THE ADVANCED DIPLOMA IN INTERNATIONAL TAXATION

June 2019

MODULE 2.09 – UNITED KINGDOM OPTION

SUGGESTED SOLUTIONS

PART A

Question 1

Changes to carried forward corporation tax loss rules

Schedule 4 of Finance (No 2) Act 2017 introduced two major changes to the use of corporation tax losses, both of which are effective from 1 April 2017:

- A relaxation allowing carried forward losses to be used more flexibly (*the relaxation*).
- A restriction on the amount of brought forward losses which can be offset in any one year (*the restriction*).

Under the relaxation, broadly:

- Trade losses can be carried forward against total profits of the company, and not just profits of the same trade.

- Non-trading loan relationship deficits (NTLRDs) can be carried forward against total profits of the company, and not just non-trading profits.

- Certain carried forward losses may be available for group relief, including trading losses, non-trading losses on intangible fixed assets, management expenses, NTLRDs and property business losses.

There are certain conditions that need to be met in each case. Importantly all of these relaxations only apply to losses arising on or after 1 April 2017. Losses arising before this date continue to be subject to the previous rules for relief.

Under the restriction, broadly:

- Brought forward losses can be set off in full up to the level of the company's *deduction allowance*.

- Beyond this, profits can only be relieved by up to 50% using brought forward losses.

The restriction applies to all profits arising on or after 1 April 2017 which are to be relieved using brought forward losses - it does not matter when the losses were incurred.

The deduction allowance for an accounting period is up to £5m, reduced proportionally where that accounting period is less than 12 months. Groups are only entitled to one deduction allowance per group, which can be allocated between group companies as they see fit.

Utilisation of Matilda Ltd and Eleanor Ltd losses

Matilda Ltd has incurred losses both before and after the relaxation was introduced on 1 April 2017. The options available for utilisation of these 'pre-April 2017' and 'post-April 2017' losses will therefore differ.

The trading losses and non-trading loan relationship deficits (NTLRDs) incurred in the year ended 31 March 2017 could be:

- Surrendered as group relief to Richard Ltd for use against that company's profits for the year ended 31 March 2017.

- Set against any other income of Matilda Ltd in the year ended 31 March 2017 (e.g. chargeable gains).

- Carried forward to set against profits of the same trade (for the trading losses) or future non-trading profits (for the NTLRDs) in a future period.

By contrast, the losses incurred in the year ended 31 March 2018 can be:

- Surrendered as group relief to Richard Ltd for use against that company's profits for the year ended 31 March 2018.

- Set against any other income of Matilda Ltd in the year ended 31 March 2018 (e.g. chargeable gains).

- Carried forward against any future profits of Matilda Ltd.

- Carried forward and surrendered as group relief in a future period.

Matilda Ltd will have to track its pre and post April 2017 losses separately due to the different options available for set off.

Eleanor Ltd only has pre-April 2017 carried forward trading losses. These will not benefit from the relaxation, meaning the company's only options for relief are to:

- Surrender the loss to Richard Ltd as group relief in the year they are incurred.
- Set off against other income of Eleanor Ltd in the current year.
- Carry forward against profits of the same trade.

The restriction will have to be considered in respect of any carried forward losses which are set against profits of the group arising from 1 April 2017. The restriction will therefore not affect the year ended 31 March 2017, but could apply in the year ended 31 March 2018. This is regardless of whether the losses set off in the year ended 31 March 2018 arose before or after 1 April 2017.

For each the year ended 31 March 2018 the UK resident group companies will have a single deductions allowance of £5m, which can be shared between them as they see fit. For each company, only 50% of any profits in excess of their share of the deductions allowance can be offset by brought forward losses.

The group should nominate a company as being responsible for allocating the £5m deductions allowance among the group companies. That nominated company then has to submit a group allowance allocation statement for each accounting period. This statement must contain a number of details (set out in s269ZV CTA 2010) including the total group deduction allowance available and how this is allocated between the various companies in the group.

Each individual company must also state their allocated deduction allowance figure in their corporation tax return.

<u>Losses of foreign subsidiaries and permanent establishment</u>

Looking first at the subsidiaries, group relief allows losses to be surrendered from loss making companies to profit making companies within a group where one owns at least 75% of the other, or the same parent company owns at least 75% of each of them. Generally, losses can only be surrendered and claimed by UK resident companies, unless they have a UK permanent establishment.

However, following the decision of the ECJ in *Marks and Spencer plc*, the group relief rules were amended to allow losses in EEA subsidiaries to be surrendered to UK group companies in limited scenarios.

There is therefore no possibility for the losses of the Indian subsidiary to be claimed as group relief in the UK (as India is not an EEA member), but there may be scope for the losses of the French subsidiary to be claimed (as France is an EEA member) provided the conditions are met.

These conditions are set out in Chapter 3, Part 5 of CTA 2010. They include:

- The equivalence condition (s114): the overseas loss must be of a kind that would be available for surrender as group relief by a UK resident company.
- The EEA loss condition (s115): the loss must be a loss for overseas tax purposes, and not be attributable to a UK permanent establishment.
- The qualifying loss conditions (s117): broadly, there must be no possibility for relief in current, past or future periods in the EEA territory in which the loss making company is resident.
- The precedence condition (s121): relief must not be available for the losses in the territory of residence of an intermediate company in the ownership chain.

These conditions, in particular the qualifying loss condition and precedence condition greatly restrict the ability to claim group relief from an EEA subsidiary, and mean the relief is only likely to apply in extremely restricted circumstances. However, a claim may be possible if, following the fact pattern in *Marks & Spencer*, the French subsidiary has ceased to trade and been dissolved by the end of the period (meaning it is impossible to carry forward the loss) and there are no other profits which can be offset in France.

It should be noted that once the UK leaves the European Union then this legislation may no longer apply.

Turning to the permanent establishment (PE), normally UK companies are taxed on the profits of their overseas PEs, and are also able to relieve any losses they incur. Maude plc should therefore be entitled to set off the losses incurred by its Italian PE against its other profits as they arise for UK corporation tax purposes. It may also be possible to surrender these losses as group relief.

However, if an election is made under s s18A CTA 2009 then the losses of the Italian permanent establishment will not be available for offset in the UK.

If an election under s18A is made in the future, and the Italian permanent establishment losses have been set off against UK profits in any of the preceding six years, then there may be a delay in the exemption of PE profits from UK corporation tax due to the operation of the transitional rules. Broadly, the exemption will only take effect until the losses relieved in that six-year period have been 'matched' by future profits of the PE.

Question 2

Taxation of distributions received from the TP 1969 Trust

In 2015/16 you received a trust distribution of approximately 10 million USD on the death of your aunt, from the TP 1969 Trust, (1969 trust) a US trust. Under the terms of the 1969 trust your late aunt was entitled to the income of that trust as it arose.

Historically all US taxes have been paid on the trust's income and gains.

The distribution is subject to UK tax in the 2015/16 tax year.

As previously explained the UK rules treat any distribution as income to the extent income arose in the trust and has not been distributed. Given that the trust was taxed on income and also that your aunt was entitled to the trust income as it arose, then provided this income was distributed to your aunt, the trust is unlikely to have contained undistributed income at the date of your aunt's death.

However, UK rules deem certain gains arising on disposal to be income. These rules apply to non-reporting funds (OIGs), and it is possible that over the years your aunt's trust held certain of these in its investment portfolio. If this is the case, although all actual income is likely to have been distributed, it is possible for UK tax purposes that an element of your distribution will be treated to be income.

To the extent the distribution is not treated as income, it will be treated to be capital gain, on the assumption that the trust accumulated gains over the period.

Although capital gains are normally charged at 20%, a surcharge is applied where capital gains arise in an offshore trust and are not distributed. These gains could be assessed at rates of up to 32% where they have been allowed to accumulate in the trust.

The further charge in receipt of capital payments (known as the supplementary charge) is calculated as 10% 'interest' per year for each of the years between the gains arising and the capital distribution (up to a maximum of six years). Where the capital gains tax rate is 20%, this means an effective maximum tax rate on capital distributions of 32% (20% tax plus the supplementary charge at 2% per year for six years).

The practical problem is that it may be very difficult to undertake an accurate computational exercise given the very long time the trust has been in existence. For UK tax purposes the exercise would commence from 17 March 1998.

If recent gains can be identified it might be possible to charge this element at the 20% rate.

The outcome will depend on the accounting records maintained by the trustees. In a worst case scenario, it may be necessary to apply a 32% rate to the full amount distributed.

US tax paid

On the assumption that all the trust income has been distributed, then you will avoid paying UK income tax at rates of up to 45% on the distribution you received. Any US income taxes paid will not therefore be available, since by definition there would be no liability to UK income tax. Regarding credit for US taxes paid on capital gains arising in the trust, I have spoken to a colleague specialising in US issues who has suggested it may be difficult to obtain relief as the trust rather than you personally paid the US tax. Unfortunately, the UK is very restrictive when providing relief for foreign tax incurred by offshore trusts.

Election for the Remittance Basis

In the first 7 tax years of UK residence, making a remittance basis claim simply involves making an election on your tax return. After 7 years there is a charge:

- £30,000 for non-domiciled individuals who have been resident in the UK for at least 7 of the previous 9 tax years immediately before the relevant tax year
- £60,000 for non-domiciled individuals who have been resident in the UK for at least 12 of the previous 14 tax years immediately before the relevant tax year
- A £90,000 charge applies only for the years 2015/16 and 2016/17 if you're UK resident in at least 17 of the preceding 20 UK tax years.

Where an individual claims the remittance basis they cannot claim their income tax and CGT allowances.

To make a valid election, where the remittance basis charge applies, the remittance basis user must "nominate" foreign income or gains in their tax return. The nominated income or gains are taxed at whatever tax rate is required to generate the applicable RBC.

To avoid the tax consequences of the distribution being assessed on an arising basis, it may be possible to elect for the remittance basis to apply for 2015/16. I understand that you have been UK resident since the late 1980s so that you would fall within the 17 out of 20 year category. A £90,000 one off charge would therefore apply.

If you elected this treatment, then it would not be necessary to undertake the computational exercise outlined above. The downside would be that in addition to paying the £90,000 remittance basis charge, that the distribution would be taxable if you ever decided to make remittances from it to the UK.

Finally the remittance basis claim is normal made via a taxpayer's self assessment tax return. However, it is possible to make an election outside the return, subject to the normal 4 year time-limit.

<u>Rebasing</u>

It may be possible to rebase your 2012 inheritance to its market value at 5th April 2017. As you became deemed domiciled on 6 April 2017.

As you have become deemed domiciled (under condition B of s835BA ITA2007) on 6 April 2017 you will be entitled to rebase certain foreign assets to their market value at 5 April 2017 for the purposes of calculating the gain or loss on the disposal of that asset. This is subject to a number of conditions.

Personal conditions:

1. You have claimed the remittance basis <u>and</u> paid the remittance basis charge Section s809H in relation to 2016/17 or an earlier year. You will meet this condition if you claim the remittance basis and pay the remittance basis charge for 2015/16;

2. You are UK tax resident for 2017/18;

3. For 2017/18 you are deemed domiciled under the 15 out of 20 rule and you have not become domiciled in the UK;

4. You were not born in the UK with a domicile of origin in the UK; and

5. For the year of disposal you must not be domiciled in the UK at any time in the year under common law.

For the assets held in your inherited portfolio:

- The asset must be held on 5/4/17;
- The disposal is made on or after 6/4/17; and
- The asset was not situated in the UK at any time in the period from 16/3/16 (or acquisition if later) to 5/4/17.

Additional points

On disposal of an asset an election can be made for the rebasing not to apply to that asset.

An election is irrevocable and can be made within normal time limits.

I would confirm you appear to meet all the necessary conditions for rebasing to apply. However, if any income from the portfolio has been reinvested, and for example shares acquired, the relief will update the value of the shares to their value at 6th April 2017, however any income used to acquire these shares would be subject to UK tax if the sale proceeds were remitted to the UK.

Shares in an Italian investment company

Under Article 13(4) of the UK-Italy tax treaty, gains arising on property other than:

- Gains arising on the disposal of immovable property (real estate such as land or buildings);

- Certain gains arising on the disposal of ships or aircraft; and

- Certain gains arising on the disposal of moveable property forming part of the business property of a permanent establishment;

Are taxable only in the state in which the alienator is resident. As Fiona is tax resident in the UK, the disposal of shares in an Italian investment company should only be subject to tax in the UK. It is necessary for Fiona to make a claim that treaty relief applies.

An Italian office building

Under Article 13(1) of the UK-Italy tax treaty, gains arising on the alienation of immovable property, e.g. an office building may be taxed in both the state of residence of the alienator (UK) and also the state in which that property is situated (Italy).

Under the UK-Italy treaty, relief for any Italian capital gains tax paid is available as a deduction from the UK capital gains tax payable on the disposal. Alternatively unilateral relief is available, either by way of a deduction from UK Capital Gains tax payable, or alternatively as a deduction against disposal proceeds (The deduction against proceeds might be preferable if this produced, or increased a loss).

Relief for Italian tax is limited to the UK capital gains tax payable on the disposal.

PART B

Question 3

Dear Derek

Many thanks for your email. It sounds like you have some exciting plans underway.

I have set out below some initial thoughts on whether the UK Controlled Foreign Company (CFC) rules could apply following the Nonagon acquisition, and also gone on to set out briefly how the Singapore LLC investment could be viewed from a UK tax perspective. It should be noted that these are based on the limited information in your email, and a more detailed study will be needed once you have more details to hand.

CFC rules

It appears likely that the German manufacturer, IP Holdco and the Irish finance company ('Finco') mentioned in your email will all be CFCs following the acquisition as:

- it is assumed that none of them are UK resident, and
- it is assumed that they will all be controlled by the Octagon Group, which is UK resident.

As a result, unless the companies can qualify for an exemption or none of their profits pass through one of the CFC gateways, their profits will be apportioned to the first UK parent in the ownership chain. This is likely to be the Octagon Group company which makes the acquisition of Nonagon, unless the Nonagon Group already contains a UK resident company which holds a controlling interest in any of the subsidiaries. You should confirm this point during your due diligence.

As the CFC entity level exemptions exempt the entire profits of a qualifying subsidiary, it is simplest to consider whether any of these apply first, before going on to consider the gateway provisions.

The exempt period exemption (s371JA) is a time limited exemption where a CFC comes under UK control for the first time. This exemption could apply to all of the Nonagon Group companies provided they have not previously been held by a UK company. However, the exemption only applies for twelve months, and requires the CFC to be exempt in the following accounting period also. It is therefore worthwhile considering whether any other exemptions may be available to the companies, as if not it may be necessary to carry out some reorganisation after the acquisition to prevent a CFC charge arising.

The low profits exemption (s371LA) may be available to the CFCs if their accounting or taxable profits do not exceed £50,000, or do not exceed £500,000 with a non-trading element of less than £50,000. It is not possible from the information provided to say whether any of the companies in your email would qualify for the low profits or low profit margin exemptions. I have therefore assumed they do not apply in the analysis below, though this should of course be checked and confirmed.

Looking at the German manufacturer, it appears likely that it will qualify for at least one of the entity level exemptions. If its local tax paid in Germany is at least 75% of the tax that would have been payable in the UK then it may qualify for the tax exemption (s371NA) - as corporate tax rates are generally higher in Germany than the UK this is likely to be the case, but should be confirmed by carrying out further analysis.

Even if the German manufacturer does not qualify for the tax exemption, then it should qualify for the excluded territories exemption (s371KA). Germany is included on the list of excluded territories found in SI 2012/3024, and also qualifies for the relaxed 'modified excluded territories exemption' which means the only other requirement is that the company's profits are actually taxed in Germany.

IP Holdco is unlikely to qualify for any of the entity level exemptions. The Cayman Islands are not included on the list of excluded territories, and given the low level of tax payable in that country it is unlikely that the tax exemption will be met. This should however be confirmed once you have further information.

It will therefore be necessary to look at the gateway conditions to see if they can exempt any of the company's income streams.

For IP Holdco, the Chapter 4 Gateway is likely to be the most relevant. S371CA says that, broadly, this Gateway will not apply (and therefore there will be no apportionment) if any of conditions A to D are met:

- Condition A - IP Holdco does not hold assets or bear risks under arrangements where the main purpose, or one of the main purposes, is to reduce UK tax.

- Condition B - IP Holdco does not have any UK managed assets or bear any UK managed risks.

- Condition C – if any UK managed assets or risks were to cease to be UK managed, IP Holdco's business would still be commercially effective.

- Condition D – IP Holdco's profits consist only of non-trading finance profits and/or property business profits.

Condition D will not be met by IP Holdco. However, based on the exact facts any of Conditions A to C could be met, particularly if Nonagon does not have any UK operations. You should confirm this position during your due diligence. This will involve looking closely at exactly what activity IP Holdco undertakes and the risks and assets it holds.

Even if one or more of Conditions A to C are met, so that no CFC apportionment arises in respect of IP Holdco at first, it may be that these conditions are not met in future if Octagon Group increases its involvement in the IP Holdco.

If none of Conditions A to D are met (either now or in the future), it will be necessary to go on to consider whether the Chapter 4 Gateway can apply to exempt any of the profits of IP Holdco. A key consideration here will be to identify the significant people functions (SPFs) which are relevant to the assets held and risks borne by IP Holdco, and determine to what extent these are carried out in the UK (either by IP Holdco or a related party). The profits which attributable to those UK SPFs will then be apportioned to the UK under the CFC rules, subject to some minor exclusions. In practice, SPFs represent active decision making or strategic oversight, rather than day to day activities.

It may be that, given the limited number of staff IP Holdco has, SPFs could be located outside of the Cayman Islands. It will be necessary to confirm going forwards whether this will be in the UK (in which case an apportionment may arise) or outside the UK (in which case an apportionment should not arise).

Finco is also unlikely to qualify for any of the entity level exemptions. Ireland is not included in the list of excluded territories, and given the low rate of corporation tax applying in Ireland the tax exemption may not apply either. The availability of the tax exemption may however be more likely for an Irish company than one based in the Cayman Islands, so this point is certainly worth confirming.

It will therefore likely be necessary to look at the gateway conditions for Finco also. However, on the understanding that Finco will only have non-trading finance profits it will be a different gateway - the Chapter 5 gateway - which is relevant.

Profits of Finco will pass through this gateway if they derive from any of the following:

- Assets and risks in relation to which the Significant People Functions (SPFs) are carried out in the UK.
- Capital investment from the UK.
- Loans made in lieu of paying dividends.
- UK finance leases.

It will therefore be necessary to determine, initially, whether any of these conditions are met. If Finco has not previously been controlled by a UK company then it is possible that none of them will be met at present, in which case no CFC charge should arise. However, if going forwards the UK based Octagon Group will be investing in the capital of Finco, or become involved in its activities (such as by installing UK based directors) then it is possible that this condition will be met in future.

If the profits of Finco were to pass through the Chapter 5 Gateway in future then it may be possible to qualify for partial exemption under Chapter 9, which would exempt 75% of Finco's profits from 'qualifying loan relationships'.

Finco's loan relationships will be qualifying loan relationship if they are made to other group companies, other than UK resident group members or UK permanent establishments.

In order to qualify for partial exemption, Finco must have premises in Ireland from which it carries on its financing business.

From 1 January 2019, a new restriction was introduced to the partial exemption rules to reflect the requirements of the EU Anti-Tax Avoidance Directive (ATAD). This states that profits are only qualifying loan relationship profits (and therefore eligible for partial exemption) if they arise from capital investment from the UK. As a result, if the profits of Finco fall within the Chapter 5 gateway because the SPFs are carried out in the UK they will not be eligible for partial exemption from 1 January 2019.

The European Commission recently concluded an investigation into whether the partial exemption regime is unlawful State Aid. This broadly concluded that allowing profits connected with UK SPFs to qualify for partial exemption was illegal State Aid, but not where those SPFs are located outside the UK. This decision may prevent Finco from claiming the partial exemption before 1 January 2019 where profits are connected to UK SPFs.

S.371IB does provide a further exemption for up to 100% of non-trading finance profits if loans are funded out of 'qualifying resources'. This exemption is very narrow in focus, and generally only applies where a loan is funded from profits generated in the borrower's territory. It is therefore unlikely to be available to Finco in the long term, but could be considered in the short term.

<u>Singapore LLP investment</u>

The UK tax treatment of the investment will depend upon whether the Singapore LLP is classed as either 'opaque' or 'transparent'.

If the LLP is opaque then the Octagon Group will be taxed on its profits when they are distributed to it. However, if the LLP is transparent, any profits or gains will be taxable in the hands of the Octagon Group as they arise, with double taxation relief potentially available.

How to determine whether an entity is opaque or transparent is not set out in legislation, and instead we have to look to case law and HMRC guidance.

HMRC's guidance does contain a list of entities where HMRC have a view on whether they are transparent or opaque, but this does not include a Singapore LLP.

A key case in entity classification is *Memec plc v CIR*. This case identified a series of factors which need to be considered, which are also set out in HMRC's guidance. These include:

1. Does the foreign entity have a separate legal existence from those investing in it?

2. Does it issue share capital or something else which serves the same function?

3. Is the entity's business carried on by the entity itself, or jointly by the persons who have an interest in it?

4. Are the persons with an interest in the entity entitled to a share in its profits as they arise, or does the amount of profits to which they are entitled depend upon a decision of the entity or its members to make a distribution?

5. Who is responsible for debts incurred as a result of carrying on the entity's business?

6. Do the assets used for carrying on the business belong to the entity or to those with an interest in it?

To decide on the status of the LLP each of the above questions needs to be considered in detail and weighed up. However, to date HMRC have always placed more weight on factors 3 and 4.

I hope the above is helpful as a starting point in your considerations. When you have further information on the acquisition and investment we can firm up our conclusions further.

In the meantime, please let me know if you have any questions or would like to discuss.

Kind regards

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Question 4

Deemed Domiciled

Under the Finance (No. 2) Act 2017, a taxpayer is deemed domiciled from 6 April 2017 where they have been UK resident for more than 15 out of the previous 20 tax years. You satisfied this condition as at 6th April 2017. The main effect of being deemed UK domiciled is that from 6 April 2017 you are no longer eligible for the remittance basis and thus are subject to worldwide taxation on an arising basis.

RK Trust

If the RK Trust is a 'protected settlement' then you will not be assessed to tax on the income or gains arising in the structure. In order to qualify as a 'protected settlement' the main condition is that the trust was created before you became deemed domiciled and that you do not make any further additions to the trust after you have become deemed domiciled.

An addition to the trust would include gifting property to the trust or making property available to the trust on favourable terms, e.g. granting the trustees an interest free loan.

If the RK Trust qualifies as a protected settlement you will be taxable on an arising basis in respect of any distributions or benefits received from the trust. This is very different to the position prior to 6 April 2017 when distributions and benefits received from the trust would only be taxable if brought to, or enjoyed in the UK.

If the RK Trust becomes tainted, e.g., because you add property after 6 April 2017 it will lose its protected trust status. The trust would also become unprotected if you became actually UK domiciled, by acquiring a domicile of choice in the UK. An individual acquires a domicile of choice in the UK, if they physically live in the UK, and have the intention to reside here permanently or indefinitely.

If the RK Trust lost its 'protected trust' status, the income and gains arising in the trust would be taxable on you as if you were UK domiciled on an arising basis, i.e. section 624 ITA 2007, and section 720 ITA 2007 et seq. and section 86 TCGA 1992, would apply.

Directly held assets

A deemed domiciled taxpayer is assessed to tax on an arising basis on their foreign income and chargeable gains. You will therefore be liable to tax on an arising basis, in respect of dividends received from your 10% shareholding in EPA (Bahamas) Ltd and any other foreign income and gains arising from directly held assets even if you do not bring these to the UK. Prior to 6 April 2017 you would only have been taxed on your foreign income and gains to the extent you remitted these to the UK.

You may be able to benefit from a tax free uplift of the value of any directly held overseas asset to their value at 5 April 2017 as you became deemed domiciled under the Finance (No. 2) Act 2017 provisions on 6 April 2017. To qualify for this 'transitional' relief certain additional conditions must be satisfied, including having paid the remittance basis charge, on at least one occasion.

Inheritance tax

You created the RK Trust in January 2010 at a time when you had been UK resident for 15 years. Under the old rules an individual who was UK resident for 17 out of 20 tax years was deemed domiciled for inheritance tax purposes and subject to inheritance tax on both their UK and foreign situs assets. As you had not yet satisfied that condition you were not yet deemed domiciled for inheritance tax purposes at the date you created the RK Trust, so that this trust is an excluded property trust and not subject to UK inheritance tax.

Before 6 April 2017 a non-domiciled taxpayer became deemed UK domiciled for inheritance tax if they were resident in the UK for 17 of the 20 years of assessment ending with the year in which the relevant time fell. Under this rule you became UK deemed domiciled for inheritance tax in 11/12 when you had been UK tax resident in 17 of the last 20 years. You therefore became subject to UK inheritance tax on your worldwide directly held assets from 6 April 2011. Thus from that date your shareholding in EPA (Bahamas) Ltd and foreign art collection would both fall within your chargeable estate at death.

Special rules were introduced effective 6 April 2017, which bring interests held in UK residential property held through foreign incorporated companies within the charge to inheritance tax.

Leaving the UK

I set out below the rules concerning leaving the UK to become non-resident. These rules are contained in the Statutory Residence Test.

Statutory residence test (SRT) – the basic rule

You will be resident in the UK for a tax year and at all times in that tax year (although the effect of this rule is relaxed under split year treatment), if you do not meet any of the automatic overseas tests and:

- you meet one of the automatic UK tests, or
- the sufficient ties test.

Therefore to be non-UK resident you must ensure either you meet one of the automatic overseas tests, or you do not fall to be UK resident under either:

- the automatic UK tests; or
- the sufficient ties tests.

These tests are explained in detail below.

To determine your residence status under the SRT:

Step 1: Consider whether you spent 183 days in the UK in that tax year. If you did, you will be resident in the UK. If not:

Step 2: Consider the three automatic overseas tests. If you meet one of these you are not UK resident. If you did not:

Step 3: Consider if you meet the second and third UK tests. If you meet one of these, you are UK resident. If you did not:

Step 4: Consider the sufficient ties test. If you meet this you are UK resident, if you do not meet this, you are not UK resident.

First automatic overseas test

This test applies if you were resident in the UK for one or more of the three tax years preceding the tax year, and you spend fewer than 16 days in the UK in the tax year. As you intend to spend more than 16 days in the UK you will not meet this test.

Second automatic overseas test

You were resident in the UK for none of the three tax years preceding the tax year, and you spend fewer than 46 days in the UK in the tax year. Clearly for the first 3 complete tax years of being non-UK resident you cannot meet this test as you were resident in the UK for the 3 preceding years.

<u>Third automatic overseas test</u>

You work full-time overseas (FTWA) over the tax year, without any significant breaks during the tax year from overseas work, and:

- you spend fewer than 91 days in the UK in the tax year,
- the number of days in the tax year on which you work for more than three hours in the UK is less than 31.

As you are retired and have no intention of taking up full-time employment this test clearly will not be satisfied.

<u>Analysis</u>

You do not satisfy the conditions of any of the automatic overseas tests.

As the three automatic overseas tests will not apply, we next need to consider the automatic UK residence tests.

<u>First automatic UK test</u>

You spend 183 days or more in the UK in the tax year. As you intend to spend substantially less than 183 days in the UK each tax year, this test should not be met.

<u>Second automatic UK test</u>

The second automatic UK test is relevant if you have or had a home in the UK during all or part of the tax year. For these purposes it does not matter whether the property is rented or owned outright. On the assumption that you wish to retain your UK home, you must ensure you do not meet the conditions necessary for this test to be met.

The legislation provides that you will meet this test:

1. If there is at least one period of 91 consecutive days, at least 30 days of which fall in the tax year, when you have a home in the UK in which you spend a sufficient amount of time, and

2. Either you have no overseas home, or have an overseas home or homes in each of which you spend no more than a permitted amount of time.

You should consider each of your homes separately to see if you meet the test.

What is a sufficient amount of time?

You spend a sufficient amount of time in a UK home if, during the tax year, you are present in that home on at least 30 days.

What is a permitted amount of time?

You spend no more than a permitted amount of time in an overseas home if, during the tax year, you are present in that home on fewer than 30 days.

The sufficient and permitted amounts of time tests operate in respect of the full tax year. The days when you are present in the home do not need to fall within the 91-day period, but they must fall within the tax year.

<u>Analysis</u>

You are very likely to meet Part A of this test since you will spend more than 30 days in your UK home each tax year.

It will therefore be necessary to fail Part B, given you have homes in Switzerland, France and Italy, you need to ensure that for at least one of these homes you spend more than 30 days each tax year. We would recommend you ensure you spend more than 30 days in a specific foreign home, e.g. your Italian home.

In order to ensure you do not meet the UK Home test it is necessary to demonstrate that you have a foreign home, rather than merely overseas accommodation available to you. The concept of home in this context possesses many attributes. This is discussed below.

HMRC emphasised the distinction between mere holiday accommodation and a home.

In many circumstances an individual owning a chalet in Switzerland may arguably occupy the property as holiday accommodation rather than 'home' if they simply use it during their annual ski holidays. In this context home should be seen as a property from which a person lives their day to day life out of. Most individuals would only have one property which would meet the characteristics required, however, where an individual spends sufficient time, etc. in more than one property for a settled purpose it is possible that multiple properties will qualify as homes in relation to that individual.

Key points:

- For the purposes of this test you are present at your home on any day that you have been present in it in person, no matter how short a period you were there. It is not necessary to be there at midnight in order for the day to be counted.
- The 30-day presence rules operate on each home separately and independently.

Conclusion

Provided you continue to use your Italian villa as your home and spend more than 30 days a tax year there you will not be UK resident under the second automatic UK test.

Third automatic UK test

You work full-time in the UK for any period of 365 days, with no significant break from UK work and:

- all or part of that 365-day period falls within the tax year

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

- at least one day which is both in the 365-day period and in the tax year is a day on which you do more than three hours of work in the UK.

Clearly you will not meet this test as you no longer work.

Further Analysis

Reviewing the above you should fail all the automatic UK residence tests so that your residence status will be determined by the sufficient ties tests considered below.

There are five ties which apply to leavers these are set out below:

1. Accommodation

You have an accommodation tie for a tax year if you have a place to live in the UK and:

- It is available to you for a continuous period of 91 days or more during that year, and you spend one or more nights there during that year.

- As you wish to retain your UK home you will have accommodation in the UK which you will retain. This counts as one tie.

2. Family

Isabella intends to become non-UK resident and perhaps become Italian resident. You have no children under the age of 18. In these circumstances you will not have a family tie.

To ensure that this is the case she should limit the time she spends in the UK to less than 90 days.

3. 90 day tie

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

4. Work tie

This condition is triggered by reference to a 40-day threshold. For these purposes, a person works in the UK if they do more than three hours work in the UK. You are unlikely to meet this test as you have retired and no longer undertake activities likely to constitute work.

5. Country tie

A country tie arises if you spend more time in the UK than any other specific country during the tax year.

I estimate you are likely to have two ties. Your position will be determined by reference to the leaver provisions, i.e. those taxpayers who have been UK resident in at least one of the last three tax years This will mean you would only be able to remain in the UK at most 90 days.

What counts as a UK day?

You are considered to have spent a day in the UK if you are here at the end of the day (midnight). This is subject to:

- the deeming rule which will count certain days even though you were not here at midnight; and

- transit days (time spent in the UK due to exceptional circumstances - those days may not count towards the total day count for certain parts of the SRT).

<u>The deeming rule</u>

A number of the SRT tests require you to count the number of days that you spend in the UK. Days you are present in the UK at the end of the day count as days spent in the UK.

As explained above, if you are not present in the UK at the end of the day that day will not count as a day spent in the UK. This is subject to the deeming rule.

The deeming rule applies to you for a tax year if you have:

- been UK resident in one or more of the preceding three tax years
- at least three <u>UK ties</u> for the tax year
- been present in the UK on more than 30 days without being present at the end of that day (called ‘qualifying days’) in the tax year.

If you meet all these conditions the deeming rule means that, after the first 30 qualifying days, all subsequent qualifying days within the tax year are treated as days that you spent in the UK.

If you meet the deeming rule, for the purposes of counting up the number of days you have spent in the UK, you must aggregate all your days spent - that is:

- those when you were present at the end of the day plus
- any qualifying days over and above the 30-day threshold.

Provided that you only have two ties to the UK the deeming rule will not apply to you.

The sufficient ties test

Analysis

Provided Isabella is not UK resident then you have only two ties with the UK:

- 90 nights previous tax year
- Accommodation tie

You will need to ensure that you spend more nights in another jurisdiction e.g. Italy than the UK. You will also need to ensure you do not work in the UK for more than 3 hours on more than 39 days. For these purposes a day may count even if does not actually count as a day of UK residence.

Monitoring

HMRC have particular success on tax residence cases where they can demonstrate that the facts put forward by the taxpayer are inaccurate, since this may undermine the foundations of the taxpayer's case. In this regard HMRC make the following recommendations:

It is very important that you monitor and record the time you spend in the UK each year, you should maintain a diary which identifies in which jurisdiction you are at midnight on a particular date. This diary should also identify whether you worked on a particular day where you spent time on that day in the UK, and in such cases the time spent on work related activities. It is important that this diary is available to defend your position for at least 20 years.

Further, HMRC suggest that regarding connections to the UK, such as family, accommodation, work or time spent here, you should keep information and records that will allow you to prove:

- *in which countries you have spent your days and midnights, for example:*
    - *travel details;*
    - *booking information; or*
    - *tickets, and boarding cards*

- *when you were present at your home or homes, or other available accommodation:*
    - *how long you owned or rented those homes, for example when you purchased, sold or leased those homes;*
    - *the time your home was unavailable for your use, for example because it was rented out.*

Conclusion

First two years of non-residence

You may become non-UK resident provided:

- You spend more than 30 days in a specific foreign home (e.g. your Italian villa) each year.

- You spend no more than 90 nights in the UK in a tax year.

- Isabella spends no more time in the UK than you do AND spends more than 30 days in a specific foreign home each year.

- You do not work in the UK for more than 3 hours a day on more than 39 occasions.

- You do not spend more time in the UK than in any other specific Jurisdiction, i.e. you spend more time for example in Italy than the UK.

- You must ensure you only have two ties to the UK.

Third year of non-residence

- The 90 day tie will fall away as you will not have spent 90 nights in the UK in either of the previous two tax years.

- You may therefore spend up to 120 nights in the UK in the third year, provided you only have one tie to the UK in that year.

PART C

Question 5

Withholding tax on interest

Under s874 ITA 2007, a UK resident company is required to deduct income tax 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 Finco will exist for over a year, Trapezium Limited will be required to withhold tax on the interest payments it makes.

The tax deducted is income tax (no corporation tax) at the basic rate of 20%. Companies must account for this income tax on a quarterly basis by filing a CT61 return and paying the amounts withheld to HMRC.

The amount of tax to be withheld may be reduced, or removed entirely under the terms of any Double Taxation Agreement (DTA) in place between the lender's and borrower's territory. Alternatively, if both companies are located in EU countries, the EU Interest and Royalties Directive may apply, provided the two companies are 25% associates.

Therefore, depending on the country of residence of Finco, relief may be available under either the relevant DTA or the Interest and Royalties Directive. However, treaty benefits may not be available if any anti-avoidance provisions in the relevant DTA apply.

In order to apply a reduced rate of withholding tax on interest under either a DTA or the Interest and Royalties Directive, Trapezium Limited must obtain clearance from HMRC. Failure to do so can result in interest being payable on the tax which should have been withheld.

Anti-avoidance

Hybrids

The UK anti-hybrids legislation can be found in Part 6A TIOPA 2010, which was introduced by Finance Act 2016 and takes effect from 1 January 2017.

The legislation addresses arrangements using hybrid arrangements that give rise to a tax mismatch, and is based on the OECD's recommendations in relation to BEPS Action 2.

There are two types of tax mismatches:

- Double deductions for the same expense.
- Deduction/non-inclusion cases: where a deduction is given for an expense and the corresponding income isn't fully taxed.

Chapters 3 to 10 set out the various different combinations of hybrid mismatches and arrangements targeted by these rules and the counteraction necessary.

The payment of interest to Finco by Trapezium Limited is likely to fall into Chapter 7 "Hybrid payee deduction/non-inclusion mismatches".

Per s259GA, for that Chapter to apply conditions A to E must be met:

- Condition A: the payment of interest is made under, or in connection with, an arrangement. This condition will be met, as the loan agreement between Trapezium Limited and Finco will be an arrangement.

- Condition B: the payee is a hybrid entity. This condition will be met, as Finco is regarded as transparent in its country of residence, but as a separate taxable person in the US.

- Condition C: the payer or an investor in the payee is within the charge to corporation tax, or the payee is a limited liability partnership. This condition will be met, as Trapezium Limited is within the charge to corporation tax.

- Condition D: it is reasonable to suppose that there is, or will be, a hybrid payee deduction/non-inclusion mismatch in relation to the payment. This condition will be met as it is assumed that Trapezium Limited will deduct 100% of the interest expense it pays, but the interest income will not be taxed in either Finco's country of residence or the US.

- Condition E: the payer is also a hybrid payee, the payer and either the hybrid payee (or an investor in it) are in the same control group, or there is a structured arrangement. This condition will be met, as Trapezium Limited and Finco are in the same group.

It therefore appears that Chapter 7 will apply to the arrangements with Finco. Per s259GC, Trapezium Limited will not be entitled to a deduction for the interest expense to the extent the income in Finco is not taxable.

Diverted Profits Tax (DPT)

The Diverted Profits Tax (DPT) is anti-avoidance legislation which aims to ensure that profits are taxed in the UK which reflect the economic activity carried on there. The DPT legislation can be found in Part 3 of Finance Act 2015.

DPT broadly targets the potential diversion of profits from the UK in the following situations:

- A foreign company seeking to avoid creating a UK permanent establishment (PE) (s86 FA 2015), or

- UK companies (or UK PEs) using arrangements or entities which lack economic substance to exploit tax mismatches (s80 and s81 FA 2015).

Where profits are found to have been diverted, DPT is charged at a rate of 25%.

As Trapezium Ltd is a UK resident company it will be s80 FA 2015 which is relevant. However, s80(1)(e) specifically excludes effective tax mismatches arising from 'excepted loan relationships' from a DPT charge. This includes any loans which produce debits or credits under the UK loan relationship rules.

The loan from Finco is therefore likely to be an excepted loan relationship, meaning that no DPT charge will arise in respect of it.

Unallowable purpose

The unallowable purpose rules are found in s441 – s443 CTA 2009. These deny a tax deduction for interest where a loan has an 'unallowable purpose'.

An 'unallowable purpose' is one which is not amongst the business or other commercial purposes of a company. This specifically includes where the loan relates to a part of the company's activities which are not chargeable to corporation tax, or the main or one of the main purposes of being party to the loan is a tax avoidance purpose.

It will need to be considered what the purpose of Trapezium Limited being a party to the loan relationship is. Even though the main purpose for Trapezium taking out the loan may be to fund its trading activities, if one of the main purposes is to achieve a tax advantage for the group as a whole then HMRC may seek to argue that the unallowable purpose rules apply.

Other limitations

Other provisions which may limit the ability of Trapezium Limited to deduct interest the interest payable to Finco include:

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

Question 6

The ATED rules

The ATED rules are found in Part 3 of Finance Act 2013. They are anti-avoidance provisions which are intended to address the potential tax benefits of holding UK residential property in a corporate structure or ‘envelope’.

Very broadly, the ATED rules will apply where:

- a ‘non-natural person’ (a company, partnership with at least one corporate partner or collective investment scheme) holds a chargeable interest in on one or more UK ‘dwellings’; and

- the value of that interest is more than £500,000.

Where these conditions are met, an annual ATED charge is payable by the company based on the value of the property. There are however certain reliefs and exemptions available which can mean no charge is payable (though there may still be filing requirements).

Looking at the specific properties outlined in the question:

House let to unrelated tenant

As this property is a dwelling and valued at over £500,000 it will fall within the ATED rules if purchased by the company.

However, it should qualify from relief under s133 FA 2013 as it is, or will be, exploited for rents as part of a property rental business. No ATED charge should therefore apply, but a relief declaration return (RDR) will have to be filed in respect of the property.

Office block

This property is not a dwelling, and therefore the ATED rules will not apply.

House let to director

This property is a dwelling and valued at over £500,000, and will therefore fall within the ATED rules if purchased by the company.

In contrast to the house let to an unrelated tenant, this property is unlikely to qualify for relief under s133 FA 2013. For this relief to apply, s133(4) requires the property to be used in a property rental business which is “run on a commercial basis and with a view to a profit”. HMRC are unlikely to accept that renting a property to a connected party for a lower than market rent meets this condition.

An ATED charge will therefore arise on this property, and an ATED return will have to be filed.

House let to director’s son

This property is a dwelling. However, it will not fall within the ATED rules as it is not valued at over £500,000. There will be no requirement to file an ATED return and no ATED charge in respect of this property.

Halls of residence

This property will not be classed a dwelling, and will therefore not fall within the ATED rules. S112(4) of FA 2013 says that any building specified in s116(2) or s116(3) of FA 2003 is not a dwelling for ATED purposes. S116(3) of FA 2003 specifically excludes “a hall of residence for students in further or higher education” from the definition of a ‘dwelling’.

There will therefore be no requirement to file an ATED return and no ATED charge in respect of this property.

Future disposal of properties

Provided the company is not UK resident at the time of disposal, any disposals it makes will not fall under the normal corporation tax on chargeable gains rules. However, a UK tax charge may still arise under the ATED related gains or non-resident capital gains tax (NRCGT) provisions. The ATED related gains rules will apply if the property was subject to an ATED charge at some point during the period of ownership and the disposal consideration exceeds £500,000. The amount of any ATED-related gain or loss depends on the number of days for which the dwelling was subject to an ATED charge – if the property qualified for ATED relief for any period then the gains or losses arising in that period will not be ATED-related. As a result, the disposal of the house let to a third party should not lead to an ATED related gain, provided relief continues to apply for the entire period it is held up to disposal.

ATED related gains are most likely to apply to a future disposal of the house being rented to a director. Assuming that an ATED charge applies throughout ownership, the gain arising will be entirely ATED-related and subject to capital gains tax (not corporation tax) at a rate of 28%. This tax needs to be self-assessed and paid to HMRC by 31 January following the tax year of disposal.

If a property is not subject to ATED related CGT, any gain arising on disposal may be taxable under the NRCGT rules. These apply to non-residents (including companies who are not diversely held) that dispose of residential property interests in the UK.

An NRCGT charge may therefore arise in respect of the house let to an unrelated tenant, the house let to the director's son and the house let to the director (to the extent any part of the ownership period qualifies for ATED relief). The gains subject to NRCGT will be taxed at a rate of 20%, and an NRCGT return must be filed with HMRC within 30 days of the disposal.

The office block and halls of residence are not residential buildings, and therefore will not be subject to NRCGT. The disposal of these properties should therefore, at present, not be subject to UK tax provided the company is not UK resident.

Note: candidates may also be given credit for referring to the Finance Act 2019 changes to the scope of NRCGT and the accompanying repeal of ATED related CGT, though they are not required to do so.

Question 7

The normal mixed fund rules apply (sections 809Q and 809R Income Tax Act 2007).

Section 809Q explains how remittances are to be identified out of mixed funds and 809Q(4) sets out the order that various types of income and gain are treated to be remitted. Apart from in the case of employment income subject to UK tax, the rule is effectively worst in first out.

Where an offshore transfer is made, such as the transfer of £200,000 from the Guernsey bank account to purchase the Spanish property, the transfer is deemed to constitute a pro-rata slice of the mixed fund.

Thus:

200/1000 x 500,000 =	100,000	*2016/17 Capital*
200/1,000 x 50,000 =	10,000	*2015/16 Foreign income*
200/1,000 x 100,000 =	20,000	*2015/16 Foreign capital gain*
200/1,000 x 150,000 =	30,000	*2014/15 Foreign income*
200/1,000 x 200,000 =	40,000	*2013/14 Foreign Income*

Total 200,000

The mixed fund at 6 April 2018 therefore comprises foreign:

16/17 capital (500k-100k) =	400,000
15/16 income (50k-10k) =	40,000
15/16 gain (100k-20k) =	80,000
14/15 income (150k-30k) =	120,000
13/14 income (200k-40k) =	160,000
Total =	800,000

Funds remitted to the UK follow a certain order and are considered on a year by year basis. Remittances are treated as coming from a later tax year first. In general, should a taxpayer make a remittance to the UK, income from the current year is taken to have been remitted before gains in the current year, with capital being remitted after all income and gains have been exhausted. If all the current year's income, gains and capital have been remitted, you then consider the previous year's income, gains and capital and so on.

Thus, if you remit £450,000 on 6 April 2019, this will be deemed to be comprised of £400,000 capital being the capital paid into the account in 2016/17 after adjustment for the offshore transfer made in 2017/18. The balance of £50,000 will be deemed to be £40,000 untaxed income and £10,000 untaxed gain, again after respective adjustments for the offshore transfer have been made.

Cleansing

It may be possible for you to cleanse your mixed fund account so that your funds are segregated into 3 accounts, i.e. a foreign income account, a foreign capital gains account and a foreign capital account. To do this you would have to create 2 new offshore accounts and transfer £400,000 capital into new account A, and £80,000 foreign gain into new account B. What would remain in the existing mixed fund account would therefore be £320,000 foreign income. These transfers would need to be made by 5th April 2019 and nominations also made by that date.

I set out below the main conditions.

From 6 April 2017 to cleanse a mixed fund account a taxpayer must:

- nominate the transfer;
- the transfer must be made between 6 April 2017 and 5 April 2019;
- only cleanse money;

- transfers must be made from one overseas account to another;
- the amount must be specified for each category;
- only nominate a transfer from account A to account B once;
- have claimed the remittance basis at least once in the years 6 April 2008 to 5 April 2017;
- not over nominate; and
- identify the category of fund

A taxpayer must nominate each transfer of income, gains and capital to be cleansed and:

- keep records of each nomination; and
- make the nomination between 6 April 2017 to 5 April 2019.

Where nominated transfers exceed the amount of specified income held in the mixed fund account immediately before the transfer then the nomination fails and the normal mixed fund rules will apply.

Question 8

To: Board of Directors, Japanese Group
From: A N ADIT
Subject: Proposed acquisition

We understand that your group is looking to acquire a number of subsidiaries in the UK and Europe, and will be setting up a new UK incorporated company – UK Acquisitions Limited ('UAL') to make the acquisitions.

This report highlights some of the UK tax issues that need to be considered in connection with this proposed acquisition.

Tax residence of UAL

It is important to consider the residency status of UAL as, if a company is UK resident, corporation tax will be chargeable on its worldwide profits.

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

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

If UAL is incorporated in the UK then it will meet the first of these conditions, and be UK resident under domestic law regardless of where its central management and control are located.

However, the final residence position will depend upon whether UAL is also deemed to be tax resident in France. If it is, then the residency of the company will need to be determined under the terms of the UK-France tax treaty.

This treaty includes a 'tie-breaker' article, which states that, if a company is resident in both the UK and France under their domestic law, it will be resident only in the country where its place of effective management is located. The place of effective management it will generally be where the day to day activities of the head office are located.

To confirm the residency status of UAL it will be necessary to establish whether the company could be treated as French resident under French domestic law and, if it is, where its place of effective management will be located.

In the rest of this report we have assumed that UAL is UK tax resident.

Stamp duty

UK stamp duty is charged on instruments that transfer on sale a beneficial interest in stock or marketable securities. It applies to:

- Instruments executed in the UK.
- Instruments executed outside the UK that relate to UK property, or to 'any matter or thing done or to be done anywhere in the UK'.

The acquisition of shares in UK companies by UAL will therefore be subject to stamp duty, as the shares are UK property.

The acquisition of shares in non-UK companies by UAL may also be chargeable to stamp duty of the instrument to transfer them is executed in the UK. However, if (as is more common) these instruments are executed outside the UK there should be no charge to UK stamp duty.

If stamp duty is payable it will be calculated at 0.5% of the amount or value of the consideration given on the transfer, rounded up to the nearest £5.

<u>Tax treatment of dividends received and paid by UAL</u>

Dividends received

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.

The distribution exemption rules are contained in Part 9A CTA 2009. These rules distinguish between companies which are small and those that are 'not small'. For these purposes, a company will only be small if, taken together with its connected enterprises, it has fewer than 50 employees and turnover and/or a balance sheet total of no more than €10m. We assume that these conditions will not be met by UAL, and have therefore not considered the small company rules further.

A distribution received by a company that is not small will be exempt from UK corporation tax if:

- It falls within one of the five exempt classes;

- It is not of a kind mentioned in paragraph E or F in s1000(1) of CTA 2010 (certain non-dividend distributions); and

- No deduction is allowed in respect of the distribution to a resident of any territory outside the UK under the law of that territory.

The exempt classes set out s931E to s931Q are as follows:

- 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; and
- 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 UAL to be exempt from corporation tax.

Where this is the case no UK tax relief will be given for any foreign taxes or withholding taxes suffered. It is possible to elect under s931R for a distribution not to be treated as exempt, and this may be useful if, under the law of the paying company's jurisdiction, withholding tax would be imposed if the distribution is not subject to UK tax and there are other deductions available in UAL to reduce the amount of taxable profits.

Paying dividends or lending money to French parent

If UAL pays dividends to its French parent company, on the assumption that the shares are normal ordinary shares (and not akin to debt), no UK corporation tax deduction will be available to UAL in respect of the amounts paid.

The UK does not impose withholding tax on dividends, regardless of where the recipient is located. There will therefore no requirement for UAL to withhold tax on the dividends it pays to its parents.

If instead UAL lends the funds it receives from its subsidiaries to its parent company, the interest income on the loan created will be subject to corporation tax under the loan relationship rules.

Under s308 CTA 2009, the interest will be taxed as it is recognised in the accounts (i.e. on an accruals basis).

As the loan will be between connected parties, the transfer pricing rules in Part 4 TIOPA 2010 will apply. These rules require a transfer pricing adjustment to be made where arrangements are not at arm's length and create a potential UK tax advantage. In considering whether a third party would have been willing to make the loan to the French parent, the amount which they would have been willing to lend and the rate of interest and other terms they would have imposed. If the loan is not deemed to be at arm's length (for example because a very low rate of interest, or no interest is charged) then a transfer pricing adjustment will be needed to increase the taxable interest income in UAL so that it reflects what it would earn on an arm's length basis.

The interest payable to UAL may be subject to withholding tax, though it should be possible to reduce this to nil under either the UK-France double tax treaty or the EU Interest and Royalties Directive. If it is not possible to reduce the withholding tax it should be possible to claim a credit for this against the UK tax payable on the income.

Note: candidates may also be given credit for identifying that France does not generally impose withholding tax on interest paid to non-resident lenders, though are not required to.

Question 9

Tax Residence

Given Hopkinton Inc, is a US corporation paying US taxes and has no significant business activity in the UK, it is very unlikely HMRC would wish to investigate its residency status. This is particularly so given that the business has very significant presence in the US and virtually none (other than the presence of its owner) in the UK.

HMRC's interest is more likely to focus on determining whether Michael's presence in the UK indicates the creation of a UK Permanent Establishment to which there may be attributed profits subject to UK corporation tax.

Even if HMRC successfully challenged the company's residence status, under the terms of Article 5 of the US-UK treaty the company's residence status would be determined by the competent authorities of both countries. Given the overwhelming substance in the US, it is extremely unlikely HMRC would wish to pursue this case, with the IRS.

Nevertheless, under UK law the residence status of a foreign incorporated company such as Hopkinton Inc is determined by reference to the case law test of 'central management and control', which focuses on identifying where a company's key strategic decisions are made. Applying this test, it is necessary to determine where the real business of the company is carried on, i.e. where the key strategic decisions facing the company are made. Given that these decisions are made at directors' meetings regularly held in Boston where the majority of directors reside, the company is likely to be resident in Boston. (*De Beers Consolidated Mines v Howe*) This is notwithstanding that if Michael attends the meetings via video link from London, he will be treated as physically present in London for these purposes. Michael's business style may suggest that control is emanating from the UK, but *Wood v Holden* makes clear that if the directors make the key decisions then control is exercised where they meet.

It should be noted that if board meeting were held in the UK, the position would be more problematic and there would be a very real risk of Hopkinton Inc becoming UK resident. This was considered in the *Datacom* Case, where a one-off UK board meeting was found, not in itself to make the relevant company UK resident. The finding was reached as the meeting in question was confined to housekeeping matters, the inference being that if the UK meeting had considered matters of strategic importance, it may perhaps have caused that company to have become UK resident.

In order, to minimise the risk of Hopkinton Inc inadvertently becoming UK resident:

- Regular board meetings should continue to be held in Boston;
- The majority of directors should continue to be based in Boston;
- Detailed agendas should be circulated prior to board meetings;
- Contemporaneous notes should be taken at these meeting to evidence the fact that the company's real business is being carried on at these meetings;
- Michael should resign as chairman; and
- No board meetings should be held in the UK.

Overseas Workday Relief (OWR)

As you are UK resident but non-domiciled you are eligible to be taxed on the remittance basis. If you elect for the remittance basis, your UK income will be taxed on an arising basis, whilst your non-UK income will only be taxed to the extent that this income is remitted to the UK.

For the first seven years of your UK tax residency there is no charge to elect for the remittance basis, thereafter a charge applies. However, you should note that a cost of electing for the remittance basis is a loss of your personal tax free allowances.

OWR is a relief that extends the remittance basis to apply to employment income where the duties are partly performed outside the UK. If the relief applies the earnings which relate to duties you perform overseas in that year are treated to be foreign earnings. These earnings are not taxable in the UK unless remitted to the UK.

In order, to qualify for OWR there is a further condition that you have not been UK tax resident in any of the three tax years prior to your arrival. As you have just moved to London you should meet this condition. OWR may be available in the year you first become UK resident and the following two years.

Provided you elect for the remittance basis and provided your salary continues to be paid into a non-UK account, you may qualify for OWR, as you carry out at least some of your employment duties outside the UK.

The earnings relating to the duties you perform in the UK will be taxable on the arising basis, whereas the element relating to your non-UK duties will only be taxable if remitted into the UK. The apportionment will be made on a 'just and reasonable' basis, e.g. on the basis of time spent. You should therefore keep a work diary to ensure that you may substantiate your claim.