraction differ for each. The rules do not require a tax avoidance motive in order to apply, so in Priscus Inc's case the extent to which the proposals are designed to secure a tax advantage will not affect the application of the rules.

The hybrid mismatch rules apply where the parties to the arrangement are in the same control group, defined in s.259NB TIOPA 2010. Broadly, companies are in the same control group where they are required to produce consolidated accounts; where one has at least a 50% investment in the other or a third person has a 50% investment in each of them; or where there is common participation, directly or indirectly, in the management, control or capital of the parties within a six-month period.

Both Vitro Ltd and Vitae Ltd are 100% subsidiaries of Priscus Inc, so the companies are in the same control group by (at least) the 50% investment condition, so the UK anti-hybrid rules must be considered.

Vitro Ltd

Naomi's proposal appears to fall within Chapter 6 of Part 6A TIOPA 2010, being a transfer by a UK PE of a multinational company. The relevant conditions are set out in s.259FA TIOPA 2010.

Condition A is that there is a multinational company. Priscus Inc satisfies this condition as it is resident outside the UK but is within the charge to UK corporation tax through its UK PE.

Condition B is that there is a PE deduction. This is satisfied as Priscus Inc's UK PE makes a "transfer of money or money's worth", being the £500,000 IP fees, back to head office in Rodinia and recognises a deduction for that amount when calculating the taxable profits of the PE.

Condition C is that it is "reasonable to suppose" that the circumstances giving rise to the PE deduction will not result in an increase in the taxable profits of the company (or a reduction in that company's loss). "Reasonable to suppose" is not defined in the legislation, but HMRC's guidance suggests that this is a test of what is a "rational, justifiable and credible view". This condition is satisfied as Priscus Inc has made an election to exempt income from its UK PE from tax in Rodinia, so there is no equivalent increase in Priscus Inc's taxable profits.

As all conditions are met, the PE deduction will be subject to a counteraction. Since all of the UK PE income is exempt for Priscus Inc in Rodinia, the extent of the mismatch is the full PE deduction of £500,000. Under s.259FB, the counteraction will be to deny the full £500,000 deduction in the UK PE for UK corporation tax purposes.

Note that s.259FB(2) provides for the carrying forward of the denied deduction, which may be deducted from Priscus Inc's dual inclusion income of future periods. Dual inclusion income is any income of Priscus Inc which is chargeable to both UK corporation tax and local Rodinia tax. Given the exemption for Priscus Inc's UK PE, it is unlikely that Priscus Inc will generate dual inclusion income so, in effect, the PE deduction will be lost.

Vitae Ltd

This proposal appears to fall within Chapter 3 of Part 6A TIOPA 2010, relating to hybrid financial instruments which are taxable as debt in one jurisdiction but equity in another. The relevant conditions are set out in s.259CA TIOPA 2010.

Condition A is that a payment (or quasi-payment) is made in connection with a financial instrument. A "payment" is defined in s.259BB TIOPA 2010 and is effectively a transfer of money or money's worth which is deductible in calculating the payer's taxable profits. In Vitae Ltd's case, the £4m of interest (£50m x 8%) is made in connection with the debt instrument and is presumably deductible for UK tax purposes in Vitae Ltd. It would therefore constitute a payment under the legislation, so this condition is met.

Condition B is that the payer (or the payee) is within the charge to UK corporation tax for the payment period, which is met by virtue of Vitae Ltd's UK tax residence.

Condition C is that, in the absence of the hybrid rules, it is "reasonable to suppose" that there would be a deduction/non-inclusion mismatch in respect of the payment. This condition is met on the basis that the interest payment gives rise to a deduction for UK corporation tax in Vitae Ltd, but the receipt by Priscus Inc is not taxable as the debt instrument is treated as equity in Rodinia, so the income is treated as a dividend by Priscus Inc and qualifies for the Rodinia participation exemption.

Condition D is that both payer and payee are related or the arrangement is a "structured arrangement", meaning it is designed to secure the mismatch. Only one of these needs to be met, but in Vitae Ltd's case both would apply as Vitae Ltd (as payer) and Priscus Inc (as payee) are related, and it is clear Naomi's suggestion is designed to secure the £4m annual interest deduction.

As all conditions are met, the mismatch will be subject to a counteraction. In this case it is the payer which is within the charge to corporation tax, so s.259CD applies to reduce the deduction in Vitae Ltd by the amount of the mismatch. Assuming the Rodinia participation exemption applies to exempt the full amount of the receipt in Priscus Inc, the mismatch will be the full £4m so the deduction in Vitae Ltd will be reduced to nil.

Part 2

The Rodinian Partnership (RP) has features typical of both transparent and opaque entities. The fact that it is considered transparent in Rodinia carries some weight, but the fact that it is considered opaque in Ambrosia will have no bearing for UK tax purposes. HMRC guidance makes reference to a range of factors to determine entity classification, and these must be considered on balance.

Share capital, or something serving the same function, is an indicator of opaqueness, which the RP does not have. Equally, assets used in the trade of the RP are legally owned by the members and therefore are not beneficially owned by the RP itself. This again suggests that the RP is transparent.

However, the RP is able to carry on business in its own right, rather than "jointly" by the members. The RP is also able to declare dividends, so the entitlement of members to the RP's profits is dependent on a decision to distribute those profits after they have arisen, rather than the members being entitled to share in the profits as they arise. Both of these factors suggest that the RP is opaque.

Although some factors suggest the RP is transparent and others suggest it is opaque, HMRC note that particular attention should be paid to the entity's ability to carry on business itself and the ability to distribute profits. The latter of these was the key element of the Memec decision.

In light of this, despite the RP having both opaque and transparent traits, it is likely that HMRC would consider the entity to be opaque. This is on the basis that the factors given most weight by HMRC both point to opaqueness in the RP's case.

Question 7

Magnolia Ltd's profitable PE will be subject to tax in the UK, as UK tax resident companies are subject to UK corporation tax on their worldwide income, and also in France based on the source principle. There is a risk that the PE's profits are therefore subject to double taxation, and each of the three proposed options is a means of protecting against this.

Branch Exemption Election

The Branch Exemption Election ("the election") under s.18A CTA 2009 protects against double taxation by exempting the entire PE, whether profitable or loss-making, from the scope of UK corporation tax.

There is no defined format for making the election, but it should be signed by a responsible officer of the company (so, in Magnolia Ltd's case, presumably one of the directors) and it should specify the accounting periods to which it will apply. The election must be made prior to the commencement of the accounting period to which it relates, so, if it is sent to HMRC in 2020, it will take effect from the start of the 2021 accounting period.

The caveat to this is where a PE is in a net loss position, as is the case for (at least) the French PE. Where a PE has historically made losses (which, by virtue of the wider UK tax system, Magnolia Ltd itself would have been able to benefit from) the transitional rules will apply to defer the exemption until those historical losses have been offset by subsequent profits. Although the French PE has been loss-making for eight years, only the losses of the last six years are within scope of the transitional rules. So, even if the exemption is made immediately, it may not take effect for some time.

Once made, the election is irrevocable. The election also applies to all of the company's PEs. This means Magnolia Ltd will need to consider not only the long-term projected profitability of the French PE, but also that of its German PE. If the German PE is expected to continue to be loss-making, the ability to utilise those losses in the UK may be worth more than the value of exempting the French profits.

The election is most attractive where the PE jurisdiction has a lower corporate tax rate than that of the UK. This is because, assuming a double tax credit will be available for the overseas tax suffered (see below), the double tax credit will usually not be sufficient to fully offset the UK tax on those same PE profits, so it is more efficient to exempt those profits from the scope of UK tax entirely. However, the applicable tax rate in France is 28%, so it is likely that any credit for tax suffered by the PE will be sufficient to offset all of the equivalent UK tax.

Incorporate the French branch into a subsidiary

The historical losses generated by the French PE will typically be carried forward in the branch, notwithstanding the earlier use of these losses in the UK by Magnolia Ltd. This means the French tax liability is minimised by the carried forward losses, thereby giving rise to a smaller double tax credit with which to offset the UK tax on the French profit. In this way, HMRC "recapture" the UK tax that was deferred by the earlier use of the PE losses.

Incorporating the French PE into a French subsidiary effectively negates this recapture, as the French subsidiary will be outside the scope of UK corporation tax. It can also repatriate profit through dividends which, in most cases will be exempt on receipt in Magnolia Ltd under one of the UK dividend exemptions, such as the exemption for distributions from controlled companies in s.931E CTA 2009. However, its ability to surrender losses to Magnolia Ltd would be considerably more restricted, if not precluded entirely.

In practice, incorporation of the PE involves transferring the trade and assets of the branch to a French company owned by Magnolia Ltd. This transfer to a foreign company would give rise to a market value disposal of the plant and machinery used in the French PE together with its stock. Capital and intangible fixed assets are also treated as disposed of and reacquired at market value.

However, a claim can be made to postpone the chargeable gains under s.140 TCGA 1992 (and similar provisions apply to postpone a gain on intangibles, if applicable for Magnolia Ltd, with the added condition that the transfer is effected for genuine commercial reasons). This requires the following conditions to be met:

- Magnolia Ltd must be carrying on a trade outside the UK, which is satisfied through the French PE;

- The trade and assets used in that trade are transferred to a non-UK resident company, which would be satisfied by the transfer to the French subsidiary;

- The transfer is wholly or partly in exchange for securities issued by the transferor, which would be met by the French subsidiary issuing shares in exchange for the transfer of the trade and assets;

- Following the issue of those shares, Magnolia Ltd holds at least 25% of the French company's ordinary share capital, which would presumably be met; and

- There is a net chargeable gain arising on the assets transferred.

As these conditions should all be met, Magnolia Ltd can claim for the net gain to be postponed. Note that, where only part of the consideration for the transfer is shares, only that proportion of the gain is postponed.

The postponed gain (or the appropriate proportion of it) will be chargeable to UK corporation tax in Magnolia Ltd when Magnolia Ltd disposes of some or all of the French subsidiary's shares or where, within six years of the transfer, the French subsidiary disposes of the transferred assets.

An alternative is available under s.140C TCGA 1992 where the branch (and therefore the new subsidiary) are in the EU, as would be the case for the French business. This operates (and continues to operate post-Brexit) in much the same way as described above and with similar conditions (together with a motive test), except the gain is immediately taxable. However, Magnolia Ltd is entitled to a "notional tax credit" for the hypothetical foreign tax that would have been suffered by the branch on the transfer of the assets to the company.

This is perhaps less favorable than the regular application of s.140 TCGA 1992 itself, but may be beneficial if there is a near-term expectation that the newly-incorporated French subsidiary's shares will be sold. Note that HMRC clearance is required for section 140C.

Continue to operate through the non-exempt PE

Continuing to operate through the French PE, without the Branch Exemption Election, means the profits of the PE will be subject to tax in both the UK and France. However, a double tax credit will be available under s.18 TIOPA 2010 in respect of the tax suffered in France, in order to remedy the double taxation of the same income. This credit will be limited to the lower of the French tax suffered or the equivalent UK tax on the same income.

As discussed above, the 28% corporation tax rate in France versus the 19% UK rate likely means that any such credit will be sufficient to offset fully the UK corporation tax that would be payable on the income. The caveat to this is the fact that the French PE will have eight years of carried forward losses which will minimise that French tax liability, and therefore the double tax credit, in the initial years of profitability.

However, the option to continue using the PE in its current form should not be dismissed simply in light of its profitability. Using a PE provides flexibility, as either of the above options can be entered into in the future. A PE also provides the key benefit of allowing the PE losses to be used by Magnolia Ltd itself. This is particularly notable for Magnolia Ltd because the German PE has flipped from being profitable to now being largely loss-making, so there is a longer-term possibility that the French PE may do the same.

With the above in mind, it is likely best to continue operating through a non-exempt PE for now. Incorporating the business into a French company may be an effective option, but will likely lead to trapped losses if the company does not maintain its profitability. Equally, the benefits of the Branch Exemption Election and the application of the transitional rules do not justify the exempting of the German PE's losses, and the French PE itself has only recently become profitable with little known about its longer-term forecasts. However, with UK tax rate increases being the direction of travel, the election may become more attractive in future, and the PE can elect into it at that time if so.

Question 8

Formerly domiciled resident

From 6 April 2017 a new category of deemed domicile, Formerly Domiciled Resident (FDR) was introduced which applied only to those born in the UK.

FDR status applies for inheritance tax if you:

- Are born in the UK with a UK domicile of origin;
- Have acquired another non-UK domicile of choice;
- Are resident in the UK and were resident in the UK in at least 1 of the 2 previous tax years.

Where a FDR, settled property on trust when they were not domiciled in the UK this is no longer excluded property for the purposes of Inheritance Tax.

The FDR category applies to individuals born in the UK with a UK domicile of origin, who have acquired another domicile and then become resident in the UK. A FDR's foreign property and the property that they settled when they were non-UK domiciled will fall within the scope of IHT while the individual is UK resident, as long as they were UK resident in at least 1 of the 2 years prior to the year in which any IHT charge arises.

If an FDR leaves the UK and becomes non-resident these rules do not apply.

As Mr Blevins is an FDR, assets held in the Blevins trust are no longer excluded property. In particular he is UK resident in 17/18, 18/19. A ten year anniversary charge arises on 1 January 2020. The charge is restricted to effectively apply for the period 1st August 2017 to 1 January 2020. (10/40) This restriction reflects the fact that prior to 1st August 2017 the property was excluded property.

In addition to the 10-year anniversary charge, the trust property will form part of Mr Blevins estate on his death as he has retained an interest in the trust and the Gift With Reservation of Benefit Rules will apply.

Taxation of Income and Gains

FDR status applies for income tax and capital gains tax if a taxpayer is:

- Born in the UK with a UK domicile of origin; and
- Has acquired another non-UK domicile of choice

As Mr Blevins is treated to be a FDR and hence deemed domiciled for income tax and capital gains tax purposes, the settlor interested provisions will apply. This means that for income tax purposes, he will be assessed on the trust's income.

In addition, to the settlor interested trust provisions, it is possible that the Transfer of Assets Abroad income tax anti-avoidance provisions (s721 ITA 2007) would apply so that income arising in Yorkstone Ltd would be assessed on Mr Blevins on an arising basis since he became UK resident. While Mr Blevins was not UK resident or domiciled at the date of creation of the trust, it is still possible that avoiding UK taxation was a purpose for transferring assets into the trust.

These provisions would not apply if the motive defence were satisfied s736 - 742 ITA 2007. For transactions effected after 4 December 2005 in order to be exempt, the individual must satisfy HMRC that, in relation to each transfer and associated operation:

> *"A – it would not be reasonable to draw the conclusion from all the circumstances of the case, that the purpose of avoiding liability to taxation was the purpose or one of the purposes, for which the relevant transactions were effected;*
>
> *or, that*
>
> *B – the transfer and each of any associated operations were genuine commercial transactions and it would not be reasonable to draw the conclusion, from all the circumstances of the case, that any one or more of those transactions was more than incidentally designed for the purpose of avoiding liability to taxation.*

In the context of this test, 'taxation' includes any UK tax liability, for example, Inheritance Tax, Capital Gains Tax, Corporation Tax as well as Income Tax" (INTM600040).

It should be noted that if income is assessable under both the transfer of assets and settlement provisions it will not be assessed twice.

Turning to Capital Gains Tax, s86 TCGA 1992 will apply in respect of capital gains arising in the trust, so that they would be assessed on Mr Blevins on an arising basis. Gains arising in Yorkstone Ltd, may be attributed to Mr Blevins but in this case a defence exists provided the structure was not set up to avoid capital gains tax or corporation tax. s3 TCGA 1992. It should be noted that gains may not be attributed under s86 in the year of death of the settlor.

Question 9

Tax Residence of Trust

From 6 April 2006 the trustees of a settlement are treated as a single person for both Income Tax and Capital Gains Tax purposes and this deemed person (‘the trust’) is distinct from the actual persons who are its trustees (ITA s474 and TCGA 92 s69(2)).

From 6 April 2007 a common residence test applies for Income Tax and Capital Gains Tax purposes.

All trustees are UK resident

The trust is UK resident for Income Tax and Capital Gains Tax purposes.

All trustees are resident outside the UK

The trust is not UK resident for either Income Tax or Capital Gains Tax purposes.

There is a mixture of resident and non-resident trustees acting at the same time

The trust is UK resident unless the settlor was:

- not resident in the UK;
- not ordinarily resident in the UK; and
- not domiciled in the UK;

at the time the settlor made the settlement or added property to the settlement (ITA s475(5) and ITA s476, TCGA 1992 s69(2B) and (2C).

The Harmen trust was settled by Ms Strigil, a non-domiciled individual, at a time she was non-resident. At present the Harmen trust is non-resident as all the trustees are non-resident. It is proposed that:

- Martha, a Canadian resident, is appointed a trustee;
- Guernsey trustees resign; and
- UK trustees are appointed.

Under Ms Strigil’s proposals there will therefore be a mix of UK resident and offshore trustees. As Ms Strigil was non-resident and non-domiciled at 6th January 2015, i.e. the date of creation of the settlement, when Ms Strigil settled 5 million euros, the trust will remain non-resident.

In order to on-shore the trust, Martha should not be appointed as trustee. The trust would then be UK resident, since as soon as the UK resident trustees are appointed and the Guernsey trustees resign, the trustees would be exclusively UK resident.

Stix Ltd is a BVI incorporated company. Under the case law test of central management and control if key strategic decisions such as financing, dividends, acquisition and disposals, are taken in the UK the company will become UK resident. Thus if the current board resigns and UK directors are appointed the company will prima facie become UK resident and be subject to corporation tax.

Consequence of becoming UK resident

The trust will become fully liable to UK income tax and capital gains tax on its worldwide income and gains. While Ms Strigil is not excluded from benefiting from the trust, the settlor interested rules will apply to assess all income on the settlor. The trustees will however be under an obligation to report the trust's income on its annual tax return and pay the tax to HMRC. For a UK resident settlement that is settlor interested any Capital Gains Tax is charged on the trustees.

The Harmen Trust will receive a UK dividend from Stix Ltd, this dividend income will be subject to income tax on Ms Strigil.

Stix Ltd will be fully subject to corporation tax. As UK companies are generally not subject to corporation tax on foreign dividends, it is likely that its liability will be restricted to interest income, and tax on gains arising on disposal of assets comprised in the portfolio. Stix Ltd should obtain a tax credit for foreign taxes deducted from the interest income, limited to the maximum of the UK tax charged on that income.