Institution **CIOT - CTA**
Course **APS Taxation of Larger Companies**

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Answer-to-Question-_1_

From: Alex Jones, tax department
To: Board of Directors of Sparkby plc ("Sparkby")
Date: 11 May 2023

Subject: Tax advice regarding the tax residency of Sparkby's subsidiaries and location of its trades

Introduction

This Report (the "Report") is addressed to the Board of Directors of Sparby. It is for internal use only.

The Report is based on Jay Smith's email from 28 April 2023, notes on tax rules in Arcadia, Benignland and Candyland and a forecast of the profits and losses of the company in the group.

The Report will adress the consequences of the new global tax rate of 15% that will be levied in all countries in which a company operates according to the OECD's project. More specifically, the Report will, in a first section explain the current position of the group and the impact of the OECD propositions. The next section will explain the way in which the tax residence/trade can be moved from the country in which they are currently located. The last section will explain the tax impact and benefits of moving the trades/tax residency of each company in the UK.

The Report is based on the tax law applicable at the date of writing. Please contact us again if any delay occurs between the day this advice is received and the day it is implemented.

Executive Summary

We do not recommend to maintain the tax residence of Broadton Ltd ("B") and Croxhume Ltd ("C") in Benignland and in Candyland respectively as this would result in an increase in the tax payable by the group overall. Less dividends could be distributed by each company to Sparkby each yer in this position. Similarly, we do not recommend to carry on operating Anwood LTD ("A") through an exempt Permanent Establishment ("PE") in Arcadia.

Commercially, if this was the case, Sparkby's position would have to be reviewed to make sure that the dividends distributed are sufficient to service the debt.

We recommend that Sparkby incorporates a new company in Arcadia ("Arcadia Newco"). The trade currently held by A would be transferred to Arcadia Newco and the Place of Effective Management ("POEM") of Arcadia Newco would be located in the UK. As such, Arcadia Newco would become tax resident in the UK and relief for the investment would be available in the UK.

We recommend to move the Central Management and Control ("CMC") of B to the UK so that capital allowances can be claimed in the UK. The company would be dual tax resident but Double Tax Relief (DTR) will be available in the UK against the tax payable in Benignland.

C's tax residence can be moved to the UK by simply moving the POEM of the company to the UK. It is recommended that this is implemented as the tax EBITDA of the UK group will increase as a result.

We recommend to seek tax advice in each of the countries involved to make sure that the advice mentioned in this Report is accurate from the perspective of tax law applicable in these countries.

It will be necessary to inform the directors on the board of B to make sure that they are aware of the need for them to meet and make decisions in the UK and not in Benignland. Commercially you might want to consider this carefully and the appointment of new directors could be necessary.

To move the POEM of Arcadia Newco and C, some concrete steps are mentioned in this Report but we insist on the fact that the records of each Arcadia Newco and C should be, from now on kept in the UK. It is also advised that all senior managers make decisions in the UK as well from the date the move will be implemented.

We recommend to carefully consider these recommendations and discuss them with the board of directors of each company involved to make sure that, in practice, these recommendations will be feasible.

Finally, we consider that another option that would be available to the group but which would need to be discussed between your tax advisors in Arcadia and Candyland could be to have C remaining tax resident in Candyland and transfer the Arcadia PE to Candyland. This could be beneficial as capital allowances are deductible in Candyland. However, this would trigger tax consequences in both countries that would need to be determined by your tax advisors in these countries.

Report

Section A current position of the group

Position with the new tax rate in all countries at 15%

This section establishes the consequences if the new tax rate of 15% applies in all overseas countries and if the investments required for the group are made.

Position in Arcadia

If the new tax rate applies in Arcadia, this will represent an increase of 5% in comparison with the tax rate currently applicable.
The investments that would be made in the country would not trigger any relief considering that the country does not allow any deductions for capital allowances.

This would trigger tax at 15% of the accounting profit of £100 million of £15 million.

Position in Benignland

In Begningland, the current tax rate applicable is 5%. If the new tax rate comes into force for the company, there would be an increase of 10% in the current rate applicable. This would also trigger an increase in the tax payable in this country to £15 million when the tax payable before the application of the tax rate was only £5 million.

However, if the position for this company stays the same and if the company's tax residence is not moved to the UK, there will be a possibility to obtain a tax free grant toward the investment in new plant and machinery. This would be tax neutral on the result of the company.

Position in Candyland

In Candyland, the current tax rate applicable in 10%. If the new tax rate comes into force for the company, there will be an increase in the current rate applicable of 5%. This would, as per the above, trigger a tax payable of £15 million.

No investments are required in this country since there is not need for new plant and machineries.

Conclusion for the group

If the position stays the same, in the future, the group will be in a less advantageous position than it was prior to the implementation of the new tax rate.

Dividends which are currently repatriated from all overseas countries to the UK tax free (with not WHT paid abroad and with no taxation in the UK) would decrease from £275 million to £255 million as a result of the increase of tax. This would have a very negative impact on the group as it would be necessary to determine whether the group can still service its debt.

Further, in this position, the group cannot benefit from any offset between the losses in the UK with the profits from the overseas territories.

Finally, considering that the group currently has interest payable, each year of £90 million with no UK EBITDA, it is not in a position to deduct the interest that it incurs in the UK and that it needs to carry forward to offset in future accounting periods.

This position would therefore not be beneficial for the group as this would result in less dividends received from overseas, more tax payable overall and no improvement in the deductibility of dividends in the UK.

Section B: Requirements to move the companies tax residence to the UK for each country

Position in Arcadia

Current position of the trade

Sparkby is currently operating A trade in Arcadia through a PE.

Although a PE is usually taxable in the UK and in the country in which it operates its trade as a distinct and separate enterprise, double tax relief is avaiable in the UK against the tax paid abroad on the trade carried by the PE.
This default method of credit relief has, however, not been applied by the group since an exemption election has been made regarding A.

As such, A is operating a trade in Arcadia which is not taxable in the UK and is only taxable in Arcadia without any further UK tax payable. This has been an advantage in the past considering that Arcadia only levies a corporation tax rate of 10%.

The profits arising in Arcadia have, in the past, been distributed by A to Sparkby without any WHT paid abroad and without any taxes payable in the UK on the receipt of the dividend.

This has been advantageous in the past given the low tax rate applicable in the country. However, the new tax rate that the OECD is planning on implementing could make the tax regime in this country a lot less advantageous for the company.

Further, considering that new investment is required to be made for the trade to carry on, Arcadia's tax regime might not be as advantageous as it has been in the past. Arcadia does not grant any deductions for capital allowances at the moment which would not be advantageous for the company.

Moving the trade to a newly incorporated company in Arcadia and moving its place of residence

As you may be aware, the PE exemption election that was made at the time is an irrevocable election. The election cannot therefore be revoked and it is not possible to simply change the taxation of the trade carried on by A for it to become taxable in the UK.

However, some steps could be taken in order to change this position.

Considering the above, a possibility would be to incorporate a new Arcadia tax resident company. The trade and asset currently held by A could be transferred to that Arcadia Newco which would start to carry on the trade. Sparkby could incorporate this new company by injecting minimum equity in exchange for new shares in the Arcadia Newco.

This Arcadia Newco would be tax resident in Arcadia by incorporation. However, considering that there is a DDT based on the OECD Model between the UK and Arcadia, it would be possible to make sure that the POEM of Arcadia Newco is located in the UK.

As such, the tax authorities of Arcadia and the UK should be in a position to consider that the Arcadia Newco is tax resident in the UK. The company would therefore become UK tax resident and UK corporation tax would apply in the future.

The POEM of a company is the place where decisions impacting a company are taken on a day to day basis. Under the OECD Model treaty, it is not only the place where the board of directors meet but it is the place where the records of the company are kept, where the senior managers make decisions, where the most important decisions are made.

Position in Beningland

Currently, the company is tax resident in Beningland as a result of being incorporated in Beningland. There is no DTT between the UK and Benignland.

The only possibility to move the place of residence of the

company, in the absence of a DTT would be to use UK domestic legislation.
Under UK domestic legislation, a company is resident where it is incorporated or where its CMC is located.

The CMC of a company is the place where the most important decisions regarding a company are taken. It is usually considered to be the place where the Board meetings of a company are held.

Under domestic legislation, the only possibility to move the place of residence of the Beningland company would therefore be to make sure that, in the future, all important decisions are taken from the UK. This would require making sure that the current directors of the company fly to the UK each time a board meeting needs to be held. This would require the company to make sure that the directors stay in the UK long enough when they come. It would be necessary to make sure that none of the directors dial in from Benignland.

However, although this seems like a simple solution, it is likely that, as a result of the lack of DTT between the UK and Benignland, the company would be considered dual tax resident. The company would, in this case not be regarded, from a Beningland perspective as resident in the UK but still as resident in Beningland as a result of its incorporation and of carrying on a trade through the Benignland company.

Position in Candyland

1. Moving the tax residency of the company

C is currently tax resident in Candyland as a result of being incorporated in Candyland. Considering that that there is a DTT between the UK and Candyland, the company's tax residence can be determined according to the OECD principles.

As such, the tax residence of the company can be moved from Candyland to the UK by simply moving the POEM of the company to the UK.

This can be done by making sure that the senior management decisions, on a day to day basis are taken from the UK in the future and not in Candyland.

Under the OECD treaty, the main elements to take into consideration regarding the POEM of a company are the place where the records are kept, the place where the senior manager conduct the business on a day to day basis, the place where board meetings take place might also influence.

As such, it would be possible to move the tax residency of C without having to incorporate a new company in the UK. This should be a straigtforward process.

2. Transferring the trade of the company

Another option that could be available for Sparkby would be to incorporate a new UK tax resident company to which C would transfer the trade.

This newly incorporated UK company would then carry on the trade through a PE. This would also trigger taxation in the UK considering that no exemption election would be made.

Conclusions

By application of the UK domestic legislation and the DTT between the UK and respectively Candyland and Arcadia, it will be possible to move the place of residence of C and B. The PE will be incorporated and the company will become tax resident in the UK.

The options available for C regarding incorporating a new UK

resident company which would carry on a trade through a PE or moving the tax residency of the company by moving the PEOM would lead to the exact same consequences in terms of tax applicable.
It would be simple to move the PEOM rather than incorporate a new company and transfer the trade and assets.

Section C Tax consequences following the move of the companies in the UK

Position in Arcadia
Once the Arcadia Newco is incorporated, it will operate the trade in Arcadia and will be considered to be UK tax resident as a result of having its POEM in the UK.

Postion in Benignland
Dual residency
Regarding Benignland, as mentioned above, the only possibility to move the company's tax residence is to move the CMC of the company.

Since there is no DTT between the UK and Benignland, this would result in the company becoming dual resident.

As a result, there would be tax payable in the UK at 25% and in Benignland at 5%. However, this should not be an issue considering that DTR would be available in the UK (Appendix 3).

As such, the fact that tax is payable in both countries should not have any impact.

Impact of Capital allowances and grant
Further, by moving the tax residence of the company to the UK, it will become possible to claim capital allowances on the qualifying expenditure in the UK. This will reduce the accounting profit of the company by £50 million as capital allowances are deductible in the UK (Appendix 3).

The only disadvantage of moving the company's tax residence from Beningland to the UK is that the grant that the Benignland government is giving to the company would have to be repaid. This would trigger a repayment of £8 million per annum and a payment of interest of £800,000 per annum.

Although this might seem like a disadvantage, the tax savings at 25% realised by the possibility to deduct capital allowance far outweight the disadvantage of having to repay the grant and pay interest on this grant.

Further, as a result of being considered a UK tax resident company, it will become possible to include the tax EBITDA of this company in the group's EBITDA. This will result in further deductions available at group level for the interest payable by Sparkby (although there would also be an increase of £800,000 in the interest payable by the group to the Benignland government).

Joining the UK loss group

Further, by being UK tax resident, the company will be in a position to join the UK loss relief group. This will have the advantage of being in a position to offset the losses realised by Sparkby against the profits from this company.

Position in Candyland

Once the PEOM of C is in the UK, the company will become taxable at 25% instead of the 15% in case no actions are taken. Although this seems to be a disadvantage, considering that this company is in a profitable position, the fact that the company becomes UK tax resident would represent a significant advantage for the group.

The company would be included in the UK group for corporate interest restriction purposes. This would have the effect of increasing the tax EBITDA of the Sparkby group. Considering that

Sparkby has a very significant debt to service and is paying interest of £ 90 million per annum, generating more EBITDA in the UK would be useful.

Further, C would join the loss relief group with Sparkby, A and B. As a result, it would be possible to offset the losses realised by Sparkby

Conclusion at group level

To conclude, the advantages of being in a position to benefit from capital allowances in the UK as a result of making sure that Arcadia Newco and B are UK tax resident will outweight the disadvantages triggered by the fact that the UK tax rate is higher than the 15% at which the overseas countries would be taxable.

Appendices

Appendix 1: Current position without relocation of the companies' tax residence and before application of 15% tax rate in all overseas countries

Similar for each tax year	Sparkby UK	Anwood Arcadia	Broadton Benignland	Croxhume Candyland
Profit/loss *	(90m)	100m	100m	100m
Tax rate		10%	5%	10%
Tax payable		(10,000,000)	(5,000,000)	(10,000,000)
Post tax accounting profit**	nil	90m	95m	90m
Divends distributio		No WHT	No WHT	No WHT

ns total				
Total dividend distributed	275m			

* No deduction is granted for capital allowance expenditure in Arcadia and in Benignland. No invesmtent on plant and machinery is made in Candyland.

** Sparkby would receive the dividends without WHT payable abroad and the receipt of the dividends would not be taxable. However, because it has no tax EBITDA of its own and is the only UK tax resident company, interest deductions would be restricted under the CIR rules

Effective tax rate on profits from overseas companies:
(90m + 95m + 90m)/300m = 9.2%

Appendix 2: OECD proposition applied to the group

	Sparkby UK	Anwood Arcadia	Broadton Benignland	Croxhume Candyland
Profit/loss *	(90m)	100m	100m	100m
Tax rate		15%	15%	15%
Tax payable		15m	15m	15m
Post tax profit		85m	85m	85m
Total dividend distributed	255m			

Effective tax rate overseas: (85m x3) / 300m = 15%
Non deductible interest of 90million

Appendix 3: Tax residence of companies moved to the UK

Similar for each tax year	Sparkby UK	Anwood Arcadia	Broadton Benignland	Croxhume Candyland
Profit/loss *	(90m)	100m	100m	100m

Capital allowances		(50m)	(50m)	nil
Interest payable on Grant			**(800,000)**	
Total taxable profit		50m	49,200,000	100m
Tax payable overseas*			2,460,000	
UK corporation tax at 25%		(12,500,000)	(12,300,000)	(25m)
Double tax relief			(2,460,000)	
Post tax result	(90m)	37,500,000	36,900,000	75m
Interest disallowance			800,000	
	nil	37.5m	(15m)	(75m)
		37.5	22.7	nil

Total EBITDA of the group now UK tax resident for a year:
100m + 100m + 100m = 300m
300m x 0.3 = 90m

There would be a total interest payable in this situation of 90m by Sparkby and 800,000 by Broadton. This would be restricted because of the application of the CIR rules and carried forward.

Current year loss offset is possible for the non trade deficit of Sparkby.

Effective tax rate of the group (37.5 + 22.7) / 300m = 20%

Appendix 4: If Candyland company not moved out of the country

Candyland post tax profits: 85m
Total EBITDA of the group now UK tax resident for a year:
100m + 100m = 200m
200m x 0.3 = 60m
Interest disallowance: 90.8m - 60m = 30.8m

	Sparkby UK	Anwood Arcadia	Broadton Benignland	Croxhume Candyland
Post tax result	(90m)	37,500,000	36,900,000	85m
Interest disallowed	30m	800,000		
Loss/profit	(60m)	37,700,000	36,900,000	85m
		(37,700,000)	(22.3m)	
	cf interest of 30m	nil	14,600,000	85m

99.6m / 300m =33.2%