

THE ADVANCED DIPLOMA IN INTERNATIONAL TAXATION

June 2025

MODULE 2.09 – UNITED KINGDOM OPTION

SUGGESTED SOLUTIONS

PART AQuestion 1Part 1

To determine whether Daniel is UK resident for 2024/25 it is first necessary to determine Daniel's day count, on the assumptions set out in the question.

	<u>Days</u>
Spain	95 (spent in his Spanish home) + 35 = 130
UK	70 + 28 (Hospital UK February) = 98
Italy	40
Other countries	97
Total	365 (6 April 2024 to 5 April 2025)

As Daniel made a deliberate choice for family reasons to be treated in the UK, his hospital stay in the UK is unlikely to qualify for the exception available for exceptional circumstances.

Daniel's residence status is determined by the Statutory Residence Test ("SRT"), a set of three tests taken in hierarchical order that generally consider an individual's presence in the UK and their connecting factors to the UK.

These are listed below, and they must be considered in the order they are presented:

- Automatic Overseas test – if any of these tests are met, you will be deemed to be non-UK tax resident.
- Automatic UK test – if any of these tests are met, you will be deemed to be UK tax resident.
- Sufficient Ties test ("STT") – under this test, the number of days that you can spend in the UK before being considered UK tax resident is dependent upon the number of 'ties' that you have to the UK.

Part A – Conclusive non-residence ("the automatic overseas test")

An individual is not UK resident in a UK tax year if they:

- Were non-resident in all of the previous three tax years and they are present in the UK in the current tax year for less than 46 days.

As Daniel was resident in one of the previous 3 years, this test is not met.

- Were UK resident in one or more of the previous three tax years and they are present in the UK in the current tax year for fewer than 16 days;

Daniel exceeds this threshold.

- Leave the UK to carry out full-time work abroad, provided they are present in the UK for less than 91 days in the tax year and no more than 30 days are spent working in the UK in the tax year.

As Daniel does no work for more than half the year he cannot meet this test.

If an individual does not satisfy the automatic overseas test, they need to consider the automatic UK residence test.

Part B – Conclusive residence ("the automatic residence test")

An individual will be treated as conclusively resident in a tax year if they:

- Are present for 183 days or more in a tax year;

Daniel only spends 98 days in the UK so fails this test.

- Have their only 'home' in the UK;

A home is defined as "a building or part of a building, vehicle, vessel, or structure of any kind". For that building, etc. to be a 'home', it must be the individual's home for more than 90 days, the individual is present in it for at least 30 separate days in the tax year, and they do not have an equivalent overseas home.

Daniel has homes in several countries and does not spend any time in his UK home during 2024/25 so fails this test.

- Carry out full-time work in the UK.

Daniel only works in the UK, for more than 3 hours on 5 occasions, so fails this test.

As none of the automatic non-resident or automatic UK residence tests are met, Daniel needs to consider the sufficient ties tests.

Part C – Sufficient ties tests

Part C only applies to those individuals whose residence status is not determined conclusively by Part A or Part B.

Part C reflects the principle that the more time an individual spends in the UK, the fewer connections they can have with the UK if they are to be non-UK resident.

'Arrivers' are individuals who were not resident in all of the previous three tax years and 'leavers' are individuals who were resident in one or more of the previous three tax years.

The relevant factors are as follows:

- "Family tie"— this condition is met if the individual's spouse or civil partner, or minor children are resident in the UK in their own right i.e. their residence is not contingent on the residence of their family under the SRT.

Daniel has no minor children. However Frederica is UK resident as she has two ties:

- the work tie as she works more than 3 hours on more than 40 days in 2024/25 and
- the 90 day tie as she spent 92 days in the UK in 2022/23;

and is resident as she spends 98 days in the UK in 2024/25.

Daniel therefore has a family tie.

- "Accommodation tie"— this condition is met if the individual has a place to live in the UK, it is available to them for a continuous period of at least 91 days and the individual spends at least one night in the accommodation during the tax year. Accommodation owned by relatives will be included, if it is used by the individual for more than 15 nights during the year.

Daniel does not have an accommodation tie as when he visits the UK all time is spent in hotels.

- Substantive work in the UK ("Work Tie") – this condition is met if the individual does substantive work (more than 3 hours) in the UK (40 days in the tax year).

Daniel only worked in the UK for more than 3 hours on 5 occasions. Even if he worked while hospitalised in February 2026, he would not satisfy this test.

Frederica works in the UK for more than 3 hours on 45 days so has this tie.

- UK presence in the previous tax year ("90-day Tie") – this condition is met if the individual spent more than 90 days in the UK in either of the previous two tax years.

Daniel (and Frederica) meet this test, since they spent 92 UK days in 2022/23.

- More time in the UK than in other countries ("Country Tie") – this condition is met if the individual spends more days in the UK in the tax year than in any other single country (but this connection is not applicable to 'arrivers').

In 2024/25 Daniel (and Frederica) spend more time in Spain so do not meet this condition.

The trade-off between connection factors and days of presence (for 'arrivers' and 'leavers') is as follows:

- 16 – 45 days in the UK: Always non-UK tax resident
- 46 – 90 days: 3 Ties
- 91 – 120 days: 2 Ties
- 121 – 182 days: 1 Tie
- >182 days Always UK tax resident

For the purposes of applying the SRT, except in cases where the 'deeming' rule applies, days in the UK are days in which the individual was in the UK at midnight.

Applying the sufficient ties test

For the 2024/25 tax year you would meet the conditions for a 'leaver' as you would have been UK resident for 1 or more of the previous 3 tax years.

Based on having 2 ties to the UK (90-day tie and Family tie) you would be able to spend up to 90 days in the UK in the 2024/25 tax year, without being UK tax resident. However, you spent 98 days and therefore you will be UK resident in 2024/25.

Part 2

As in 2024/25, Daniel is UK resident under the Statutory Residence Test, and Spanish tax resident under domestic Spanish tax law, his residence is determined under the Spain-UK tax treaty, residence tie-breaker article. This provides that, when under paragraph 1 an individual is a resident of both states, their status shall be decided as follows:

- A person is considered a resident of the country where they have a permanent home. If they have permanent homes in both countries, they are considered a resident of the country where their personal and financial ties are stronger.
- If it's unclear which country their strongest ties are with, or if they don't have a permanent home in either country, they are considered a resident of the country where they usually live.
- If they usually live in both countries, or in neither, they are considered a resident of the country whose citizenship they hold.
- If they are a citizen of both countries, or of neither, then the governments of the two countries will decide together which one will count them as a resident.

We are told Daniel has homes available in both England and Spain. It is clear both homes have the character of permanence given that they both house personal libraries. The question states Daniel does not visit his UK home in the tax year, however, this is not a Treaty requirement.

As Daniel has a home in both countries, we need to consider in which country Daniel's centre of vital interests are closer.

HMRCs guidance states:

An individual is a resident of the State to which their 'personal and economic relations' (a wide expression intended to cover the full range of social, domestic, financial, political and cultural links and relationships) are closer.

Daniel's partner, Frederica is a resident of Spain, however, she also spends much time in the UK. We are told Daniel's children and grandchildren visit him in Spain, but also that Daniel spends much time visiting friends and family on his visits to the UK. We are also told that he has an extensive library of English literature in his Spanish home. Whilst insufficient facts are given to determine the issue it appears arguable that Daniel's centre of vital interests lies in the UK.

Habitual abode

An individual is a resident of the State in which they have their habitual abode. If they have a habitual abode in both States or in neither, then the final test is nationality.

An individual is a resident of the State of which they are a national.

As Daniel has homes in both England and Spain and spends significant time in both countries as part of his pattern of life, Daniel has a habitual abode in both countries. However, Daniel has sole British citizenship.

In summary, whilst insufficient information is provided to conclusively determine the outcome of applying the treaty tie-break test, nevertheless, the evidence presented suggests significant risk that treaty residence would be awarded to the UK, given Daniel's centre of vital interests, particularly personal, seems weighted towards the UK.

Part 3

The temporary non-residence (TNR) rule means that in a situation where an individual who has been UK resident for at least 4 of the 7 tax years prior to departure, leaves the UK and then returns after a period not exceeding 5 calendar years, they will be considered to be within the TNR rules.

If the conditions for TNR are met, any capital gains which arose during the period of non-residency, in relation to assets owned prior to departure from the UK, will be treated as having arisen in the tax year of return to the UK and taxed accordingly.

This does not apply to disposals of interests in UK land, which continue to be subject to tax on non-UK residents.

The TNR rules also apply to various types of income, including distributions (such as dividends) from close companies.

As prior to leaving the UK, on 1 April 2023, Daniel had always been UK resident, he clearly satisfies the 4 out of 7 year condition. While Daniel was non-UK resident in 2023/24, he became UK resident again in 2024/25 and therefore did not meet the requirement to be non-UK resident for more than 5 years. Therefore the TNR rules apply.

As AI-5 is a public listed company, it should not be treated as a close company. The £40 million dividend Daniel receives from his shareholding in AI-5, though subject to UK tax, qualifies for relief under the disregarded income rules in s.811. However, the gain (£160 million) arising on the disposal of his shares in 2023/24, will be subject to UK tax in the year of Daniel's return, i.e. in 2024/25.

Question 2

To: The board of Solaris Future SA
From: Tax adviser
Subject: Corporation Tax implications of current structure

Under UK domestic law, non-UK resident companies are only taxable on profits in the UK arising through a UK Permanent Establishment.

Under s1141 CTA 2010, Solaris Future SA will have a UK PE if:

- It has a fixed place of business in the UK through which Solaris Future's business is wholly or partly carried on; or
- An agent acting on behalf of Solaris Future SA has and habitually exercises authority to do business on behalf of Stratus Inc in the UK (a "dependent agent PE").

The UK's view is that a server either alone or together with web sites could not constitute a PE of a business that is conducting e-commerce through a web site on the server.

Therefore, under the current structure it is unlikely that the company will have any exposure to UK Corporation Tax on its UK sales.

Option 1

Option 1 is likely to result in a UK Permanent Establishment. s1141 CTA 2010 specifically references an office being a fixed place of business.

Solaris Future SA will be carrying on its trade through the office, a fixed place of business PE. The fact the office is rented is not relevant.

s1143 CTA 2010 states that a company will not be regarded as having a PE if the activities carried on at a fixed place of business are of a preparatory or auxiliary character. The legislation goes on to list certain specific activities which are considered to be preparatory or auxiliary, including "collecting information" for the company.

It does not appear that the activities of the UK employees will fall to be treated as "preparatory or auxiliary". Therefore, the s1143 exemption will generally not apply.

As a result under option 1, Solaris Future SA will need to register for UK Corporation Tax and submit an annual Corporation Tax return each year. The profits attributable to the PE will be subject to UK corporation tax.

Attribution of profits to the PE must follow the authorised OECD approach (per article 7 of the OECD model DTA). This approach broadly follows transfer pricing principles.

I note that under this option, Solaris Future SA will hold some board meetings in the UK. This creates a risk that the UK authorities may view the company as centrally managed and controlled, and so tax resident in the UK, even if the decisions are formally signed off in Spain. As a UK resident company, the worldwide profits of Solaris Future SA would be liable to UK Corporation Tax. This would create a double taxation risk if Spain also views the company as Spanish resident under Spanish law.

In the absence of such any agreement between the UK and Spain over the company's residency, the company would be seen as "dual-resident" (resident in the UK and Spain under both country's respective domestic laws). Such dual-resident companies are not entitled to treaty protection and may as a result suffer from unrelieved double tax.

Therefore, I would advise against holding board meetings in the UK and would advise the board to ensure that all strategic decisions affecting the company are actually made in Spain.

Option 2

Under option 2, Solaris UK Ltd will be incorporated in the UK, so will be considered resident in the UK under UK law (as per s14 CTA 2009). For completeness, the central management and control and place of effective management also appears to be in the UK; the board meetings take place in the UK and there is no suggestion that strategic decisions affecting the company are taken outside the UK.

As a general rule, UK resident companies are chargeable to UK CT on their worldwide profits (s5 CTA 2009).

Presumably Solaris UK Ltd will acquire solar panels from Solaris Future SA. Assuming the SME exemptions don't apply, all transactions between Solaris UK Ltd and Solaris Future SA will be within scope of the UK's transfer pricing rules, meaning that Solaris UK Ltd will need to compute an arm's length price for these transactions.

Unallowable purpose

The unallowable purpose rule is set out at s.441 and s.442 CTA 2009. The rule is a targeted anti avoidance rule and applies where a loan has an unallowable purpose. An unallowable purpose is defined as a purpose that is not amongst the business or other commercial purposes of the company.

The legislation specifically provides that where one of the main purposes of a loan is to secure a tax advantage for the taxpayer or any other person, such a loan will be within scope of the rule. For loans within scope of the rule, no tax deduction is available for any part of the interest attributable to the unallowable purpose.

The operational expenses (£70m) clearly serve a commercial UK purpose. It is therefore unlikely that any interest on the £70m will be within scope of the unallowable purpose rule.

However, it is unclear how the £30m investment in Solaris Research SA is for the business/other commercial purposes of Solaris UK Ltd. Therefore, it is possible that the UK authorities may argue that the loan relationship debits attributable to the £30m should be disallowed under the unallowable purpose rules on the basis that:

- The funds are used to acquire a non-UK asset with no direct link to the UK's operations.
- The return is unlikely to be commercial (e.g., Solaris Research is loss-making).
- A main purpose may be to create UK tax deductions for interest on a loan that doesn't benefit the UK company itself.

To avoid a restriction under the unallowable purpose rules, the company needs to clearly document the commercial rationale of the £30m investment for example by showing how it expects to benefit directly from the investment (e.g. through strategic collaboration for UK-specific product customisation, access to R&D results).

Following recent case-law (including the "Blackrock" and "Development Securities" cases), it is important that the board of Solaris UK Ltd actively considers this portion of the loan and that this consideration is clearly documented. Simply ensuring the loan is formally approved in the UK is unlikely to be sufficient for these purposes.

Dividend payments

The OECD model treaty permits the source country to deduct withholding tax on dividends.

However, there are no provisions within UK domestic law that require tax to be withheld on dividend payments, so no withholding tax will be due on payment of any dividends by Solaris UK Ltd.

The withholding tax position on any dividends received by Solaris UK Ltd will depend on the domestic law of the source country.

Most foreign and UK dividends received by UK companies are exempt from corporation tax under the provisions contained in Part 9A CTA 2009.

Assuming the company is not classified as a small company, any dividends received by Solaris UK Ltd from Solaris Research SA is likely to be exempt under S931G CTA 2009 as Solaris UK Ltd holds less than 10% of the issued share capital of Solaris Research SA.

PART B

Question 3

Part 1

We understand you are currently a UK resident, non-domiciled individual. You currently have a significant portfolio of investments and you actively manage your investments.

At present you reinvest your income and gains arising from your portfolios which have generated capital growth. You have two portfolios one of which contains a share portfolio and the other contains a sophisticated asset class being private equity funds, with significant calls due.

You wish to understand whether a “wrapper” (an offshore insurance bond) could be used to shelter the income and gains arising from your assets.

Key Tax Characteristics

Wrappers are taxed in accordance with the provisions of ITTOIA 2005, Part 4, Chapter 9. Broadly, this legislation provides that the investment returns accrue without a tax charge within the umbrella of the bond with a tax charge payable only on the encashment of the bond or other chargeable event (as defined in ITTOIA 2005, s 484). An additional feature is that you can withdraw up to 5% of your initial premium tax free on an annual basis. Where a taxpayer does not use up their annual allowance, this will mean that they will be able to withdraw this in the following year, i.e. 10% would be available to draw down tax free in year 2. This would mean you can withdraw up to 25% of the bond in year 5, and this would still be within your tax free limit, provided that you do not make any earlier withdrawals. However, you need to be aware, as explained below, that a taxable remittance may occur if these funds were to be brought to the UK, since your bond would contain an element of untaxed foreign income and gains.

Such bonds may not only avoid high rates of income tax but also capital gains tax when investments are switched. Tax implications on creation of the wrapper

If assets are transferred to the ‘wrapper’, (or their sale proceeds) this would constitute a disposal and might generate capital gains. These would be subject to tax on the remittance basis, if withdrawals from the wrapper were ever brought to, or used in the UK.

Remittances

In addition to gains mentioned directly above, if the portfolio used to fund the wrapper was originally acquired using unremitted foreign income or gains, arising while you were UK resident but non-domiciled, if withdrawals made from the wrapper are brought to the UK, these could constitute taxable remittances. This would apply even though the 5% withdrawal would not otherwise be subject to tax.

Part 2

The bond should invest in listed shares and bonds and it should not hold personal assets e.g. shares in your family company or bespoke investments, such as your private equity holdings. In broad terms it should only hold investments which a discretionary investment manager would propose to the ‘public’.

For example, the private equity fund, would not prima facie be assets an insurance company would normally be happy to invest in and in any event suggest a heightened risk the PPB legislation would apply.

Part 3

Transfer of Assets Abroad anti-avoidance

If the Transfer of Asset Abroad legislation applies, the underlying income arising in the bond would be assessed on you on an arising basis.

The tax case of IRC v Willoughby [1995] STC 143, 70 TC 57, CA supports the position that where the bond is held directly, as part of a normal investment strategy, HMRC should not succeed in invoking the anti-avoidance legislation contained in ITA 2007, s 720.

Personal Portfolio Bond (PPB) legislation

There is also a heightened risk in your personal circumstances from the Personal Portfolio Bond (PPB) legislation. The PPB legislation, which is explained below, imposes very significant tax charges, where its conditions are satisfied. The risk is heightened as you are a hands-on investor, with significant experience in actively managing your portfolio.

In order to reduce the risk of the PPB anti-avoidance legislation applying, you would need to be comfortable in stepping back and becoming a passive investor.

The legislation taxing PPBs in ITTOIA 2005, ss 515–526 applies an annual income tax charge on the bonds for each policy year except for the final year.

We set out below HMRC guidance on PPBs:

PTM3610 - Personal portfolio bonds: meaning: bonds made on or after 17 March 1998: ITTOIA05/S516

The following definition applies to personal portfolio bonds (PPBs) made on or after 17 March 1998. ...

A PPB is a life insurance policy, life annuity contract, or capital redemption policy under whose terms: some or all of the benefits are determined by reference to:

- fluctuations in, or in an index of, the value of property of any description, or

- the value of, or the income of, property of any description

and

the terms of the policy or contract permit the selection of the index, or some or all of the property, by:

- the holder of the policy or contract

....

except where the terms of the policy or contract only permit the selection of certain narrowly-defined property or indices, listed in IPTM3630[gov.uk] and IPTM3640[gov.uk], to determine the benefits.

Ability to select property

The following is an extract from HMRC's Manual:

IPTM7730 - Personal portfolio bonds (PPB): ability to select property: broker bonds and investment advisers: circumstances where policy may be a PPB

Exceptionally, a policy may be a PPB even where there is a broker or investment adviser involved. The arrangements between the insurer and the adviser or broker, or between the adviser or broker and the policyholder, or in the case of a tripartite agreement among all three of them, could prove material.

The investment objectives of the policyholder in accordance with which the adviser or broker has to act may be so restricted that it is effectively the policyholder that is selecting the property held in the policy.

In this case, the adviser or broker is no more than a conduit or agent through whom the policyholder gives the insurer its instructions.

Avoiding the PPB trap

if you retain a power of selection, over some or all of the property, the 'wrapper' may become a personal portfolio Bond (PPB), which may have very negative tax implications.

This may even apply if control is exercised indirectly, through a restricted investment policy - see IPTM7730 above. HMRC may attempt to apply these rules even if this power is not specified in the terms of the policy, but is de facto exercised by you.

The implication of these provisions is that wrappers, only are potentially of benefit, when a taxpayer is happy to take a hands off approach and leave the management of the portfolio with a discretionary investment manager.

Conclusion

An offshore 'wrapper' may be used, so that income and gains may accrue in the bond and not be subject to taxation on you until a 'chargeable event' occurs.

Not all of the assets you currently hold personally are likely to be suitable, as broadly, 'wrappers' must not hold bespoke assets, to avoid the risk of the PPB or other anti-avoidance applying.

You may withdraw 5% of your initial premium each year without being subject to income tax or capital gains tax. However, if you remit withdrawals to the UK these may be taxable as remittances of offshore income or gains which arose in the period you qualified for the remittance basis.

You must ensure that you do not trigger the PPB rules, by retaining involvement in the selection policy, either actively, or indirectly through the use of a restrictive investment policy condition.

Question 4

Part 1

The UK Controlled Foreign Company (CFC) regime, found in Part 9A of TIOPA 2010 is designed to prevent profit shifting and base erosion by UK-resident companies through low-taxed foreign subsidiaries.

The regime achieves this by attributing certain profits of foreign companies back to the UK parent company, where those profits have been artificially diverted from the UK.

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.

Where a non-UK company is treated as a CFC, its profits may be apportioned to UK corporate shareholders and subject to UK Corporation Tax to the extent they fall within one of several statutory “gateways,” each targeting a specific type of profit.

The CFC regime includes an initial gateway, which acts as a preliminary filter to assess whether any of the main gateways are likely to apply to the CFC’s profits. If no profits pass through the initial gateway, there is no requirement to consider the main gateways further.

If the initial gateway is passed, the regime then applies five main gateways, each targeting specific categories of potentially high-risk profits:

- Profits arising from UK activities
- Non-trading finance profits
- Trading finance profits
- Captive insurance profits
- Solo consolidation waiver profits

However, there are five statutory exemptions available under the UK CFC regime, and if any of these apply in full, the CFC’s profits will be exempt from apportionment. These are summarised as follows:

- Low Profits Exemption – Applies where the CFC’s accounting profits are less than £500,000, of which no more than £50,000 are non-trading income. In such cases, the CFC charge does not apply.
- Excluded Territories Exemption – Available where the CFC is resident in a jurisdiction with a comprehensive double taxation agreement with the UK or is an EEA member state, provided it does not carry out specified higher-risk activities.
- Low Profit Margin Exemption – This exemption applies where the CFC’s accounting profits are no more than 10% of its relevant operating expenditure. It is designed to exclude low-risk, low-value-added activities such as local marketing, back-office services, toll manufacturing, or data processing carried out outside the UK.
- Tax Exemption – Applies where the local tax paid by the CFC is at least 75% of the equivalent UK Corporation Tax that would otherwise have been due, after adjusting for any withholding tax suffered.
- Exempt Period Exemption – Provides a temporary exemption (typically up to 12 months) where the CFC has only recently come under UK control, to allow time for restructuring or compliance planning.

In general, any CFC profits passing through the gateways and not subject to any of the exemptions are apportioned to UK resident companies in proportion to their interest in the CFC. UK resident companies apportioned at least 25% of the total chargeable profits of the CFC will be subject to a CFC charge equivalent to the applicable rate of UK Corporation Tax.

Part 2

Zurich R&D SA:

- Although incorporated in Switzerland, the company is treated as UK-resident under the terms of the UK–Switzerland double tax agreement. As the CFC regime applies only to non-UK resident companies, Zurich R&D SA is not a CFC and no CFC exposure arises.

Eire Trading Ltd:

- Meets the criteria for being a CFC. However, trading profits of below £500,000 mean that the low profits exemption is likely to apply assuming profits are not artificially reduced through avoidance. Therefore, no CFC charge will arise in relation to Eire Trading Ltd’s profits.

Dutchco BV:

- Meets the criteria for being a CFC. The amount of Dutch tax paid should be compared to the notional UK tax payable if the company was UK resident. Then if the former is greater than 75% of the latter, the exemption will apply.

Lux Finco SARL and Cayman Ventures Ltd are both CFCs, because they are controlled by a UK-resident person (Airtrain Ltd).

Part 3

None of the wholly-owned subsidiaries have chargeable profits for CFC purposes for the reasons set out above.

It appears that Lux Finco SARL and Cayman Ventures Ltd have chargeable profits for CFC purposes (through the Chapter 5 gateway). As their profits are fully attributable to UK activities, the full amounts would go through the gateway; the chargeable profits will be £400,000 and £1,600,000 respectively.

UK resident companies are only chargeable companies for CFC purposes if they have at least a 25% interest in the CFC. Therefore, although Lux Finco SARL is a CFC, there will be no CFC charge arising to London Holdco PLC given that London Holdco only holds a 20% shareholding.

There will be a CFC charge arising on London Holdco PLC in relation to £1,600,000 of chargeable profits relating to Cayman Ventures Ltd.

£480,000 of Cayman Ventures Ltd's chargeable profits ($30\% \times £1,600,000$) will be apportioned to London Holdco in proportion to London Holdco's shareholding.

The CFC charge is not Corporation Tax but applies as if it is Corporation Tax. Therefore, the CFC charge arising on London Holdco Plc will be £120,000 ($£480,000 \times 25\%$), 25% being the main rate of Corporation Tax.

PART C

Question 5

Part 1

Section 835B(4) ITA provides that an individual becomes deemed domiciled when they have been UK resident for at least 15 of the 20 years immediately preceding the relevant tax year. As Chloé first became UK resident in 2012/13, she will have been UK resident for 15 years in 2026/27. The split year counts as a full year for these purposes. Chloé will therefore become UK deemed domiciled on 6th April 2027.

If Chloé wished to be eligible for the remittance basis again, the earliest this could be achieved is after 6 years of consecutive non-residence.

The consequences of becoming deemed domiciled are that Chloé will no longer be entitled to the remittance basis for income tax or capital gains tax. Thus from 6th April 2027 she will be liable to tax on an arising basis in respect of her worldwide income and gains.

Therefore Chloé will be subject to income tax on an arising basis on any income (and deemed income) generated on her foreign equity portfolio. She will also be subject to income tax on an arising basis in respect of net rental income received from her holding of foreign commercial property. She will be entitled to a tax credit in respect of foreign taxes paid, to the extent they do not exceed UK tax payable on that income. However, it is a requirement that Chloé reduces foreign taxes by making any applicable claim under a relevant tax treaty.

Chloé will be liable to capital gains tax on an arising basis on any disposals of foreign chargeable assets, with relief for foreign taxes paid where applicable.

The rules governing deemed domicile for inheritance tax contain a significant difference. While, as is the case for income tax and capital gains tax, an individual becomes deemed domiciled when they have been UK resident for at least 15 of the 20 years immediately preceding the relevant tax year, the time they remain deemed domiciled after ceasing to be UK resident is shortened.

Where an individual is deemed domiciled, the individual ceases to be UK deemed domiciled for inheritance tax purposes from the beginning of the individual's fourth consecutive year of non-residence.

From 6th April 2027, Chloé will also be deemed domiciled from an inheritance tax perspective. She will therefore from that date be subject to inheritance tax on her worldwide assets.

Part 2

Where a UK resident and domiciled, (including 'deemed' domiciled,) individual creates an offshore trust, the income and gains arising in that trust are normally assessed on that individual on an arising basis, under UK anti-avoidance legislation. This treatment is avoided where a non-domiciled individual, who like Chloé is not yet 'deemed' domiciled, creates a 'protected settlement'.

'Protected settlements' and 'tainting'

Non-UK resident trusts created ('settled') by UK resident non-domiciliaries, who were not deemed UK domiciled at the time, benefit from 'protected settlement' status. Therefore, provided Chloé creates an offshore trust before 6th April 2027, the trust may benefit from protected settlement status.

The protected settlement regime prevents the taxable attribution of foreign income and gains arising within the trust structure to the settlor. Without this protection, once the settlor has become UK deemed domiciled, income and gains arising in the structure may be assessed on the settlor on an arising basis.

Protected settlement status is lost where the trust is 'tainted'. Broadly a protected settlement becomes tainted where value is provided, directly or indirectly, at trust or underlying entity level, by the settlor.

The attribution rules

Subject to the 'motive defence', the ToAA Code attributes income of a non-UK resident entity to which assets have been transferred, to the UK resident 'transferor'.

Where the person abroad is a non-UK resident trust or a non-UK resident company in which such a trust is a participator, the attribution of income to a UK resident settlor is subject to an exemption for Protected Foreign Source

Income(PFSI). Broadly, this exemption applies to non-UK source income of the person abroad. Where the transferor is deemed domiciled, the exemption only applies if the settlement has not been tainted.

There is corresponding relief under the settlor-interested settlements provisions (ITTOIA 2005, Part 5, Chapter 5: 'the Settlements Code'). Where the Settlements Code applies, the rules attribute trust level income to the settlor. There is no attribution of income that is PFSI under the Settlements Code where the trust qualifies as a protected settlement.

This exemption broadly applies only to non-UK source income. Where the settlor is deemed domiciled, the exemption is available only if the trust has not been tainted.

Under TCGA 1992, s 86 ('Section 86') Gains arising within settlor-interested trusts are also attributed to the settlor. This rule generally applies both to gains realised by underlying non-UK resident companies, as well as to gains realised by the trustees directly. However, Section 86 only applies to a foreign domiciled settlor, where the individual has become deemed domiciled and the trust has been tainted.

From an inheritance tax perspective, provided Chloé settles an offshore trust before she becomes deemed domiciled, the property contained in the trust provided it is foreign situs, will be 'excluded property' and not be subject to UK inheritance tax, even after she becomes UK deemed domiciled. Interests held in UK residential property do not qualify as excluded property.

In summary, if Chloé creates an offshore discretionary trust prior to becoming UK domiciled on 6th April 2027, she could settle on this trust, her foreign equity portfolio, together with several foreign homes, and foreign commercial property. Provided she did not taint this trust by adding value after she becomes deemed domiciled, this trust would continue to provide valuable income tax and capital gains tax advantages, and she would only be subject to UK tax if the trust paid benefits to her. Any benefits paid to her would be taxable regardless of whether or not Chloé remitted these to the UK.

Finally, if Chloé settled foreign property onto an offshore trust prior to becoming deemed domiciled, this would constitute excluded property and not be subject to inheritance tax.

Question 6

Part 1

The 'protected trust' status applying to the Jasper No 1 Trust will end on 1 January 2025. On that date all foreign income may be subject to tax on an arising basis under the Transfer of Assets Abroad legislation or the Settlements code.

Likewise from 1st January 2025 any foreign chargeable gains arising within the structure may be assessed on Conrad on an arising basis.

Any UK source income, e.g. rental income arising on the UK commercial properties would have previously been assessable on Jasper on an arising basis under the settlement Code, with the UK tax liability probably covered by the UK tax paid by the trustees on the income.

Part 2

Ten Year Anniversary Charge at 1 April 2024

Directly held UK commercial property

£8 million @10 years (6%) = £480,000

UK residential property Interest

£5 million @ 7/10 x 6% = £210,000

Part 3

Conrad would have become deemed domiciled on 6th April 2017. From that date Conrad would have been subject to UK inheritance tax on his worldwide assets.

On 1 January 2025, Conrad is treated as acquiring a UK domicile of choice. Conrad would continue to be subject to UK inheritance tax on a worldwide basis.

The Jasper No 1 Trust would continue to constitute 'excluded property' and not be chargeable to IHT to the extent it comprised foreign property. The UK commercial property and UK residential property interest would continue to be subject to UK inheritance tax under the relevant property regime.

As Conrad remains a beneficiary of the trust, property held by the trust, to the extent it does not constitute excluded property, would be potentially within the Gift With Reservation of Benefit rules and may be included within his estate at death.

Question 7

Part 1

The UK transfer pricing rules are contained in Part 4 of TIOPA 2010. The rules generally require companies to apply the arm's length principle to their transactions with connected parties. However, Small and Medium Enterprises (SMEs) are normally exempt from these rules.

A SME is defined as an enterprise with fewer than 250 staff, and an annual turnover of no more than €50m or gross assets of no more than €43m.

Health Solutions Ltd appears to meet the UK SME threshold on a standalone basis. However, the SME limits apply to the group as a whole. The Health Solutions group has turnover and gross assets well above the limits for the SME exemption to apply, meaning that Health Solutions UK Ltd will not qualify for the SME exemption. Given that the group's turnover and assets are above the SME limits, the number of staff employed by the group is irrelevant.

Part 2

Accounting and payroll support services – this appears to be a low-value added service (as defined in the OECD Transfer Pricing Guidelines) so cost-plus a small mark-up appears to be appropriate.

Manufacturing services:

- As per the functional analysis, Health Pvt. Ltd should be characterised as a contract manufacturer and carries limited risk.
- It appears the services provided are not unique, given the functions are similar to independent contract manufacturers.
- Therefore a transactional profit split method may not be appropriate. A CUP method may be more appropriate if appropriate CUTs can be identified. If not, other transfer pricing methods such as cost-plus may be appropriate.

R&D services:

- There are some indications from the functional analysis that a cost-based method may not be appropriate given that Health Solutions Ltd appears to contribute unique and valuable IP in the form of technical knowhow.
- A cost-based method, especially one with a low mark-up may result in the UK being under-rewarded.
- There are also suggestions that Health China LLC may make unique and valuable contributions which may suggest a transactional profit split method could be more appropriate.

Part 3

An Advance Pricing Agreement (APA) is a binding agreement between a taxpayer and a tax authority which determines an appropriate transfer pricing methodology for future controlled transactions over a fixed period.

A unilateral APA involves only one tax authority. It provides UK tax certainty but does not eliminate the risk of double taxation if the counterparty jurisdiction (e.g. India) makes a conflicting adjustment.

A bilateral APA involves two tax authorities, typically under the Mutual Agreement Procedure (MAP) article of the relevant DTA. It provides coordinated agreement between both jurisdictions, reducing the risk of double taxation.

A multilateral APA involves more than two tax authorities and used for complex multinational transactions.

Benefits:

- Provides certainty on pricing of complex or high-value transactions.
- Minimises the risk of future tax audits or disputes.
- Can prevent double taxation when agreed on a bilateral/multilateral basis with other jurisdictions.

Drawbacks:

- APAs can be time-consuming and costly to negotiate.
- They require detailed documentation and full disclosure.

The provision of accounting and payroll services may be considered low risk and it may not be appropriate or cost effective to seek an APA in respect of this transaction.

It may be appropriate for Health Solutions Ltd to consider applying for bilateral APAs in respect of the manufacturing services and R&D services. Following the functional analysis, these transactions may require a change in transfer pricing methodology which is likely to allocate more profits to the UK.

Agreeing a bilateral APA in respect of these transactions would help prevent double taxation in the event that the counterparty jurisdictions (India and China in this case) do not agree with the change in methodology and corresponding decrease in taxable profits in these jurisdictions.

Question 8

Part 1

The CIR rules restrict the interest expenses deductible for UK corporation tax purposes within groups who have a net interest expense over the threshold of £2m.

The rules seek to restrict a group's deductions for interest expense and other financing costs to an amount which is commensurate with its activities taxed in the UK, taking into account how much the group borrows from third parties. Where amounts are disallowed in one accounting period they may be carried forward and can potentially be deducted in a subsequent period.

Groups with a net interest expense above the de minimis of £2m will be subject to a cap on interest deductions under the CIR.

Where a group's net interest expense is greater than its interest capacity in an accounting period, the excess (the 'total disallowed amount') will be disallowed. The interest capacity can be worked out using either the 'fixed ratio' method or the 'group ratio' method, depending on which gives the largest allowance. Under the fixed ratio method, the interest capacity is the lower of:

- 30% of the group's UK taxable earnings before interest, taxes, depreciation, and amortisation (EBITDA); and
- the group's worldwide net interest expense

Any restriction is given effect by allocating the disallowed interest to companies in the group that are within the charge to UK corporation tax and which have a net interest expense in that period.

Amounts that are disallowed under the corporate restriction are carried forward indefinitely for relief as a deduction in a later period in which there is sufficient capacity for the deduction to be made (i.e. a period in which the interest capacity exceeds the groups net interest expense as calculated under the CIR rules).

Part 2

The first part of the statement, "Any interest deductions not disallowed under the CIR regime will be fully deductible for UK Corporation Tax purposes", is largely accurate in principle, but is an oversimplification.

Interest (and other financing costs) are generally deductible for UK Corporation Tax purposes if they meet the usual tax rules (e.g., the "wholly and exclusively" test, transfer pricing, unallowable purpose rules, anti-hybrid rules).

The CIR regime is an additional restriction. If interest expense survives both the normal rules and the CIR limitation, then yes — the remaining deduction is available in full.

However, the statement ignores that interest can still be restricted by other regimes (e.g., unallowable purpose rule, transfer pricing adjustments), not just CIR.

So it's broadly correct, but it gives the impression CIR is the only restriction, which isn't true.

The second part of the statement, "Interest disallowed under the CIR regime can be carried forward and offset against profits in future years", is not accurate.

Disallowed interest under CIR is not lost permanently, but it isn't simply "carried forward against profits."

Instead, disallowed amounts become "interest allowance disallowed amounts" (IADA), which can be carried forward and potentially reactivated in future periods if the group has spare interest capacity under the CIR rules.

The ability to relieve these carried-forward amounts depends on the group's future interest allowance, not just having taxable profits.

So this part of the statement is misleading. You can't simply offset against profits, but require available CIR capacity in later years.

Question 9

To: Group Tax Manager, AI Optima

From: UK Tax Adviser

Subject: Diverted Profits Tax – Potential Exposure in Relation to Irish Sales Structure

The UK's Diverted Profits Tax (DPT) is contained in Part 3 FA 2015. DPT is a standalone UK tax intended to counteract aggressive tax planning by multinational groups involving the artificial diversion of UK profits offshore. It applies at a rate of 31%, which exceeds the UK Corporation Tax rate (currently 25%)

DPT applies in three situations summarised below:

- UK Company with Tax Mismatch Due to Lack of Substance (s.80) - Applies where a UK company enters into arrangements with a related party resulting in a significant UK tax reduction compared to any increase in overseas tax, and the arrangement lacks economic substance.
- Non-UK Company Trading via a UK PE with Lack of Substance (s.81) - Similar to s.80, but applies to non-UK companies trading through a UK PE.
- Non-UK Company Avoiding UK PE - (s.86) - applies where a non-UK company supplies goods, services, or property to UK customers, and activity is carried out in the UK in connection with those supplies. If the arrangements are designed to avoid a UK taxable presence, and either:
 - the main purpose is to avoid UK tax, or
 - a tax mismatch is achieved,

then a DPT charge may arise. Broadly speaking, tax mismatch refers to UK-related profits being taxed at a lower rate abroad.

While there aren't enough facts to say for sure whether AI Optima's UK sales structure will be subject to the DPT, a concern arises under s.86 (PE avoidance), because:

- Optima (Ireland) Ltd earns significant UK revenue;
- It does not have a UK PE (under UK domestic law or the UK-Ireland DTA); and
- The arrangement achieves significant tax savings by routing UK sales through Ireland (12.5% tax rate).

If the Irish entity lacks genuine substance (e.g. decision-making, risk control, and personnel), and the sales activity is effectively carried on in the UK, the UK tax authority may challenge the structure under DPT.

There is a de minimis exemption under s.87 FA 2015: no DPT charge arises under s.86 if UK-related sales are less than £10m and UK-related expenses are less than £1m.

Requirement to notify

There is no requirement to self-assess liability to DPT. However, under s.88 FA 2015, certain companies must notify HMRC if they "reasonably believe" that DPT could apply. This must be made within 3 months of the end of the relevant accounting period.

No notification is required if:

- it is reasonable to conclude that no charge to DPT can arise;
- HMRC have confirmed that the company is not required to notify;
- the company has provided sufficient information to HMRC to inform their decision as to whether to issue a preliminary notice; or
- the company has already notified HMRC (or was not required to notify) for the preceding accounting period and there have been no material changes to the circumstances.

The notification must be made by the affected UK resident or foreign company in writing and must state:

- whether the duty to notify arises as a result of ss 80 or 81 (entities or transactions lacking economic substance) or s.86 (avoidance of a UK permanent establishment (PE));
- the name of the avoided PE in s 86 cases;
- in ss 80 or 81 cases, a description of the material provision (i.e. the transaction(s)) involved, together with the names of the parties concerned; and
- in s.86 cases, whether or not the mismatch condition is met, and if it is, a description of the material provision involved, together with names of the parties concerned.

Failure to notify may lead to penalties (based on “potential lost revenue”), and does not prevent HMRC from issuing a preliminary notice of DPT.

For AI Optima, notification should be considered unless the group is confident that the Irish structure has sufficient commercial substance and that there is no tax avoidance purpose.

A protective notification is often advisable where there is uncertainty, to mitigate the risk of penalties.

Double taxation risks

If a company has paid UK Corporation Tax, or an equivalent foreign tax based on its profits, a credit may be allowed against its Diverted Profits Tax (DPT) liability, or that of another company in respect of the same diverted profits. This relief is available under s100 FA 2015 if it is just and reasonable but no credit is allowed for tax paid after the end of the review period.

However it may well be the case that a foreign tax is paid on diverted profits after the review period has ended meaning no credit is available under s100 FA 2015. This would raise the risk of double taxation as the UK tax authorities take the view that the DPT is not a tax covered by the UK's double taxation treaties.

HMRC considers DPT outside the scope of UK double tax treaties, as it targets avoidance arrangements designed to exploit treaty provisions. Ireland may also deny relief for DPT, potentially seeing it as a non-equivalent tax for treaty purposes.

Furthermore, Ireland may be unlikely to grant relief or deduction for DPT, if the Irish authorities take the view that DPT is not an equivalent foreign tax to Irish Corporation Tax for treaty purposes.

Therefore, there may be limited scope for relieving any double taxation arising from a DPT charge.

Recommendations

Given the risk of DPT and limited treaty protection:

- Conduct a functional analysis of Optima (Ireland) Ltd;
- Confirm whether KPFs and decision-making for UK sales are genuinely located in Ireland;
- Consider OECD-aligned transfer pricing as a possible defence;
- Consider restructuring, such as operating through a UK PE or subsidiary, if exposure is high.