THE ADVANCED DIPLOMA IN INTERNATIONAL TAXATION

June 2023

MODULE 2.09 – UNITED KINGDOM OPTION

SUGGESTED SOLUTIONS

PART A

Question 1

To: Cupful Ltd
From: An Advisor

Incorporation of new French entity

A company is resident in the UK where it is either:

- incorporated in the UK; or
- its central management and control of its business is in the UK.

The new entity in Cupful Ltd will be incorporated in France, therefore we need to consider its central management and control. The case law concept of central management and control is, in broad terms, directed at the highest level of control of the business of a company. It is usually distinct from the place where the main operations of a business are, although these two places are often the same. There have a number of significant cases brought before the courts which have set precedents for clarifying the tax residency of a company but may of the decided cases have emphasised that the place of central management and control is wholly a question of fact.

The original test case for determining a company's residence was set down in the De Beers Consolidated Mines v Howe (5TC 198). Following the original case and its appeal, it was stated by Lord Loreburn in the House of Lords that "A foreign corporation may reside in this country for the purposes of income tax. The test of residence is not where it is registered, but where it really keeps house and does its real business. The real business is carried on where the central management and control actually abides. Whether any particular case falls within that rule is a pure question of fact, to be determined not according to the construction of this or that regulation or byelaw, but upon a scrutiny of the course of business and trading." The company owned or had interests in extensive diamond mines and mining property in South Africa, together with various farms and landed property there along with investments in English Government securities and shares in an English joint stock company. The majority of the company's profits arose from the mining trade and the sale of diamonds, in particular through significant contracts with certain diamond merchants. These contracts were negotiated and executed in London.

The 'central management and control' test, as set out in De Beers has been endorsed by a series of subsequent decisions. It was described by Lord Radcliffe in the 1959 case of Bullock v Unit Construction Company (38 TC 712) as being "as precise and unequivocal as a positive statutory injunction. I do not know of any other test, which has either been substituted for that of central management and control, or has been defined with sufficient precision to be regarded as an acceptable alternative to it. To me… it seems impossible to read Lord Loreburn's words without seeing that he regarded the formula he was propounding as constituting the test of residence".

Whilst the new entity is incorporated in France, all activities in France will be undertaken by a third party. We need to consider the UK France Double Tax Treaty (which for these purposes is based on the Model Tax Treaty) to determine the taxing rights. As the management and control of the new entity will be in the UK, the entity could be a dual resident entity and the management and control tie-breaker should be considered to determine the tax position.

Cupful Ltd

As a UK incorporated entity, Cupful Ltd should be UK tax resident. However, the management As and control of the company were to move to Bigland or Vastland, this may change the tax residency of Cupful Ltd. As Chip and Cerise will no longer be in the UK for the majority of time, there is a risk that the management and control of Cupful Ltd may move. To ensure that the management and control remains in the UK, the shareholders should have all board meetings in the UK, with Chip and Cerise attending in person as much as possible, increase number of UK directors on the Board, any new strategy or significant business decisions should be discussed and made in the UK, provide Charlotte with a deciding vote – as she is remaining in the UK. Cupful could make a branch election to exempt profits from tax. In these cases, the company should obtain a certificate of residence from the overseas authority and enable HMRC to satisfy itself that the company should be regarded as resident in the other country under the tie-breaker.

In order to minimise the risks to Cupful of becoming treaty non-resident, the Shareholders and Directors should consider:

- Maintaining a registered office address in the UK where official correspondence can be received;
- Holding board meetings in the UK and keep accurate records of these meetings;
- Ensuring all major management decisions are discussed, documented and decided in the UK;
- Having a majority of directors who are UK residents or ensure that the majority of board meetings are held in the UK;
- Keeping financial records and prepare financial statements in compliance with UK accounting standards;
- Not treating Cupful solely as a shell or pass-through entity for transactions in the other jurisdictions; and
- Avoiding maintaining a bank account exclusively in a foreign country for the UK company's operations.

<u>Permanent Establishment</u>

Under the model tax treaty, a permanent establishment is created where an overseas company has:

- a fixed place of business through which its business is carried on; or
- an agent in the exercises authority to do business on its behalf.

A fixed place of business specifically includes:

- a place of management;
- a branch;
- an office;
- a factory;
- a workshop;
- an installation or structure for the exploration of natural resources;
- a mine, an oil or gas well, a quarry or any other place of extraction of natural resources;
- a building site or construction or installation project.

In addition, where no fixed PE may arise, a PE could arise where the company engages with a dependent agent which has and habitually exercises an authority to do business on behalf of the company.

There are specific exclusions in respect of preparatory or auxiliary activities, which include:

- The use of facilities for the purpose of storage, display or delivery of goods or merchandise belonging to the company;
- The maintenance of a stock of goods or merchandise belonging to the company for the purpose of storage, display or delivery;
- The maintenance of a stock of goods or merchandise belonging to the company for the purpose of processing by another person; and
- Purchasing goods or merchandising, or collecting information, for the company.

As Chip will be concluding on sales in Vastland, these activities would meet the definition of an agency therefore a PE would be created in Vastland.

Cerise will be located in Bigland and there will be an office available, therefore a fixed place of business would be in Bigland creating a PE.

Whilst PEs would be created in Vastland and Bigland, Cupful would remain UK tax resident and subject to UK corporation tax on its worldwide income. The profits attributable to the PEs need to be calculated using an arm's length basis.

They could avail of the branch election whereby the profits attributable to Vastland and Bigland PEs would be excluded from UK corporation tax. There would be no double tax relief available where an election is elected into and the election would apply to all PEs in Cupful. Management should consider the impact of the loss of double tax relief, particularly if Vastland and Bigland's corporation tax rate exceeds that of the UK. The exemption election is treated as a form of double taxation relief as an alternative to credit relief.

Question 2

Part 1

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

Automatic overseas residence tests

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

The second automatic overseas test applies to arrivers, i.e. those who have been UK resident in none of the three prior years. Under this test you would be non-UK resident for the tax year if you were resident in the UK for none of the 3 tax years before the current tax year, and spend fewer than 46 days in the UK in the tax year. As you expect to be in the UK for 95 days in 2023/24 and 80 days in 2024/25 you will not meet this test in either year.

The Third automatic overseas test applies where a person leaves the UK to take up full time employment abroad. There are various conditions that must be met to satisfy this test. You’ll be non-UK resident for the tax year:

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

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

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

If you have a significant break from overseas work you’ll not qualify for full-time work overseas. Unfortunately you plan to work in the UK for about 60 days each tax year so that you will not qualify to be treated as non-resident, under the working full-time abroad test.

Automatic UK tests

As you have not passed any of the automatic non-resident tests, the next tests that must be considered are the ‘automatic’ UK tests. The First automatic UK test is that you will be UK resident for the tax year if you spend 183 days or more in the UK in the tax year. As you intend to spend only 95 days in the UK in 2023/24 and 80 days in the UK in 2024/25 you will not meet this test in either year.

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

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

As you intend to spend more than 30 days in your Canadian home in 2023/24 you will not meet the conditions of the second automatic UK test for that year. However, for 2024/25 you have made clear your intention is to rent out your Canadian home. On the assumption that you carry out this plan, you will not have a Canadian home in 2024/25, so that you will become UK resident that year under the second automatic UK residence Test.

The Third automatic UK test relates to full-time working in the UK. It provides that you will be UK resident for the tax year if all the following apply:

- you work full-time in the UK for any period of 365 days, which falls in the tax year;
- more than 75% of the total number of days in that 365 day period when you do more than 3 hours work are days when you do more than 3 hours work in the UK; and
- on at least one day which must be both in the 365 day period and the tax year you do more than 3 hours work in the UK.

As you will spend the majority of your time living and working abroad you will not qualify under this test.

To summarise, you will become UK tax resident for 2024/25 by virtue of satisfying the second automatic UK residence test (UK home) that year. Your residence for 2023/24 is determined as set out below.

Turning to 2023/24, as you do not satisfy any of the automatic non-resident tests or the automatic UK resident tests, your tax resident status will be determined by the sufficient ties tests. As you have not been resident in at least one of the three previous tax years you will be classified as an arriver for the purpose of applying these tests. The number of UK ties you have will determine how many days you may spend in the tax year without being UK resident. As you are an ‘arriver’ 4 ties are relevant.

<u>Accommodation</u>

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

<u>Family tie</u>

As Jules is not a minor child, you will not have a tie under this condition.

<u>90-day tie</u>

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

<u>Work tie</u>

This condition is triggered by reference to a 40-day threshold. For these purposes, a person works in the UK if they work more than 3 hours in the UK. As you intend to work in the UK for at least 7 hours, for 60 days you will have a tie under this connecting factor. Table B applies to determine residence status for those qualifying as arrivers to the UK.

Table B: UK ties needed if you were UK resident in none of the 3 tax years before the tax year under consideration

Days spent in the UK in the tax year under consideration	UK ties needed
46 - 90	All 4
91 - 120	At least 3
Over 120	At least 2

You will have 3 ties. This means you would be UK tax resident if you spend 91 or more days in the UK. As you intend to spend at least 95 days in the UK in 2023/24 you would become UK tax resident, under the circumstances you propose.

Conclusion

You will become UK resident under the sufficient ties test in 2023/24. In 2024/25 you will become UK resident under the second automatic UK residence test.

Part 2

The importance of tax residence and domicile

Your exposure to UK tax depends both on your domicile and on your tax residence status. A person who is domiciled and resident in the UK will be subject to UK income tax and capital gains tax on all their income and gains worldwide. They will be subject to UK inheritance tax (IHT) on their worldwide assets.

A person who is non-UK resident is only generally liable to tax on certain types of UK source income, and, since April 2019, is also subject to capital gains tax on the sale of UK commercial property (having been subject to capital gains tax on the sale of UK residential property since April 2015). If the person is non-UK domiciled, IHT applies only to any of their UK assets (including residential property held through offshore structures), but if the person is UK domiciled (or deemed domiciled), IHT applies to their worldwide assets, even if they are not UK resident.

As you were born in Quebec Canada, of Canadian-French parents, it is very likely that your domicile of origin will be non-UK. Given that you still currently reside in Quebec, it also appears very likely that your domicile remains non-UK. Provided you do not decide to reside permanently or indefinitely in London, whilst you are UK resident, it is likely that your foreign domicile will be preserved.

Non-UK Domiciled tax regime

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

The election for the remittance basis is made on the individual’s tax return.

Where a non-domiciled individual is taxed on the remittance basis they are assessed on their UK income and UK chargeable capital gains on an arising basis, however they are only taxed on their foreign income and capital gains to the extent these are remitted to the UK.

An individual may elect for the remittance basis without charge for the first 7 years of their UK tax residency. After an individual has been UK resident for more than 7 years an annual remittance basis charge applies, currently £30,000. This Remittance basis charge increases where the individual remains UK resident for more than 12 out of 14 years.

When an individual has been UK resident for more than 15 of the last 20 tax years that person becomes deemed domiciled and is no longer eligible for the remittance basis.

Where an individual elects for the remittance basis they may lose their personal income and capital gains tax allowance.

Investment portfolio

Any dividends from UK listed companies would be taxed on an arising basis, as would any capital gains arising on the disposal of shares held in those companies. However, any dividends and gains arising on the foreign listed companies would be eligible for the remittance basis and only be subject to tax if remitted to the UK.

Canadian property portfolio

Any income arising on your Canadian commercial property portfolio would only be subject to UK income tax if remitted to the UK. If the income were remitted it would need to be recomputed using UK tax rules, so that for example, depreciation would not be an allowable deduction. If the income were remitted, Canadian tax suffered could be set against the UK income tax to reduce the amount of UK income tax payable.

IHT

As you are non-UK domiciled, inheritance tax would only apply to UK situs assets, thus your shares held in UK listed companies would be subject to inheritance tax.

Part 3

For trading income to be treated as relevant foreign income and hence to be eligible for the remittance basis, the trade must be carried on wholly abroad. If you perform legal services for UK based clients you would clearly be carrying out, at least part of your trade in the UK.

Even if you worked only for non-UK clients, it is generally considered that a UK resident person cannot avoid carrying on a trade at least in part in the UK see Ogilvie v Kitton (1908) 5 TC 338. It is argued that the person carrying on a trade directs the whole commercial adventure with the consequence that the trade is carried on where the individual is based. The result is that normally trading income of non-domiciled taxpayers cannot benefit from the remittance basis.

Your trade consists of providing legal services, and these engagements can be broken down:

- 25% Preparatory and finalisation activities including initial familiarisation, research, and writing up reports mainly performed at home.
- 75% Project fulfilment based at the geographic location of your client.

It is clear, that even if all your clients were non-UK, and you move to the UK and spend 60 days each tax year undertaking preparatory and finalisation activities, from your home in London; that you would be carrying on your trade, partly in the UK. Therefore you would not be entitled to the remittance basis on your trading income, which would be liable, instead, to UK income tax on an arising basis.

PART B

Question 3

Dear Finance Director,

Following our recent meeting, where we discussed the overseas subsidiaries of the Alpha Ltd, we have outlined below the UK's Controlled Foreign Company (CFC) rules and how they impact the disclosures and returns of Alpha Ltd.

The UK's Controlled Foreign Company rules are designed to prevent UK companies from artificially diverting profits to low-tax jurisdictions to avoid UK tax. The rules apply when a UK resident company holds a controlling interest in a foreign subsidiary and that subsidiary's profits are subject to a low level of taxation in the jurisdiction where it is resident. A controlled foreign company is a foreign subsidiary in which a UK resident company has a controlling interest, typically defined as owning 25% or more of the voting rights. The CFC is considered to be controlled by the UK parent company because it has the power to control the foreign subsidiary's operations and financial decisions.

The UK's CFC regime is divided into three key components: the CFC charge, exemptions, and gateways.

CFC Charge

Under the CFC charge, HMRC will attribute profits of the CFC to the UK parent company and subject them to UK tax if certain conditions are met. The conditions include:

- The CFC is located in a low-tax jurisdiction (i.e., a jurisdiction with a tax rate of less than 50% of the UK rate).
- The CFC's profits are subject to a low level of taxation (i.e., less than 75% of the UK corporation tax rate).
- The UK parent company has control over the CFC (i.e., holding 25% or more of the voting rights).

The profits attributed to the UK parent company are subject to UK corporation tax at the prevailing rate.

Exemptions

There are certain exemptions that may apply to prevent profits from being attributed to the UK parent company under the CFC charge. These include:

- Low profits exemption: If the CFC's accounting profits are less than £500,000, the CFC charge does not apply.
- Excluded territories exemption: if the CFC is located in a territory that has a comprehensive double taxation agreement with the UK or is a member of the European Economic Area, and the CFC is not involved in certain types of activities, the CFC charge does not apply.
- Low margin exemption: this exemption applies if the CFC's accounting profits are (or the profit margin is) no more than 10% of its relevant operating expenditure. It includes relatively low value added functions that are undertaken outside the UK such as back-office functions, local marketing and distribution operations, toll manufacturing, or call or data- processing centres.
- Tax exemption: this exemption applies where the local tax amount is greater than 75% of the corresponding UK tax (after deducting any withholding taxes suffered).
- Exempt period: this provides an entity-level exemption for CFCs that have come under UK control for the first time. The period of exemption is temporary, usually 12 months.

Gateways

The gateways provide an opportunity for UK parent companies to demonstrate that the CFC should not be subject to the CFC charge. The gateways include:

- Business purpose gateway: If the CFC has a genuine commercial reason for being located in a low-tax jurisdiction and its activities are not mainly aimed at tax avoidance, the CFC charge does not apply.
- Substantial commercial activities gateway: If the CFC has substantial commercial activities, including employing staff and owning assets, in the jurisdiction where it is located, the CFC charge does not apply.
- Exceptions for oil and gas companies: Certain rules apply for CFCs that are involved in oil and gas extraction activities.

Application to Alpha Group

Alpha Ltd holds over 25% of its subsidiaries therefore meets the condition of company that controls foreign entities therefore is within the UK's CFC regime.

Beta Ltd should fall under the low profits exemption for the period as the profits of £350,000 are below the threshold of £500,000.

Charlie Ltd should meet the low margin exemption as the profit margin applied under the intercompany agreement is under 10%, being 5%. In addition the activities need to be low value adding activities. The administration activities that are being undertaken in Turkey by Charlie Ltd relate mostly to the finance function therefore should be deemed as that of back office functions that met the low value adding condition. As Charlie meets the low profit margin exemption there is no requirement for Alpha Ltd to disclose this or the exemption on the CFC return.

Delta Ltd should meet the tax exemption as the rate of tax in France is higher than the current rate of 19% in the UK

Echo Ltd should avail of the exempt period for the first period of account, however after the first 12 months a detailed analysis should be undertaken. As there should be substantial activities happening in UAE the business purpose gateway should be met and no CFC charge should arise.

If you have any queries, please let us know.

Yours Sincerely,
Tax Partner

Question 4

Part 1

As you are a UK resident but non-domiciled taxpayer and assuming that you have claimed the remittance basis, you are subject to UK taxation on your UK income and gains on an arising basis. You are also subject to UK taxation on any foreign income or gains you remit to the UK.

I note you arrived in the UK on 5 May 2016 and have remained UK resident. I also note that on the date you became UK resident you had a balance of £400,000 in your offshore deposit account. At this point the account held clean capital which you could have brought to the UK without incurring a tax charge, as remitting clean capital to the UK, does not create a UK tax liability.

On 30 August 2017, you disposed of a painting, which I assume was a foreign asset, for £300,000. As the original cost of the painting was £30,000 you made a gain of £270,000 on the sale. The UK does not provide for a step up to market value at the date a taxpayer becomes UK resident. As you are claiming the remittance basis, and all the proceeds were paid into your offshore deposit account, and kept offshore, you would not have been taxable on this gain in the 2017/18 tax year.

The payment of the sale proceeds into an account containing clean capital has created a mixed fund. There are strict ordering rules that apply to transfers made from mixed fund accounts. These will be elaborated below.

On 1 March 2019 you received a foreign dividend of £200,000 which you paid into your offshore deposit account. As no remittances were made from this account in 2018/19, the foreign dividend is not subject to UK income tax in 2018/19.

Section 809Q ITA 2007

Section 809Q ITA 2007 sets out the ordering rules that apply where transfers are made from mixed funds. These rules are explained in HMRCs Residence, Domicile and Remittance Basis Manual at RDRM35240.

“For each tax year in which a transfer is made, the mixed fund must be analysed to identify the amounts present in the order listed below (s809Q(4)) fund immediately before the transfer, for each of the categories of income, gain and capital in paragraphs (a) to (i) listed below.

Start with the ‘relevant tax year’ (if necessary you may need to repeat the exercise for income, gains or capital for each earlier tax year

a) employment income (which can include UK employment income) not subject to a foreign tax (that is, amounts not appropriate to any of ‘b’, ‘c’ or ‘f’ in the list below).
b) relevant foreign earnings (not if subject to a foreign tax - refer to ‘f’).
c) foreign specific employment income (not if subject to a foreign tax - refer to ‘f’)
d) relevant foreign income (not if subject to a foreign tax - refer to ‘g’).
e) foreign chargeable gains (not if subject to a foreign tax - refer to ‘h’).
f) employment income subject to a foreign tax.
g) relevant foreign income subject to a foreign tax.
h) foreign chargeable gains subject to a foreign tax.
i) any income or capital not included in one of the previous eight categories.”

Applying the rules to the remittance made on 1 April 2019

At 1 April 2019 the mixed fund comprises:

Capital	£400,000	16/17
Capital gain	£270,000	17/18
Capital	£30,000	17/18

Dividend Income	£200,000	18/19 (Relevant foreign income)

The £50,000 transfer made on 1 April 2019 will be treated to be made from 18/19 dividend income and will be subject to income tax in 2019/20. The filing deadline for the 19/20 tax return is 31 January 2021. Penalties and interest may be payable if this remittance has not been included on that tax return.

Proposed 1 February 2023 Transfer

At 31 January 2023 the mixed fund comprises:

Capital	£400,000	16/17
Capital gain	£270,000	17/18
Capital	£30,000	17/18
Dividend Income	£200,000	18/19
UK Transfer	(£50,000)	
	£150,000	18/19 (Relevant foreign income, ‘RFI’)
1 May 2021 (Inheritance)	£500,000	21/22 (Capital)

The proposed 1 February 2023 transfer would therefore comprise:

Capital	£500,000	21/22
RFI	£50,000	18/19

If you remit £550,000 to the UK on 1 February 2023, £50,000 RFI will be taxable in 2022/23.

Part 2

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

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

- The investment is a qualifying investment made in an eligible company, within 45 days of the foreign income and gains being brought into the UK;
- A claim must be made on the individual’s tax return.

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

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

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

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

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

An eligible trading company is a private limited company that:

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

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

Condition B

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

- No relevant person has either directly or indirectly enjoyed a benefit or become entitled to enjoy a benefit; and
- There is no expectation that such a benefit will be obtained which is related, either directly or indirectly, to the making of the investment. (s809VF ITA 2007)

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

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

A subscription for 50 ordinary shares in a trading company for £500,000 potentially qualifies for BIR. It is noted that this is a UK holiday home letting business which would qualify as a commercial trading company. Subscribing for the issued share capital of Swallows Ltd would therefore appear to meet Condition A. However. Condition B would not be met, as a key attraction of making this investment is that this investment would entitle you to a benefit, being substantially discounted rates reserved exclusively for the company's shareholders.

The legislation also includes an extraction of value rule which applies where any relevant person receives value from the company that is directly or indirectly attributable to the investment. An extraction of value can be either money or money's worth received by or for the benefit of any relevant person. It is likely that a discounted booking would also breach these rules.

In conclusion, a subscription for shares in Swallows Ltd would not qualify for BIR.

PART C

Question 5

The UK transfer pricing rules are based on the three-tier approach developed by the Organisation for Economic Co-operation and Development (OECD). The three-tier approach consists of the following.

The Master File

The Master File provides an overview of the multinational group's global business operations, including its transfer pricing policies and strategies. The Master File should include information such as the group's organizational structure, its intangible assets, and its financial and tax positions.

The Local File

The Local File provides detailed information on the transfer pricing arrangements of the UK subsidiary. The Local File should include a functional analysis of the UK subsidiary, benchmarking studies, and other information that supports the transfer pricing arrangement between the UK subsidiary and its related parties.

Country-by-Country Reporting

Country-by-Country Reporting requires multinational groups to provide information on their global business operations to the tax authorities of the countries in which they operate. This information includes details such as the group's revenue, profit, taxes paid, and number of employees in each country.

The three-tier approach is designed to provide tax authorities with the information they need to assess whether a multinational group's transfer pricing arrangements are consistent with arm's length pricing. The approach also aims to promote transparency and consistency in transfer pricing across different jurisdictions.

Multinational companies operating in the UK are required to comply with the three-tier approach and provide the relevant documentation to the HMRC upon request.

Transfer Pricing legislation applies to large enterprises (more than 250 employees, greater than €50 million turnover or greater than €43 million of a balance sheet total). There are exemptions for SME's - if it has no more than 50 staff and either an annual turnover or balance sheet total of less than €10 million.

As a result, Sunburst Industries would be considered large for UK transfer pricing purposes. Sunburst Industries should undertake the following:

- Ensure there are intercompany agreements in place to cover the sales and distribution agreements and management charges. Functional analysis and appropriate benchmarking studies undertaken to determine the arms' length price for each transaction.
- Review the Master File for the Group and ensure the UK activities are accurate and true reflection of the work undertaken in the UK.
- Prepare a UK Local File. This file will include a more detailed, specific analysis of the UK intercompany transactions and should have the local organisation structure, list of key competitors, details of the controlled transactions, a detailed comparability and functional analysis, details of the transfer pricing method used and the UK financial statements.
- Submit country by country reporting notification of the reporting company to HMRC. Prepare a country by country report and submit to HMRC.

Penalties

There are two main types of transfer pricing penalties in the UK, failure to keep or produce documentation and a tax geared penalty for a careless or deliberate error.

The fixed penalty for failure to keep or produce documentation records is currently £3,000.

There is also a tax-geared penalty which is dependent on how HMRC view the error by the company:

- careless (maximum penalty of 30% of potential lost revenue);
- deliberate but not concealed (70%); or
- deliberate and concealed (100%).

Where there is a reduction in the amount of losses carried forward, a penalty of 10% of the reduction may be due. In addition, HMRC may rescind a penalty where the Company can outline that it had made a reasonable attempt to demonstrate an arm's length result.

An enquiry into a tax return by HMRC may be made up to 12 months from the due filing date of the tax return, unless the return is filed late in which case the enquiry can be made 12 months after the return is filed. HMRC may in certain circumstances make an enquiry on a company for prior years (a 'discovery' assessment) under certain circumstances. Discovery assessments can be raised up to four years where the loss of tax is not due to careless or deliberate behaviour, six years where the behaviour is careless or 20 years in serious deliberate cases.

HMRC also charge penalties in relation to non-compliance with country by country reports and notifications. There is a fixed penalty of £300 for not meeting an obligation, of which there could be multiple including inaccurate return, late notification or late submission of a return. There may be further daily penalties of £60 per day where these obligations have not been rectified.

Finally, HMRC can charge a penalty up to £3,000 for each report which has inaccuracies or errors.

Question 6

To Art Print GmBH
From Tax Adviser

Thank you for reaching out for advice on Art Print GmBH's VAT obligations in the UK. As a German-based retailer with plans to open a physical store in London, there are a number of VAT rules and UK corporate tax and VAT compliance requirements to be aware of.

Corporate Tax compliance

Art Print GmBH will need to register as a permanent establishment for UK corporate tax purposes. It will be required to allocate profits to the UK permanent establishment using an arm's length basis and ensuring that these comply for transfer pricing purposes.

There will be an annual corporation tax return that will be due for submission to HMRC within 12 months of the end of the accounting period. Any corporation tax will be due for payment within 9 months and 1 day of the end of the accounting period.

The UK permanent establishment is subject to UK corporate tax at a rate of 25% on its trading income, and will also be subject to tax on any capital gains which arise.

The permanent establishment will be subject to the UK tax regime more generally, and will able to make use of applicable benefits such as capital allowances claims. Any losses incurred may be carried over and counted against future UK profits; depending on German law, it may also be possible for such losses to be recorded against Art Print GmBH's profits in Germany.

The online sale of watches to Art Print GmBH's UK customers via its website will also likely be taxable under the UK digital services tax rules. The website will likely be characterised as an online marketplace, which is one of the digital activities to which the digital services tax applies.

VAT implications

When Art Print GmBH opens a physical store in London, it will be considered a UK permanent establishment for VAT purposes. This means that any sales made in the UK, including those made through the physical store and online sales shipped from the UK store, will be subject to UK VAT at 20%.

Regarding the sale of watches to UK customers via the website, if the goods are sent from Germany to the UK, the supply may be treated as an import of goods and will be subject to UK import VAT at 20%. If Art Print GmBH holds stock in the UK, it will need to register for UK VAT and charge VAT on sales to UK customers.

VAT registration and compliance requirements in the UK

If Art Print GmBH's taxable turnover in the UK exceeds the VAT registration threshold, which is currently £85,000, it will need to register for UK VAT. Art Print GmBH will need to submit UK VAT returns on a regular basis (usually quarterly), and will need to pay any VAT due by the 7th day, following the month after the quarter end. All VAT returns are required to be made electronically and comply with HMRC's Making Tax Digital rules.

Art Print GmBH will be required to comply with the record keeping requirements set out by HMRC:

1) Invoices. Art Print GmBH must keep copies of all invoices issued and received, as well as credit notes and debit notes. The invoices must include certain information, such as the date of supply, a description of the goods or services, the VAT rate applied, and the amount of VAT charged.

2) Accounting records. Art Print GmBH must keep accounting records that show all VAT transactions, including purchases and sales. These records must be kept in a clear and orderly manner, and must be able to be easily accessed and reviewed by HMRC.
3) VAT returns. Art Print GmBH must keep copies of all VAT returns submitted to HMRC, as well as any calculations or adjustments made to the returns.
4) Customs and import documents. If Art Print GmBH imports goods into the UK from outside the EU, it must keep copies of customs and import documents, such as the commercial invoice, bill of lading, and customs declaration. These documents may be required to support the input VAT claimed on the VAT return.
5) Other documents. Art Print GmBH may be required to keep other documents to support its VAT transactions, such as bank statements, purchase orders, and delivery notes.

All of the above records must be kept for a minimum of 6 years from the end of the VAT accounting period to which they relate. They may be required to be produced in the event of a VAT inspection by HMRC, or to support any VAT repayments or claims made by Art Print GmBH.

Question 7

To: Stoney Island Ltd
From: Tax Adviser
Subject: Application of ATED rules to Stoney Island Ltd

The Annual Tax on Enveloped Dwellings (ATED) is an annual tax that applies to residential properties in the UK that are owned by companies or other "non-natural persons." The tax was introduced in 2013 as a measure to discourage the use of corporate vehicles to hold high-value residential properties and to promote the use of such properties for residential purposes. The tax applies to properties valued at more than £500,000 and is based on the property's value. The amount of tax payable depends on the value of the property. The tax rates for the 2022-23 tax year range from £3,700 for properties worth between £500,000 and £1 million, up to £243,450 for properties worth more than £20 million.

For properties that are within the charge to ATED for the first time, the deadline for filing the first return and paying the tax due is 30 days from the date the property first falls within the charge to ATED. Properties that were within the charge to ATED in the previous year, the deadline for filing the annual return and paying the tax due is 30 April each year. If the property is sold or otherwise ceases to be within the charge to ATED during the year, an interim return and payment are due within 30 days of the date on which the property ceases to be within the charge to ATED.

I have reviewed our files and have outlined the obligations in respect of ATED for the properties held by Stoney Island Ltd below:

1) Willow Lodge. Whilst the property is over the value threshold of £500,000, there should be no ATED charge arise as the letting relief exception should apply. Stoney Island will still need to submit an annual ATED return to claim this relief or via the relief declaration form.
2) Chestnut House. Whilst there is currently no tenants in the property, as the property is being prepared for rental and there will be no undue delay in letting the properties once complete, letting relief should also apply to this property.
3) Sunflower Cottage. ATED charge should arise on this property and paid to HMRC by 30 April. Letting relief is not available as the property is not currently let nor has it been let recently therefore it would not meet the requirement of being a dwelling that is being let commercially with a view to profit.
4) Bluebell Manor. This property is not a residential dwelling as it is trading as a commercial care home, therefore ATED charge should not apply.
5) Oakwood Estate. Letting relief should apply to the three properties let to third parties. Whilst the fourth property is let out, as the shareholder's sister is renting the property they would be treated as a non-qualifying person due to the connection with the company. Connection rules for ATED are quite wide and include any individual that is connected to the owner of the company that holds the property. However, as the properties individually do not exceed £500K they are outside the scope of ATED.
6) Wonderland Tower. As the property is available to the public for more than 28 days per year, no ATED charge should arise.

Question 8

Taxation of non-domiciled settlors

The taxation of non-domiciled settlors of offshore trusts was radically changed by the F(No 2)A 2017. The F(no 2)A 2017 changes had two broad effects in relation to the TOAA regime. On the one hand, the transferor of an offshore trust was excluded from section 720 (and 727) charges provided that he was a non-UK domiciled remittance basis user. This apparently very generous treatment of non-UK domiciled settlors was however counterbalanced by the fact that the new provisions brought the transferor within the section 731 benefits charge, thereby extending the scope of that charge.

The ToAA code is still subject to the motive defence if the purpose of the “relevant transfer” (the transfer to the trust), or any associated operations, was not made for a UK tax avoidance purpose. However, as Pieter had created the Pieter Hamaekers discretionary trust on the advice of his accountants to avoid UK tax, the motive defence would not apply.

Capital distribution

Pieter is subject to tax under s731 on any benefit received from the trust, if this is brought to the UK. If Pieter receives a capital distribution, this is clearly a benefit, the value of which is the amount paid to him. If the Trustees make a £1.5 million capital distribution to Pieter in the UK he will be assessed to UK income tax on the sum to the extent of the trust’s relevant income. As the trust has received a £1 million foreign dividend, this will constitute the trust’s relevant income so that Pieter will be assessed on £1 Million at say 45%. If the trust subsequently receives further relevant income Pieter may be subject to tax on this income capped at 500k (£1.5 million minus £1 million = 500k).

Interest free loan

Pieter is subject to tax under s731 on any benefit received from the trust, if this is brought to the UK. If Pieter receives an interest free loan, this is clearly a benefit, the value of which is the amount of interest forgone. The value is prescribed by reference to the ‘official rate’. If we assume the official rate is 2% the benefit will be £1.5M x 2% = £30,000. This will be subject to income tax at say 45%. Pieter will be subject to income tax annually on this benefit, until the loan is repaid.

We attach a Technical Note explaining the underlying analysis.

Technical Note

The F(no 2)A 2017 changes:

1) The F(No 2)A 2017 changes apply to both the Settlements code and the TOAA regime.

The Settlements Code following 6 April 2017:

2) From 6 April 2017, the Settlements Code does not apply to “protected foreign-source income” (s 624(3)) (“PFSI”).
3) PFSI is defined in s 628A ITTOIA, by reference to conditions A to F. Certain key conditions are that the income would be “relevant foreign income” if it was income of a UK resident individual (see s 830 ITTOIA: essentially non-UK source income); the individual is not UK domiciled at any point in the year; and the trustees are non-UK resident.
4) Thus income arising on or after 6 April 2017 is not attributed to non-UK domiciled settlors under s 624 ITTOIA, even if they have not claimed the remittance basis.
5) Similarly, the s 633 charge does not apply to post 6 April 2017 income.
6) In summary, the F(No2)A 2017 changes have the effect that income arising to trustees after 6 April 2017 is excluded from the Settlements Code.

<u>Section 720 and 727 charges</u>
Post 6 April 2017 income
Section 720 charge:

7) In relation to income arising from 6 April 2017, where the settlor is non-UK domiciled, the income that is treated as arising to the settlor is so much of the income that is not "protected foreign source income": 720(4B) ITA 2007. Protected foreign source income ("PFSI"), as defined for the TOAA code, includes post 6 April 2017 income arising to the trustee of a trust created by a non-domiciled settlor (s 721A(3)).

8) The effect of the F(No2)A 2017 changes is thus to remove the section 720 charges on non-domiciled settlors. Thus such income, arising after 5 April 2017, is not caught by the section 720 charge.

<u>Section 731 charge after the 2017 changes</u>
Income arising on or after 6 April 2017 :

9) The benefits charge, which charges benefits received by beneficiaries, applies, from 6 April 2017 onwards, to all beneficiaries, including the transferor.

10) Thus any relevant income that has arisen within the trust is matched to the benefit provided to the beneficiary.

Question 9

Domicile

The common law concept of domicile requires that every individual has a domicile in a specific legal jurisdiction, for example in England and Wales or in Scotland. Under English law, whilst an individual must always be domiciled somewhere, it is only possible to have one domicile at a time.

1) Domicile of Origin. A domicile of origin is acquired at birth. It is usually that of the individual's father. Domicile of origin, is particularly adhesive, however, it may be displaced by domicile of dependency or choice.

2) Domicile of Choice. A domicile of origin may be displaced by a domicile of choice in another jurisdiction. To acquire a ‘domicile of choice’ the individual must have attained the age of 16 and be physically present in that jurisdiction and have a fixed and settled intention to live there permanently or indefinitely.

   If an individual does establish a domicile of choice in another country, and that domicile of choice is abandoned for any reason without being replaced by the acquisition of another domicile of choice, their domicile of origin automatically revives. This rule applies (whether or not the person has any present links with that country). The domicile of origin then remains their domicile until they have a fixed and settled intention to acquire another domicile of choice.

3) Domicile of Dependency. An unmarried child under the age of 16 has a domicile of dependency which normally follows that of their father.

Assuming that Filipa’s parents were both originally Danish and lived in Denmark before their move to London, her father had a Danish domicile. Although Filipa was born in London, it is likely at the time of her birth, that her father retained his Danish domicile, since the move is expressed as a temporary assignment.

While a domicile of origin is adhesive, by 1993, Filipa’s parents had both purchased burial plots in London and considered London their permanent home. In these circumstances Filipa’s father acquired a UK domicile of choice. As Filipa was only fifteen at the time, her Danish domicile of origin was replaced by a UK domicile of dependency.

Filipa has retained this domicile of dependency, unless she acquired a domicile of choice in Switzerland (or abandoned, her UK domicile of dependency/choice, whilst living in Switzerland). She has lived in Switzerland for 18 years and it is therefore possible she has acquired a Swiss domicile, or abandoned her English domicile, during this period.

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

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

A similar rule applies for IHT (although broadly, the IHT rule, contains relief in respect of the first year of residence).

Although Filipa was born in the UK, and will be UK resident, her domicile of origin is Danish, so that this new rule will not apply.

In summary, Filipa’s domicile status is unclear and requires further investigation.

Taxation of Filipa's Trust

If Filipa has acquired a Swiss domicile of choice, or if she has abandoned her UK domicile of dependency/choice, then Filipa will have a foreign domicile. The trust, of which we assume that Filipa is a benecifiary, would then be an excluded property trust for Inheritance Tax purposes. If Filipa elects for the remittance basis, she would only be subject to UK Income Tax and Capital Gains Tax to the extent she receives benefits from the trust in the UK.

If Filipa has retained her UK domicile, the creation of the trust may have triggered a charge to Inheritance Tax, and te trust would also be subject to the ten yearly charge. The Income Tax settlement provisions would apply to the trust. Filipa might be subject to a liability to Iincome Tax or Capital Gains Tax on an arising basis, regardless of whether benefits are received.