THE ADVANCED DIPLOMA IN INTERNATIONAL TAXATION

December 2020

MODULE 2.09 – UNITED KINGDOM OPTION

SUGGESTED SOLUTIONS

PART A

Question 1

Dear Danielle

Many thanks for your email regarding the proposed addition of John Smith to your board of directors. As requested, I have set out below some further details regarding how this might affect the tax residence of Annabelle SL, as well as what the corporation tax consequences would be if Annabelle SL became UK tax resident.

Tax residence of Annabelle SL

Under UK law a company is UK resident if it is either:

- Incorporated in the UK; or
- Centrally managed and controlled in the UK.

As Annabelle SL was incorporated in Spain, it is the second of these tests which we will need to consider.

The test as to whether a company is centrally managed and controlled in the UK has developed through case law, starting with the case of De Beers Consolidated Mines. This case established that a company is resident where its real business is carried on and where the central management and control actually abides.

De Beers Consolidated Mines and later cases such as Bullock v Unit Construction established that the place of central management and control of a company is primarily a question of fact. You therefore have to look carefully at all the facts and circumstances surrounding the company.

Central management and control concerns the highest level of control of the business, which may not be the same place as where the main operations of the company are located.

Central management and control will often be exercised by the Board of Directors, and therefore the location of Board meetings is often key. However, this will only be the case if the Board are actually exercising central management and control at those meetings. This may not be the case if, for example, decisions are taken outside those meetings and merely ‘rubber stamped’ by the Board when they meet.

The proposed addition of John Smith, who is a UK resident, to the board of Annabelle SL may increase the risk of the company being deemed to be UK resident. However, in your email you indicate that the other board members live in Spain, so his appointment on its own should not cause problems (though if the board was to have a majority of UK resident directors this could be an issue).

You mention in your email that John will continue to live in the UK, and may dial in to board meetings from the UK. If this happens regularly it could increase the risk of HMRC arguing that the company is UK resident. Similarly, if the board were to meet in the UK this could increase the risk of the company becoming UK resident.

In your email you also refer to the possibility of John making decisions outside of board meetings. Although you understandably want to make the most of John’s expertise, you need to be careful that this does not result in him exercising central management and control outside of board meetings, especially if he is making those decisions in the UK. You should ensure that all key decisions are taken at board meetings, and that there is no element of rubber stamping decisions previously made by John in the UK.

Here are some practical steps which may reduce the risk of Annabelle SA being deemed to be UK resident:

- Try to ensure more non-UK resident directors than UK resident directors are on the board.
- At any one meeting, try to ensure that a majority of the directors are resident outside the UK.
- Have board meetings outside the UK as much as possible,
- Avoid John dialling into board meetings from the UK wherever possible.
- If John does dial into board meetings from the UK, ensure the chair of the meeting and as many directors as possible are outside the UK.
- Be careful of decisions taken outside meetings – document meetings carefully, including minutes to show key decisions are actually being taken there.
- In particular, ensure all significant decisions (such as approving major new projects or changes in the business) are taken by the board together, ideally outside the UK, and that this is properly evidenced.
- Avoid giving John a casting vote, or more power than other directors
- Put guidelines in place setting out the above and covering exactly what power John has to make decisions regarding the business.

If HMRC do argue that Annabelle SL is tax resident in the UK, then the company could be deemed to be 'dual resident', and the double tax treaty between the UK and Spain will be relevant in deciding which of the two countries the company is resident in. This treaty includes a 'tie-breaker' article, which states that, if a company is resident in both the UK and Spain under their domestic law, it will be resident only in the country where its place of effective management is located.

Effective management is similar to, but not the same as central management and control. As a result, the place of effective management is not always the same place as that where central management and control are located. It will generally be where the day to day activities of the head office are located, and is less likely to be affected by who sits on the board, where they met etc. Depending on the exact arrangements it may be that, under this tie breaker test, the place of effective management would remain in Spain, though this would need to be confirmed, especially if John starts to take more of a role in the management of the business.

<u>Consequences of becoming UK resident</u>

If Annabelle SL were to become UK resident, it would be subject to UK corporation tax on its worldwide profits. This would take effect from the day the company became resident in the UK.

The company would need to notify HMRC within three months of becoming subject to corporation tax. Failure to do so could result in penalties.

The company will then have to file UK corporation tax returns and pay corporation tax in the same way as any other UK company. The corporation tax return has to be submitted within 12 months of the end of the accounting period, together with detailed computations and statutory accounts. These must be filed online complete with the required iXBRL tagging.

Any corporation tax due will normally have to be paid within 9 months and 1 day of the end of the accounting period. However, if Annabelle SL has profits of over £1.5m they may have to pay their corporation tax in instalments before that date. If the company's profits are over £20m, they will have to pay these instalments even earlier (broadly in in months three, six, nine and twelve of the period to which the liability relates).

Your email mentions that Annabelle SL's main assets are its investments in subsidiaries and factories in Spain. The normal rule is that, for UK corporation tax, the base cost of these assets on becoming UK resident remains the same as their original cost. Similarly, the ownership period is treated as starting when the company originally acquired the assets – this may be of importance for the purposes of qualifying for the Substantial Shareholding Exemption (SSE) if Annabelle SL were to sell any of its investments in subsidiaries after migration.

However, under s184J TCGA 1992, if Annabelle SL ceases to be resident in Spain (an EU country) on or after 1 January 2020 and any of its assets are subject to an exit charge in Spain, then those assets will be rebased to market value for UK corporation tax purposes.

You email mentions that Annabelle SL receives dividends from its overseas subsidiaries, and in turn pays dividends to its parents.

The basic rule is that any dividend received by a UK resident company is subject to corporation tax unless it falls within the distribution exemption rules contained in Part 9A CTA 2009. These rules distinguish between companies which are small and those that are 'not small'. Assuming that Annabelle SL is not small, then the dividends it receives should be exempt provided no deduction is available in the subsidiaries in respect of them, and that they fall within one of the exempt classes set out s931E to s931Q:

- Distributions from controlled companies.
- Distributions in respect of non-redeemable ordinary shares.
- Distributions in respect of portfolio holdings (broadly a holding of less than 10%).
- Distributions derived from transactions not designed to achieve reduction in UK tax.
- Dividends in respect of shares accounted for as liabilities under the loan relationship rules (e.g. preference shares).

A number of anti-avoidance provisions apply to prevent companies from achieving a tax advantage by manipulating the dividend exemption.

As can be seen, the exempt classes cover a wide variety of situations. Therefore, assuming that the transactions are not part of a scheme designed to secure a tax advantage, and no deduction is available in the territory of the paying company, we would expect the dividends received by Annabelle SL to be exempt from UK corporation tax. Where this is the case no UK tax relief will be given for any foreign taxes or withholding taxes suffered.

When Annabelle SL pays dividends to its parent it will not be required to withhold tax (as there is no withholding tax on dividends under UK domestic law). However, it will not be entitled to a corporation tax deduction in respect of the dividends it pays.

Your email also mentions that Annabelle SL pays interest to a group financing company in Luxembourg.

Under s874 ITA 2007, a UK resident company is required to withhold tax at the income tax basic rate (20%) from payments of yearly interest. Interest will generally be yearly interest where the loan is expected to last for a year or longer. Therefore, provided the loan from the financing company exists for over a year, Annabelle SL will be required to withhold tax on the interest payments it makes. However, it may be possible to reduce this under the relevant double tax treaty.

Interest is generally deductible for UK corporation tax purposes; however, this may be restricted under the following rules:

- The unallowable purpose rules
- The corporate interest restriction
- The thin capitalisation rules
- The transfer pricing rules
- The anti-hybrid rules

A thorough study of the nature of the loan from the finance company, including the terms of lending and the nature of the lending entity and arrangements will need to be carried out to confirm whether any of the above may apply.

If Annabelle SL were to become UK resident, it would also need to be considered whether the Controlled Foreign Company (CFC) rules would apply to any of the subsidiaries it holds. Where these rules apply, the profits of the subsidiaries are apportioned to the UK parent and subject to corporation tax. A number of entity level exemptions and gateways apply which should remove most subsidiaries from the scope of the rules, however, the Cayman Island subsidiary may be of concern.

Finally, if Annabelle SL does become UK resident and maintains its activities in Spain, it is likely to have an overseas permanent establishment (PE) in that country. If that is the case the profits of the Spanish PE will remain subject to UK corporation tax, with double tax relief available in respect of any tax paid in Spain.

Alternatively, an election can be made to exempt the PE from UK corporation tax under s18A CTA 2009. This may be beneficial if the taxes paid in Spain are lower than those in the UK, such that double tax relief does not offset the UK corporation tax liability on the PE profits in full.

I hope the above is helpful and addresses your concerns.

Please let me know if you have any questions or would like to discuss.

Kind regards
A N ADIT

Question 2

Your residence will be determined by reference to the statutory residence test, which is set out in FA 2013 Schedule 45 Part 4. Within this test there are various 'tests' which may apply. The tests are hierarchical. The highest level tests are the 'automatic' UK resident tests and the 'automatic' overseas residence tests. The automatic overseas tests have primacy and if you satisfy any of the automatic overseas tests then you are not UK resident.

The first automatic overseas residence test is that you will be non-UK resident for the tax year if you were resident in the UK for one or more of the 3 tax years prior to the current tax year, and you spend fewer than 16 days in the UK in the tax year. Clearly, as you need to be in the UK for many more than 16 days you would not satisfy this test.

The second automatic overseas test does not apply to leavers, i.e. those who have been UK resident in any of the three prior years so I will not consider this further.

The Third automatic overseas test applies where a person leaves the UK to take up full time employment abroad. As you can imagine there are various conditions that must be met to satisfy this test.

You'll be non-UK resident for the tax year if you work full-time overseas over the tax year and:

- you spend fewer than 91 days in the UK in the tax year;
- the number of days on which you work for more than 3 hours in the UK is less than 31; and
- there is no significant break from your overseas work.

A significant break is when at least 31 days pass by and not one of those days is a day where you:

- work for more than 3 hours overseas; or
- would have worked for more than 3 hours overseas, but you did not work because you were on annual leave, sick leave or parenting leave.

If you have a significant break from overseas work you'll not qualify for full-time work overseas.

Unfortunately you plan to work in the UK for at least 45 days each tax year so that you will not qualify to be treated as non-resident, under the working full-time abroad test.

As you have not passed any of the automatic non-resident tests, the next tests that must be considered are the 'automatic' UK tests.

The First automatic UK test is that you will be UK resident for the tax year if you spend 183 days or more in the UK in the tax year. As you intend to spend at least 250 days each tax year residing in Switzerland you will not meet this test.

Turning to the Second automatic UK test; you will be UK resident for the tax year if you have, or have had, a home in the UK for all or part of the year and the following conditions all apply:

- there is at least one period of 91 consecutive days when you had a home in the UK;
- at least 30 of these 91 days fall in the tax year when you have a home in the UK and you've been present in that home for at least 30 days at any time during the year; and
- at that time either, you had no overseas home, or if you had an overseas home, you were present in it for fewer than 30 days in the tax year.

As you intend to spend more than 30 days in your Swiss home each tax year you will not meet the conditions of the second automatic UK test.

The Third automatic UK test relates to full-time working in the UK.

It provides that you will be UK resident for the tax year if all the following apply:

- you work full-time in the UK for any period of 365 days, which falls in the tax year;

- more than 75% of the total number of days in that 365 day period when you do more than 3 hours work are days when you do more than 3 hours work in the UK; and

- on at least one day which must be both in the 365 day period and the tax year you do more than 3 hours work in the UK.

As you will spend the majority of your time living in Switzerland you will not qualify under this test.

As you do not satisfy any of the automatic non-resident tests or the automatic UK resident tests, your tax resident status will be determined by the sufficient ties tests.

As you have been resident in at least one of the three previous tax years you will be classified as a leaver for the purpose of applying these tests.

The number of UK ties you have will determine how many days you may spend in the tax year without being UK resident. As you are a 'leaver' 5 ties are relevant.

Accommodation

Any accommodation that is available for your use whilst in the UK will be relevant for these purposes. The accommodation must be available to use for a continuous period of at least 91 days during the tax year and you must actually use it for at least one night during that tax year, before it counts as a tie.

As you currently intend to reside in your UK home when you visit the UK, your UK home will be treated as an accommodation tie for these purposes.

Family

As Sam is a minor child who will remain UK tax resident, you will have a tie under this condition.

90 day tie

As you have spent more than 90 days in the UK in at least one of the two previous tax years you will have a tie under this test.

Work tie

This condition is triggered by reference to a 40-day threshold. For these purposes, a person works in the UK if they work more than 3 hours in the UK.

As you intend to work in the UK for at least 5 hours, for 45 days you will have a tie under this connecting factor.

Country tie

A country tie arises if a taxpayer spends more time in the UK, than in any other jurisdiction, You will not have a country tie as you intend to spend more time in Switzerland than the UK each year.

Analysis

You will have 4 ties. This means you would be UK tax resident if you spent 16 or more days in the UK. As you intend to spend at least 60 days in the UK each tax year, you would remain UK tax resident, under the circumstances you propose.

Although under domestic law you will be UK resident, it is possible that the treaty residence tie-breaker contained in the Swiss-UK double tax convention will override this. I have not considered this in detail at present, as this would add a significant level of complication which is perhaps best avoided.

Taxation in the period of non-residence including consideration of the 'temporarily non-resident' anti-avoidance provisions.

When an individual is non-resident, they are only subject to UK tax on UK source income. Special rules apply to UK source dividend income, the effect of which is to ensure that such income does not generate a liability to UK tax. Thus in the three years in which you will be non-resident, you will only be subject to UK tax on your net UK rental income. However, anti-avoidance applies which may tax certain income in the year of your return as is explained below. Where an individual is temporarily non-resident anti-avoidance legislation may apply so that certain income and gains arising in the period of non-residence are subject to tax in the year the individual returns to the UK.

FA 2013 Schedule 45 Part 4 at para 110(1) provides that an individual is to be regarded as "temporarily non-resident" if:

(a) the individual has sole UK residence for a residence period,

(b) immediately following that period (referred to as "period A"), one or more residence periods occur for which the individual does not have sole UK residence,

(c) at least 4 out of the 7 tax years immediately preceding the year of departure were either:

    (i) a tax year for which the individual had sole UK residence, or

    (ii) a split year that included a residence period for which the individual had sole UK residence, and

(d) the temporary period of non-residence is 5 years or less.

As you have been UK resident in at least 4 of the 7 years preceding the year of your intended departure, you will be treated as temporarily non-resident if you return to the UK within 5 complete tax years of your departure.

As you intend to return to the UK after just three years of non-residence you will fall to be treated as temporarily non-resident. Thus any gains arising on assets held at the date of departure but disposed of in the period of non-residence will be subject to UK tax in the year you return to the UK. Further, any dividends you receive from Hexogen in the period of non-residence may similarly be subject to tax in the year of your return to the UK.

It should be noted that the net rental income arising from your UK property portfolio would continue to be subject to UK tax throughout any period of non-residence, as UK source income such as income from UK property is subject to tax on non-UK resident taxpayers. The temporarily non- residence rules do not apply to your dividend income from UK listed companies. Nor would the rules apply to assets both acquired and disposed of in your period of non-residence.

In order to be outside the temporarily non-residence rules it would be necessary for you to remain non-resident for more than 5 complete tax years.

BVI Ltd

Hexogen Ltd would need to consider Transfer pricing rules, since Hexogen Ltd and BVI Ltd would be associated enterprises. Generally, enterprises are associated if there is direct or indirect control by one of the enterprises of the other or they are under common control. As Michael would control both companies the control requirement would be met. TIOPA 2010, s 148. (The "participation condition")

Where UK transfer pricing rules apply, the prices between associated enterprises must be charged at an arm's length price, that is at a price, equivalent to the price that would have been charged between independent parties in the same circumstances.

Under UK transfer pricing rules an adjustment of profits for tax purposes is required where a transaction between associated persons is not undertaken at arm's length and has created a potential UK tax advantage. This adjustment could result in an increase in income or a reduction in costs or losses. The rules apply regardless of whether the transaction is cross border or within the UK.

There are certain exemptions from the UK transfer pricing rules for small and medium sized enterprises (SMEs). The definition of SMEs follows the EU definitions as modified. As Hexegon Ltd has less than 250 employees and its turnover is less than 50 million Euros, it qualifies as a medium sized enterprise for the purposes of the SME exemption.

The SME exemption does not apply to any transactions which take place with an entity in a 'non-qualifying territory'. A qualifying territory is one with which the UK has a double tax treaty which includes a non-discrimination article.

As the BVI is a 'non-qualifying territory' the conditions for the exemption are not met and therefore Hexogen Ltd must apply arm's length pricing. Thus Sarah Walker's suggestion to set up a BVI company, which would provide services to Hexogen Ltd at inflated prices, does not result in a corporate tax saving for Hexogen Ltd as the inflated price must be reduced to the arm's length price for tax purposes.

I hope the above is helpful. Please do not hesitate to contact me if anything is unclear or requires further clarification.

PART B

Question 3

Briefing note – UK permanent establishments (PEs)

Are the proposals likely to generate a UK PE?

Under s1141 CTA 2010 a non-UK tax resident company will be deemed to have a PE in the UK if:

- It has a fixed place of business in the UK through which its business is wholly or partly carried on, or

- An agent acting on its behalf has, and habitually exercises, authority to do business on behalf of the company.

For these purposes, a fixed place of business has a wide meaning, and includes:

- A place of management
- A branch
- An office
- A factory
- A workshop
- Building sites, construction projects
- Oil wells, installations for exploring natural resources, etc.

There are exclusions for activities carried out by an agent of independent status (s1142) and preparatory or auxiliary activities (s1143).

This approach is broadly in line with that of the OECD model tax treaty.

Applying this to our client, sending employees to the UK could constitute a PE if those employees are carrying out the business of the company through a fixed place of business, or acting as agents with the authority to do business on behalf of the company.

Initially, as the employees are not negotiating and concluding contracts, it is likely to be the first of these tests which is most relevant.

As the company is seeking to expand its operations into the UK, it appears that they will be ‘carrying out the business of the company’ there. It is however also necessary to consider if they will be doing this ‘from a fixed place of business’.

Provided there is some place where the employees can work this is capable of constituting a fixed place of business. Whether the company rents separate office space, or uses that of another group company is not relevant. The place of business does not have to be owned by the overseas business, but be they must have some right to use it to undertake their activities in the UK. There must also be some degree of permanence.

It therefore seems that this first test could be met by the initial activities in the UK. However, there may still not be a UK PE if the feasibility and market research studies fall to be classed as preparatory or auxiliary activities under s1143.

S1143(3) defines what is meant by preparatory or auxiliary activities, and these include 'collecting information for the company'. It may therefore be that the initial activities are preparatory or auxiliary, such that no PE arises.

However, in line with the OECD BEPs report on Action 7, from 1 January 2019 activities will not be classed as preparatory or auxiliary if they are 'part of a fragmented business operation'. Activities will be part of a 'fragmented business operation' if:

- They are carried on in the same territory by the company, or a closely related person;
- They are complementary functions which are part of a cohesive business operation; and
- Taken together the functions are not of a preparatory or auxiliary character.

It is therefore necessary to consider what activities other group companies (such as the company with an office in Manchester) are carrying out in the UK in order to determine if the preparatory or auxiliary exemption is available. If they are carrying out similar functions in the UK then the initial activities of the employees may generate a PE.

If this initial feasibility work is promising, it is proposed that the employees will remain in the UK and start to conclude contracts. This activity is likely to generate a PE under the second test of s1141 (i.e. an agent acting on its behalf has, and habitually exercises, their authority to do business on behalf of the company).

If instead of its own employees, the company were to use an 'agent of independent status' then the activities would not create a PE under s1142. This is tested by reference to the legal, financial and commercial characteristics of the relationship between the business and agent. If their relationship is the same as that between independent businesses dealing with each other at arm's length then the agent will be an independent agent.

If another group company is used to conclude contracts in the UK then they could qualify as an independent agent – the fact they are part of the same group does not necessarily preclude this. However, it will be important to consider how independent the other group company is in practice and whether the arrangements are on arm's length terms. If the group company effectively only acts for this company, and is under detailed instructions and control then it is unlikely to be accepted as an independent agent and a PE could still arise. By contrast, using a third party agent may present less of a PE risk, especially if that third party had significant skill and knowledge in the sector and also carries out similar work for other businesses.

<u>How would the taxable profits/losses of a UK PE be calculated?</u>

If the company does have a UK PE it will be subject to corporation tax on the profits attributable to that PE.

How these profits are to be attributed is set out in s19 – s23 CTA 2009. Broadly, these follow general transfer pricing arm's length principles, and require you to assume that the PE is a distinct separate enterprise which:

carries out the same or similar activities under the same or similar conditions; and
deals wholly independently with the non-resident company.

In carrying out this attribution it should be assumed that the PE has the same credit rating as the non-UK resident company, and has appropriate equity and loan capital.

In general, transactions between the non-resident company and the UK PE are treated as taking place on an arm's length basis.

It is possible, when calculating the attributable profits of the PE, to deduct allowable expenses incurred for its purpose. It does not matter if these costs are incurred in the UK or elsewhere, or whether they are borne directly or reimbursed by the PE. It should therefore be possible to allocate the administrative costs, travel, rent etc. incurred in respect of the PE to it for UK tax purposes.

However, depending on the exact arrangements, it may be more difficult to deduct a portion of the interest on the loan. In particular, it is not possible for the PE to make a deduction for UK corporation tax purposes in respect of any interest which the overseas company charges it. However, a deduction may be available if the overseas company instead allocated a reasonable portion of the third party interest it pays to the PE.

Question 4

Lorenzo

The Finance (No.2) Act 2017 introduced new rules regarding deemed domicile which for the first time applied the concept of deemed domicile for income tax and capital gains tax purposes, previously this concept only applied to inheritance tax. The new regime introduced a provision that treated an individual as deemed UK domiciled for both income tax and capital gains tax where that individual:

- was born in the UK;
- has a UK domicile of origin; and
- is UK resident for the tax year in question.

As Lorenzo was born in the UK, has a UK domicile of origin and will be UK resident from 6 April 2019, he will be treated as UK deemed domiciled whilst he remains UK resident. This means he will not be entitled to the remittance basis. Thus Lorenzo will be subject to tax on the arising basis in respect of all his worldwide income and gains.

Lorenzo will therefore pay tax on an arising basis on any UK income plus all foreign income generated from his share and property portfolios.

Lorenzo may also be subject to income tax and capital gains tax on the arising basis in respect of any income or gains that arise in the Lorenzo discretionary trust.

IHT

As Lorenzo has a UK domicile of origin, Lorenzo falls into the category of returning foreign domiciled resident (FDR). 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. The new rules will ensure that his foreign property and the property that he settled when he was non-UK domiciled will be within the scope of IHT whilst Lorenzo is UK resident, as long as he is UK resident in at least 1 of the 2 years prior to the year in which any IHT charge arises.

There is therefore a one year period of grace before these provisions apply. Thus if Lorenzo becomes UK tax resident from 6th April 2019, he will be fully within the scope to UK IHT from 6th April 2020. Thus if Lorenzo dies whilst UK resident, on or after 6th April 2020 his worldwide assets including his foreign shares and foreign property portfolios will be subject to UK IHT. Further assets within the Lorenzo discretionary trust will fall within his estate under the gift with reservation of benefits rules. A 10 yearly anniversary charge may also apply if Lorenzo were UK tax resident in the year the anniversary falls due.

Robyn

Robyn was born with a UK domicile of origin, as at the time of her birth, her parents Giovanni and Sarah had retained their UK domicile. However, she does not satisfy all the conditions necessary to be treated as FDR, as she does not meet the born in the UK condition.

The normal non-domicile rules therefore apply to Robyn. As Robyn became UK resident from September 2016 she has not met the 7 out of 9 year rule, so that there is no charge for accessing the remittance basis. While making a claim to be assessed on the remittance basis does forfeit RR's personal income tax allowance, given her level of income this allowance would not have been available to her in any event.

If the remittance basis is claimed any foreign income arising from her inherited share and property portfolios would only be taxable to the extent remitted to the UK.

A non-domiciled individual may avail of Overseas Workday Relief (OWR). (ITEPA 2003, s26)

During the tax year, the earnings which relate to duties performed overseas are foreign earnings and not taxable in the UK unless they're remitted to the UK if:

- the individual is not UK domiciled;
- they are taxed on the remittance basis; or
- their duties of employment are carried out wholly or partly outside the UK, and that year is either:
    - the first tax year immediately after 3 consecutive tax years where they were not resident in the UK; or
    - one of the next 2 tax years after such a year.

This relief would therefore apply to Robyn for 16/17, 17/18 and 18/19, provided the relevant proportion of her salary had been paid into an overseas bank account and had not been remitted to the UK.

<u>IHT</u>

As Robyn is non-domiciled and not deemed domiciled, she is only liable to UK inheritance tax on her UK situs assets. Thus her foreign shares will be outside the scope of UK inheritance tax, as will be her inherited collection of art provided that this is kept outside the UK.

PART C

Question 5

The Offshore Receipts in respect of Intangible Property (ORIP) rules were introduced by Finance Act 2019 with effect from April 2019. The aim is to allow the UK to tax income received by entities in low tax territories in respect of intangible property (IP) which is used to support UK sales.

The ORIP legislation is found in Chapter 2A of Part 5 of ITTOIA 2005. This provides for income tax (not corporation tax) to be charged at the basic rate (currently 20%) on UK derived amounts received by companies who are not UK resident and not resident in a full treaty territory. A full treaty territory is broadly a territory with which the UK has a full double taxation agreement which includes a non-discrimination article.

An amount is a UK derived amount if:

- It is an amount in respect of the enjoyment or exercise of rights that constitute any IP; and

- The enjoyment or exercise of those rights (or of any rights derived, directly or indirectly from those rights) enables, facilitates or promotes UK sales (directly or indirectly).

A UK derived amount can be either revenue (e.g. a licence fee or royalties) or capital in nature (e.g. the sale of IP).

For these purposes, IP has a wide definition, and includes any property except for tangible property (and rights over it), estates, interests or rights over land, financial assets, shares or other rights in relation to profits, governance or winding up of a company and any other property as prescribed in regulations.

The amount chargeable to tax is the income received by the overseas company which is linked to the UK sales. Where an amount received by the overseas company relates only partly to the IP in question, or that IP supports both UK and non-UK sales, the amount subject to tax is apportioned on a just and reasonable basis.

There are however a number of exemptions which can apply, including:

- IP makes an insignificant contribution – if UK sales are made by an unconnected party and the contribution of the IP to the sale is insignificant, those sales can be disregarded.

- Limited UK sales – if the overseas company (together with any connected persons) has UK sales of £10m or less in the tax year.

- Company resident in a specified territory – this exemption takes out of scope those companies in specified non-full treaty territories that would otherwise be within scope. There are various conditions that must also be met for this exemption to apply.

- Business undertaken in the territory – exemption can be claimed if the overseas company is resident in the territory and all (or substantially all) of the relevant activity in relation to the IP is, and always has been, undertaken in the territory and the IP has not been transferred from a related person and is not derived from IP held by a related person.

- Foreign tax at least half of UK tax – if tax on the UK-derived amounts in the territory of residence is at least half the amount they would pay under the ORIP legislation.

- Where a partnership is itself taxed in a full treaty territory as a separate entity from the partners.

- Where there are multiple charges on group companies from the same income flow, the tax is only charged once.

Turning to the scenario in question, the IP held by JogRight Inc and JogRight IPCo enables, indirectly, the sales of the fitness trackers to customers in the UK. The income that JogRight Inc and JogRight IPCo receive in respect of that IP is therefore potentially within the scope of the ORIP rules.

However, the ORIP rules should not apply to the income received by JogRight Inc, as the company is resident in the US, which is a full treaty territory.

The ORIP rules could apply to the income received by JogRight IP Co, as it is resident in a territory with which the UK does not a have a double tax treaty (and which is therefore not a full treaty territory).

It will however be necessary to first consider whether any of the exemptions listed above could apply.

From the information provided it appears unlikely that the disregard where IP makes an insignificant contribution to sales will apply. Although the UK sales are made by a third party, the JogRight brand appears on the trackers sold and the software forms an integral part of the product. It also appears likely that the ‘business undertaken in the territory exemption’ will not apply, as even if the relevant activity in relation to the IP is undertaken in Ruritania, the IP was previously transferred to the company by a related party (JogRight Inc). As Ruritania is a low tax territory, it also seems unlikely that the foreign tax exemption would apply.

In order to see if any exemptions apply, it would be necessary to:

- Identify the level of UK sales made by the JogRight group (are these less than £10m)?

- Check whether Ruritania is on the list of specified exempt non-full tax treaty territories.

- Confirm the amount of tax paid on the UK derived amounts in Ruritania.

If no exemptions apply, the income subject to income tax in JogRight IPCo will be that portion of the company’s royalty income which supports the sales made by BuildCo to UK retailers. Amounts which support the sales made by BuildCo to non-UK retailers will not be subject to tax under the ORIP rules.

Whilst apportionment of the royalty income should be carried out on a just and reasonable basis, s608G(3) sets out that, in cases where IP income supports both UK sales and other sales, the just and reasonable proportion is to be calculated by applying the following fraction: $X/(X+Y)$

Where X is the value of UK sales, and Y is the value of other sales. It will therefore be necessary to seek this information on sales from BuildCo in order to calculate the income subject to an ORIP charge.

Question 6

Part 1

Since 6 April 2020 non-UK resident companies are chargeable to corporation tax, rather than income tax, on their profits from a UK property business. This will involve changes both to the tax calculations of the overseas companies and their compliance obligations.

One of the main changes is a reduction in the rate of tax which is charged. Prior to April 2020, non-resident companies were subject to income tax at a rate of 20% on their UK property profits. From April 2020 corporation tax will be chargeable at the lower rate of 19%.

The overseas companies should continue to be able to deduct allowable expenses under corporation tax in much the same way as they do for income tax purposes. However, one area where they may see some changes is interest deductibility.

We assume that, for income tax purposes, the companies have to date deducted the interest expenses on their loans from third parties and other group companies in full as they are incurred wholly and exclusively for the purposes of the property business. Although there is a restriction under income tax on the finance costs which can be deducted in relation to residential property, this only applies to non-resident companies if they are acting in a fiduciary or representative capacity.

However, under corporation tax, there are a number of provisions which may act to restrict the interest deductions which the companies can make. These include:

- The corporate interest restriction;
- The anti-hybrid mismatch rules; and
- The transfer pricing and thin capitalisation rules.

The companies will have to carefully monitor whether any of these apply, as if they do they could restrict the interest deductions available to them, and increase the tax they have to pay. In particular, depending on the level of third party vs group borrowing the corporate interest restriction could result in the companies' interest deductions being limited to 30% of profits. If the corporate interest restriction applies the group will also have to file a corporate interest restriction return.

If the overseas companies are currently claiming capital allowances on any elements of plant and machinery or fixtures in the properties they rent out then they can continue to do so under corporation tax. Normally the transition to corporation tax would be treated as a cessation for capital allowances purposes, meaning that balancing adjustments would arise. However, specific transitional rules have been introduced which mean the movement from income tax to corporation tax will not be treated as a cessation, and assets will instead be transferred to the corporation tax regime at their tax written down value.

The question mentions that some of the overseas companies are loss making and have carried forward losses.

Looking at the carried forward losses first, under income tax, these losses were available for offset against future profits of the property business without any specific restriction. Normally the transition to corporation tax would be deemed to be a cessation of the property business, meaning that these losses would be lost. However, special transitional rules make it possible to carry over any unused losses from income tax to corporation tax. There will however be some restriction on how these losses can be used under corporation tax. In particular, they can only be carried forward against income arising to the non-resident company from the UK property business (and not their total profits). It will also not be possible to group relieve these carried forward losses.

In addition, on moving to corporation tax, the companies will become subject to the corporate loss restriction rules – these broadly restrict the use of brought forward losses to 50% of group profits over £5m. Depending on the level of losses in the wider group, this may result in the companies suffering a restriction in the amount of carried forward losses they can offset each year, extending the period it will take them to get relief. As with the corporate interest restriction, the corporate loss restriction will also introduce new compliance obligations for the companies.

If the companies continue to incur losses after the transition to corporation tax, they can set them against any other income in the period and may be able to surrender them to other group companies within the charge to corporation tax as group relief. If the losses can't be used in the period they arise, they can be carried forward against total profits of the company, and may also be available for group relief in future periods. The corporate loss restriction mentioned above may however apply to restrict the use of these losses if they are carried forward.

In addition to tax changes, there are also be administrative changes on moving from income tax to corporation tax.

Importantly, tax will change from being charged on a tax year (April to April) basis under income tax to an accounting period basis under corporation tax.

The first accounting period for corporation tax will be set by HMRC to start on 6 April 2020 and will end on the earliest of:

- 5 April 2021; or

- The date the company's accounts are drawn up to.

Under income tax, non-resident companies have to file a paper tax return for the tax year ending 5 April by the following 31 January. However, from April 2020 they will fall within the requirements of corporation tax self-assessment (CTSA). This will bring a number of changes, including:

- Companies will need to file a CT600 return, supporting computations and company accounts.

- Filing must be online.

- The filing deadline is 12 months after the accounting period end.

iXBRL tagging will need to be applied to computations and generally the accounts.

The times when tax has to be paid will also change. Under income tax, payments are generally made on account on 31 January and 31 July each year. When corporation tax will be payable will depend upon the size of the companies and groups. If they qualify as small or medium sized they will have to pay corporation tax nine months and one day after the end of their accounting period. If they are large, or very large, then they may have to pay quarterly instalment payments (QIPs) of corporation tax. However, transitional rules mean the QIPs requirements do not apply to the first accounting period which straddles April 2020. As a result of this change, small and medium companies may have longer to pay their tax, but larger companies will need to make more frequent, and earlier payments of tax under corporation tax.

<u>Part 2</u>

A future disposal of the properties located in the UK may give rise to a corporation tax charge at a rate of 19%.

The amount which is taxable will depend upon whether the property is residential or non-residential and whether the company is a close company or not. Broadly, a close company is one which is under the control of five or fewer participators, or any number of directors.

Gains on disposals of residential properties by non-resident close companies have been subject to tax since 6 April 2015.

This was extended from 6 April 2019 to include disposals of all kinds of property (whether residential or commercial) by all types of non-resident company (whether close or not).

It is only the gain arising since 6 April 2015 or 2019 (as appropriate) which is subject to tax, and this is achieved by rebasing the assets to their market values on that date. This effectively means that:

- If the company making the disposal is not close, then the base cost for calculating the gain on disposal of either residential or non-residential property will be market value at 6 April 2019.

- If the company making the disposal is close, then:

    - the base cost for calculating the gain on disposal of a residential property will be its market value at 6 April 2015;

    - the base cost for calculating the gain on disposal of a non-residential property will be its market value at 6 April 2019.

For any properties acquired after these dates, the normal rules should apply for base cost (i.e. the base cost is equal to the consideration given).

It is possible to elect not to rebase the market value in this way, which may be beneficial if the rebased value would be lower than the actual purchase cost.

Question 7

The question has made clear, that Professor Tolstoy will not elect for the remittance basis. He will therefore be assessed to UK tax on an arising basis on his worldwide income. The professor will therefore be entitled to his personal income tax allowance, subject to the normal rules.

French pension income

Under UK domestic law, foreign pension income is subject to UK taxation with unilateral relief granted for foreign tax deducted. However, the UK-French double tax treaty provides further relief as follows.

Article 18 of the French-UK treaty sets out the treatment of Pensions, and follows closely Article 18 of the OECD Model treaty. Article 18 of the OECD treaty provides: Subject to the provisions of paragraph 2 of Article 19, pensions and other similar remuneration paid to a resident of a Contracting State in consideration of past employment shall be taxable only in that State.

Article 19, paragraph 2, of the OECD Model Treaty provides: ... [P]ensions and other similar remuneration paid by, or out of funds created by, a Contracting State or a political subdivision or a local authority thereof, to an individual in respect of services rendered to that State, or subdivision or authority shall be taxable only in that State. However, such pensions and other similar remuneration shall be taxable only in the other Contracting State if the individual is a resident of, and a national, of that State.

Applying these provisions to Professor Tolstoy's French pensions:

Civil service pension

Professor Tolstoy's Civil Service pension which arose from his employment with the French Government shall under Article 19, para 2, only be assessable in France. It is to be noted that Professor Tolstoy is not a UK national so that the exception from this rule contained in the last sentence of paragraph 2 does not apply.

Private pension

Professor Tolstoy's private pension, which arose from an employment with a large French company falls within Article 18, and therefore would only be taxable in the state of residence, i.e. the UK. Professor Tolstoy should claim relief in France so that no French tax is suffered on this pension.

Parisian apartment

Under Article 6 of the French-UK tax treaty income from property located in a state, may be taxed in that state. The income may also be assessed in the state of residence. Therefore Professor Tolstoy will suffer tax in both France and the UK in respect of the French rental income. Article 24 of the UK-French treaty provides for the elimination of double taxation. Under Article 24, Professor Tolstoy should obtain a deduction for any French tax suffered against his UK liability on that income.

French dividend Income

The French-UK tax treaty at Article 11, provides that dividend income may be subject to tax in both states. It provides that the state in which the company paying the dividend is resident may not charge more than 15%, so that French withholding tax is limited to 15%. Relief for the French withholding tax deducted is provided for in Article 24 which deals with the elimination of double taxation. A credit against Professor Tolystoy's UK liability should be available for any French tax deducted.

Unilateral relief (TIOPA 2010, s9(1)(3)(4)

Where no credit is available for foreign tax under the bilateral double tax agreements unilateral relief may be available. The relief applies where:

- tax is paid under the law of a territory outside the UK;
- the tax is calculated by reference to income arising in that territory; and
- the tax is charged on income and corresponds to UK income tax or is charged on income or gains and corresponds to UK corporation tax (see further below).

Credit for the foreign tax is allowed against any UK income tax calculated by reference to that income.

The credit is limited to the foreign tax suffered.

Question 8

Whilst UK resident and domiciled taxpayers are chargeable to UK tax on their worldwide income and chargeable gains on an arising basis, UK resident but non-domiciled taxpayers who elect for the remittance basis are only liable to UK tax on their foreign income and gains to the extent these are remitted to the UK. UK resident but non-domiciled taxpayers may elect for the remittance basis in the first 7 years of being UK tax resident, free of charge, thereafter a remittance basis charge applies in order to qualify for the remittance basis.

As you are non-domiciled, and have only been UK tax resident for 4 years, you may elect for the remittance basis free of charge. This election is made on your tax return. If you make this election you will be liable to UK tax on the arising basis in respect of your UK source income and UK gains. However, you will only be liable to tax on your foreign income and gains to the extent that these are remitted to the UK. Where an individual elects for the remittance basis, they forfeit entitlement to their personal allowance.

For UK purposes there was no step up in basis cost in your shareholding in DCL when you became UK resident. The gain on the disposal of your holding in DCL is therefore approximately £100 million. To avoid being subject to UK capital gains tax on the disposal it is important to make a claim for the remittance basis of taxation. You will then only be subject to UK capital gains tax on the gain to the extent this gain is brought to the UK.

As you were a director of DCL and held a majority of the shares, it may be possible to qualify for a reduced rate of tax on the disposal. This relief which is named ‘Entrepreneurs Relief’ (ER) may be amended in each year’s Finance Act, but recently has applied to the first £10 million of gain, and operates by charging this gain at the reduced rate of 10% rather than the normal capital gains tax rate of 20%. I will consider your eligibility in detail when I have been provided with further details concerning DCL.

Turning to your proposed remittances:

Residential property

The remittance of £20 million of the proceeds of the gain to facilitate the purchase of UK residential property would constitute a taxable remittance of the gain in the year the remittance is made. As explained the rate of tax applying to the remittance will be 20%, although a reduced rate of 10% may apply to the first £10 million if the gain qualifies for ER.

Acquisition of 40% shareholding in SGEL

Business Investment Relief was introduced in the 2012 Finance Act to encourage UK resident non-domiciled taxpayers to invest into the UK by providing that certain remittances made to subscribe for shares or lend to UK trading companies, would not trigger a taxable remittance. The relief has been extended to include the acquisition of shares either by subscription or purchase in an ‘eligible trading company’. To qualify as an ‘eligible trading company’ SGEL must carry on one or more commercial trades and the carrying on of those trades must be all or substantially all it does s809VD(3). As SGEL’s trade is software development this would prima facie constitute a qualifying trade so that SGEL would be an eligible trading company. In cases where there is doubt as to whether BIR would apply, it is possible to seek a view from HMRC.

There are anti-avoidance provisions that prevent the extraction of value to ensure that the relief is not vulnerable to abuse. There are also provisions disqualifying the investment where the investor is expecting to obtain a related benefit s809VC(4) 809VD.

Your investment into SGEL would therefore appear to qualify for BIR. The relief must be claimed. A claim for relief under this section must be made on or before the first anniversary of the 31 January following the tax year in which the income or gains would, but for subsection (2), be regarded as remitted to the United Kingdom by virtue of the relevant event s809VA(8).
In the event you dispose of your holding in SGEL you must take the proceeds offshore within 45 days of the disposal, or alternatively reinvest within 45 days in another investment which qualifies for the relief.

Commercial office building

For the purposes of BIR the term trade includes anything deemed to be a trade for corporation tax purposes and rental businesses (s809VE) The business of generating income from land is treated as a trade for these purposes.

You may therefore qualify for relief if you incorporate a company, which acquires the commercial office building. The acquisition of the property could be funded either by a subscription for shares, or alternatively the making of a loan to the company.

The BIR rules as explained above (in relation to SGEL) would apply.

In conclusion, provided you make a remittance basis election, you would only be subject to capital gains tax on the disposal of DCL to the extent proceeds are remitted to the UK. The acquisition of your new residence would constitute a taxable remittance, although depending on whether ER is available, a reduced rate of tax might apply to at least part of this remittance. Regarding the proposed acquisition of a 40% shareholding in SGEL and the commercial office building, both would constitute taxable remittances. However, provided both qualify for BIR and claims for BIR are duly made these remittances may not be chargeable to tax.

Question 9

De-enveloping

Mechanics

There are various strategies available to implement de-enveloping of the property. For example, Ace Properties Ltd could be placed into liquidation and the property distributed to Raphael.

Income Tax

If Ace Properties Ltd is to be put into liquidation there should be no charge to income tax if the property is distributed to Raphael during liquidation.

Capital Gains Tax

Ace Properties Ltd: Disposal of property

For 2019/20 onwards, a person, (including a company) who is not UK resident for a tax year is chargeable to capital gains tax on gains arising on the disposal in that year of any interests in UK land.

If Ace Properties Ltd is liquidated and the property distributed this would constitute a disposal of the property by the company. As the company is non-resident and the property is UK residential property, the company would be entitled to a step up to market value at 5 April 2015. However, even though Ace Properties Ltd is entitled to a step up in base cost, under anti-avoidance legislation Raphael may be assessed on the gain arising from the date the property was acquired by the company to 5TH April 2015 (£8 million minus 3.2 million) this 4.8 million GBP gain may be attributed to Raphael as a participator under section 3 TCGA 1992.

As Raphael's structure was set up in contemplation of achieving inheritance savings but not to avoid capital gains tax, a motive defence may apply, which would prevent the section 3 charge crystallizing.

Raphael may claim the motive defence on the basis that the structure was not set up to avoid CGT so that the 4.8 million GBP gain would not be chargeable to tax on either Raphael or the company.

Gain on disposal of Raphael's shareholding in Ace Properties Ltd

A gain will accrue to Raphael on the disposal of the shares, on the liquidation. The amount of the gain is broadly the increase in value of the shareholding from the date of Raphael's acquisition (April 2009, cost £6 million) - to its current market value £10 million i.e. 4 million (ignoring any reduction required to reflect potential liabilities of the company). Although Raphael is non domiciled and the gain arises in respect of a non-UK situs asset it will nevertheless be chargeable since it is remitted, i.e., Raphael will receive a capital distribution in the UK being the London home.

ATED

ATED periods run from 1st April to 31st March each year. The return must be submitted by 30 April. The tax is charged by reference to valuation bands, which determine the amount of the ATED charge.

As ATED only applies to enveloped properties, if the property is de-enveloped, the property will no longer be subject to the annual ATED charge. ATED is a tax which is payable in advance, so that a partial (pro-rata) refund of the ATED charge for the current year would be made, to reflect the fact that the property is not enveloped for the entire year.

SDLT

On liquidation of the company the property will be distributed to Raphael. The distribution of property on a liquidation is normally not subject to SDLT. As the property is not encumbered with a mortgage, a liability to SDLT should not arise.

IHT

The Finance (No 2) Act 2017, contained provisions that ensured shares in closely owned foreign companies such as Ace Properties Ltd would not qualify as excluded property where they reflected the value of UK residential property. Thus there is no longer any incentive for a non-domiciled taxpayer to hold UK residential property through foreign incorporated companies.

The transfer of the property into Raphael's direct ownership is therefore broadly neutral from an IHT perspective.

Conclusion

Significant tax liabilities may arise, if the property is de-enveloped and the property is transferred into Raphael's direct ownership.

In summary, any de-enveloping of the UK residential property would be likely to trigger two charges to capital gains tax. One on the disposal of the property by the company, and the second on the disposal by Raphael of his shareholding in the company.

Regardless of whether the motive defence can be relied on to prevent section 3 TCGA 1992 applying, the capital gains tax cost of transfer the property out of the company would be significant The total cost of de-enveloping should be compared to the cost of paying the annual ATED charge.

The harsh tax environment faced by Raphael is due to the fact that the trailed relief for de-enveloping was not enacted so that often there would be significant tax costs incurred when de-enveloping UK residential property.