Answer-to-Question-_1_

Memorandum in respect of the proposed acquisitions and controlled foreign company rules

To: Mr Singh
From: An Adviser
Date: 08/12/21

Controlled foreign company (CFC) rules were implemented to counter tax avoidance.

CFC rules are intended to counter siturations were UK imcome will be shifted to lower tax jurisdictions in an attempt to reduce a company's or indeed a group's tax liability.

Classification of a CFC

In order for an entity to be considered a CFC the following conditions need to be met:

- The entity needs to be a non-uk resident company which is controlled by a UK resident person or persons.

-Therefore the UK resident persons (being a company or natural people) need to contol the company.

-Control can mean the following:

- Holding shares or voting power in the company.

- Having powers conferred by the articles or association or other document over the company.

- A person can control a company if they have greater than 50%

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of the share capital of the company, will receive 50% of the proceeds of the disposal of the shares, if the whole of the company's income was distributed then greater than 50% of the distributed amount, or in the event of winding up of the company then greater than 50% of the assets which would be avaialble for distribution.

It is also possible to control the company by holding at least 40% of the compay , provided that a non-Uk resident owns at least 40% of the company but does not own more than 55% of the company.

It is also possible to determine control by refernce to the accounting standards.

This is provided that the company is CFC at the time and the CFC is recognised as a subsidiary in the accounts of the UK parent.

Where a company is considered to be a CFC then an apportionment of the companys profits based on the pro-rata percentage owndership by Panda plc will be subject to tax at 19%.

However, where Panda Plc's ownership in the CFC is less than 25% of the CFC then no profits will be apportioned.

CFC Charge

The tax charge will be a CFC charge and will be repoted in Panda Plc's corproaation tax computations and return.

Please note that a CT600B will also need to completed in respect of the CFC profits.

Any exemptions available (outlined below) will also need to be repoted.

Even where a company would fall to be a CFC as a result of any

one of the conditions explained above, there are five exemptions that mean that there is no CFC charge.

Exemptions

Exemptions from the CFC charge are listed and breifly explained below. Where an exemption is relevant then further detail will be provided:

(1) The Exempt period exemtion - this is available in the first period when a CFC comes under the control of a UK company. This is to allow the UK parent to get the affairs of the group in order e.g. address instances where profits are being moved overseas.

However in order to qualify fo rthis exemption the company needs to be exempt in the next accounting period too.

(2)The excluded territories exemption- this exemtion is available where a CFC is resdient in another country which is considered to have a simialr tax regime to that of the UK. Other conditions need to be met to also fall wihtin this however this is not relevant to the circumstances of Panda.

(3)The low profit exemption - where the taxable profits of the CFC is under £500,000 and the non-trading income is no more than £50,000. The limits are pro-rata for periods of less than 12 months.

(4) The low profit margin exemption - where the profits for the period of the CFC are no more than 10% of the operating costs of the CFC.

(5)The tax exemption - where broadly speaking the tax charge in the CFC is 75% of the tax charge in the UK.

Gateways

Even if an exemption is not met then the profits will need to pass through a gateway in order to be assessable to a CFC charge.

These gateways are:

(1) Profits attributable to UK activities
(2) Non-trading finance profits
(3) Trading finance profits
(4) Profits derived from captial insurance business
(5) Cases involing solo consideration.

Application to proposed acquisitons

Polar Inc

This company will be a CFC by virtue of being 100% owned by Panda Plc.

Based on the information provided there will be no exemptions available as Bermuda is not an excluded territory, the profits or £10 million are in excess of the low profit exemption threshold.

It appears that it receives payments for holding IP and so it is unlikely that the low profit margin will apply as there seem to be no costs incurred by the CFC giving rise to income.

As the tax charge is £nil then the tax exemption will not be met.

It appears that the profits would fall thorough the Profits attributable to the Uk activities gateway and so the profits would be subject to a CFC apportionment. Unless it were the case that orignally the IP was not created in the UK then it is possible that the profits could be exempt from the CFC charge.

However that arguement may fail if there was a tax avoidance motive of setting up a company in Bermuda.

However, if the directors can ensure that the IP is no longer held in Bermuda and instead in say, Uk, by the end of this accounting period then it may be possible that the the exempt period exemption could previal to ensure that there is no CFC charge on the CFC.

However that arguement may fail if there was a tax avoidance motive of setting up a company in Bermuda.

Sun Ltd

This company will be a CFC by virtue of being 100% owned by Panda Plc.

On first glance it appears that the tax exemption is relevant to Sun Ltd becasue a corporte tax rate of 15% is at least 75% of the Uk previaling rate of corproation tax of 19%.

However, it appears that they only paid £120,000 of tax in Maruitius to Decemeber 2020, being an effective rate of 12%.

Thus may be in part due to tax relief in resepct of overseas tax suffered of £40,000 in Nigeria.

In order to see if the exemption applies the we need to calculate the effective rate of coproation tax in the UK.

The corprotion tax charge would be £190,000 less relief for the £40,000 resuling in tax suffered of £150,000 in the UK.

Therefore £120,000/£150,000 is 80% so the exemption is in point and the profit from the CFC would be exempt.

Kodiak srl

The company is a CFC by virtue of being at least 40% owned by Panda Plc and greater than 40% but less than 55% of shareholding held by a non-UK company.

As the taxble profits are less than £500,000 and the non trade income is under £50,000 then the low profit exemption applies.

Ursa GmbH

Uk companies will hold no more than 55% of Ursa and 45% will be held by a non-resident person so the company is a CFC.

However, as Panda will only own 20% of the share capital of Ursa then it appears that there will be no CFC charge.

However we should get confirmation that there are no other powers in the articles or any other docuement that could give Panda control over Ursa.

<u>Digita Services Tax (DST)</u>

This seeks to impose a tax of 2% on revenue greater than £25 millions pounds in resepct of digita services.

Digital services include online market places.

Digital service tax is in point where the worldwide group revenues exceed £500 million.

However, the tax suffered can be claimed as a deduction against the Uk corporation tax.

Panda would also need to file DST returns, on the assumption that

the group companies nominate Panda Plc to file the returns.

The returns must be filed by one year from the end of the accouting period.

The DST will need to be paid 9 months and 1 day from the end of the accounting period.

Answer-to-Question-__2_

<u>Part 1</u>

It might be advisable to consult the relevant double tax treaties to understand whch juristiction has rights to tax the income from business profits.

HMRC may seek to aportion soem of the business profits to the Uk in light of the preparatory work and analysis.

I think that the issue is where was Ms Katz when the income was generate.

In essence, what is the source of the income. Uk source income will be subject to UK tax.

Even if it were the case that the business overseas income is paid to a foreign account, if there were any element that that was Uk related then as it has a UK source it would be taxable in the UK.

Domicile is a legal concept which means where an individual belongs.

<u>Part 2</u>

The remittance basis works by a taxpayer making a claim on their self-assessment tax return stating that they wish to be taxed on the remittance basis. The taxpayer has until one year following the filing deadline to make the claim.

The remittance basis means that they will only pay UK tax on

foreign income that they bring into (remit) into the UK.

If a remittance basis claim is not made then the tax payer will be taxed on the arising basis, that is to say that all their worldwide income and gains will be subject to Uk tax.

The remitance basis is only avaialbe to non-uk domiciled indivuduals.

As Ms Katz has been Uk resident for 7 (out of the last 9) years then the remittance bassi claim will cost her £30,000, which will be paid through self assessemnt.

Once Ms Katz has been Uk resident for 12 (out of the last 15) years then the remittance basis claim will cost her £60,000, which will be paid through self assessemnt.

It does not matter the source of the income e.g bank interst, dividends, rental profits etc, the income will be taxed at the non-savings rate of income tax - being 20%, 40% and 45%.

Any capital gains on the shares and secutities will be taxed at the CGT rtes of 10% and 20%. Gains on commerical proerty will be taxed at 18% and 28%. The lower rates of 10% and 18% apply to amounts falling wihtin the basic rate band of income tax.

By claiming the remittance basis, Mrs Katz will lose her personal allowance for income tax of £12,500 and her Capitl gains tax annual exempt amount of £12,300.

In order to ensure that the assets she has inherited do not suffer UK income tax or capital gains tax then she should ensure that thay are paid into a foreign account.

This is so that the funds will not be remitted into the UK.

It might be advisable to ensure that different income and gains streams are paid into different accounts, e.g. rental income in one account, bank interest credited to another account, any gains credited to another.

This is because any funds remitted into the Uk can be idetifed easily and also the most tax efficient funds can be remitted in priority, e.g. capital gains.

Part 3

The offshore non-compliance facility applies to people who have offshore non-compliance to correct since the end of the 2016-17 tax year.

offshore non-compliance can be corrected by notifying HMRC that a mistake as been made either through self-assessment, using the digial disclose service or whilst under enquiry.

The penalty can be up to 200% of potential lost revenue (in this case the tax due on the dividend income).

HMRC can assess a person to the offshore tax until 05 April 2021.

It would be advisable to quatify the amount of income received and the calcualte the tax thereon and advise HMRC of the tax due as well as an explaination of how the omission occured.

The extended time limits will apply.

We are still in time to amend the 2020-21 tax return.

Answer-to-Question-_3__

Part 1

A Uk permanaent establishment (PE) is created by vitrue of their being:

- a fixed place of business through which the business of the company is wholly or partly carried on ; or
- an agent acting behalf of the company has and habiually exercises the authority to do business on behalf of the company.

A fixed place of business is:

- A place of managment;
- a branch;
- an office;
- a factory;
-a workshop;
-an instalaation or structure for the exploitation of natural resources
- a mine, an oil or gas well, a quarry or any other plave of extration of natural resources; and
- a building site or construvtion or installation project.

Of course a degree of permanence is where it is expected to last more more than 12 months.

in resepct of the sales staff, they wil have a place to work, being the office of a subsidiary. Being a subsidiary will not create a PE, however the availability of an office for the staff might.

There however may be an exemption for where the staff undertake preparatory or auxillary activities. These are things like carrying out market research.

However, that exemption may not apply if the trade/business of any of the group companies or indeed Gondor Ltd is that of carrying out market research. From the information provided this is unliekly to be the case.

Generating leads might be considered to be a preparatory or auxillary. However this needs to be viewed in light of all of the work the sales team will be providing as this may not be considered preparatory due to anti-frgamenting whereby finctions of the sales team are split so as not to create a PE.

The sales team will not have the power to conclude contacts so may still not be considered as creating a UK PE, however the commentary to the double tax treaty (Kees Van Raad)suggests that where the staff can negatiate terms then they will create a PE.

The is in line with the Dell case as the commisionaire arrangments whereby by not allowing a sales team to conclude contracts then a PE is avoided.

Part 2

A company is resident in the Uk if it is incorporated in the UK or its central management and control (CM&C) is in the UK.

CM&C is where the high level decisions in resepct of the strategy of the company is decided.

CM&C origins is form court bases such as debeers mining where the CM&C was held to be the UK.

These include for example, where to invest and which markets to try and break into and the overall direction of the company.

By moving half of the board to the UK and allowing them to attend board meetings remotely in the Uk then there is a risk that HMRC may assert that the company has migrated to the UK.

This is because the CM&C could be argued to be taking place from the uk.

In this case the company will be subject to Uk corporation tax on all of its profits.

The company will need to complete a corporation tax computation and return and file these with HMRC.

Further the company will need to prepare accounts and file with Companies House.

I tmight be worth not permitting the Uk based directors from being able to log-in in the uk to the meetings and instead only alowing them to turn up in person to the meetings in Holland.

Part 3

Under the double tax treaty the two competant authorities (the Dutch and the UK authorties) will need to decide under the mutual agrement procedure (MAP) - in accordance with the double tax treaty.

However, the MAP will take into factors such as the place of effective managment (POEM).

This means that where the day to day running of the company takes place.

This includes things like the operational running of the company takes place, e.g. the supply chain management of the hyperdrive.

Answer-to-Question-__7_

Part 1

By making a branch election you will be be exempting both the French and the German Branch profits and losses from uk corporation tax (CT).

This is because you cannot just choose to exempt one branch.

The profits and losses will no longer fall within UK CT and will therefore not be subject to UK CT.

The election is irrevocable.

However, where there were losses in a PE, we need to take count of the losses of the past six years.

These losses will be effectively set against the profits from the PEs going forward and those profits that are match with the broughforward losses will still be in charge to UK CT.

It is possbile to stream the losses so that only the losses from the french PE are offset agiainst future profits of the french PE.

However it may not be worth doing if there were profits the german PE in the previous years as the total of the PE losses will be reduced, so the losses to offset against future profits will be lower by not making the streaming election.

Even then, as the rate of CT in france is 28%, it is unlikely that there will be any further UK CT in resepct of the profits arising in France anyway.

Part 2

By incorpating the French branch you will be treated to have ceased the French branch for the purposes of the Magnolia Ltd.

The assets will be treated as being disposed for maket value and and gains will be subject to corporation tax.

It is possible to defer the gains over a perod of 6 years (assuming EU laws still apply).

Any assets from which capital alowances were claimed will be treated aas being dispsed.

Dividends from the French Sub can be paid to the UK and should be exempt from UK CT as a result of being paid by a 100% subsidiary.

The french authorities may impose a withholding tax (WHT) on the dividend, however provided that the shares have been owned for 365 days then the tax withholding tax can be reduced to 5%.

You wil have to apply to HMRC and the french authorities for this reduce rate of WHT.

As the Uk does not tax dividends (unless you elect for them to be taxed, however there is no point of doing that here), then the 5% WHT cannot be repaid.

Part 3

The corporation tax rate in France is 28% and therfore higher than the rate of tax in the UK at 19%.

I am not sure that the double tax treaty between uk and france permits the french authorities to lower their rate of CT

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applicable to these profits.

Therefore as the french PE is starting to make profits then it will suffer tax in france and unlikely to suffer tax in the uk.

The excess tax cannt be refunded so it is in essence wasted.

It seems unnecessry to exempt the branch as under either option it will be paying 28% tax in France.

In the even the UK co were to be loss making then the tax paid in france could be instead treated as a dudction against the UK income so that the loss could be effectively carried forward as a deduction and therefore be utilised in furture years.

In light of all of the above I would recommend operating the French PE though a non-exempt PE.

Answer-to-Question-_6__

Part 1

Vitro Ltd

In this case the profits of the UK PE are not brought into account in the computations of Priscus Inc.

The payer (UK PE) is a hybrid entity by virtue of being Opaque for Uk tax purposes by transparent for Rodinia tax purposes.

It appears that the UK PE (the payer)is in charge to UK Corporation tax (CT) for the period in question.

This has given rise to a Deduction/non-inclusion mismatch (D/NI).

This is under chapter 5 of part 6A TIOPA 2010 in resepct of hybrid entities.

This is because the payment for the IP is deductable in the Uk but not taxable in Rodinia.

Where there is a D/NI mismatch, then the primary counteraction is to deny the deduction. So in this case HMRC will deny the payment as deduction in the tax computations of the UK PE.

The secondary counteration would be to tax Priscus Inc on the payment mad by the PE.

Vitae Ltd

In this situation the interest payment will be tax deductable in

the computations of the UK entity.

However it will be treated as a receipt of a distribution in the Rodanian company and exempt from tax.

This has given rise to a Deduction/non-inclusion mismatch (D/NI).

This is under chapter 3 of part 6A TIOPA 2010 in resepct of financial instruments.

This is because the interest payment is deductable in the Uk but not taxable in Rodinia.

This is also the case as the £50 million funding is treated as a loan in the accounts of Vitea Ltd but as an investment (so equity) in the accounts of Priscus Inc.

Where there is a D/NI mismatch, then the primary counteraction is to deny the deduction. So in this case HMRC will deny the payment as deduction in the tax computations of the UK PE.

The primary counteraction applies as the payer (being Vitae Ltd) is in the charge to UK CT.

The secondary counteration would be to tax Priscus Inc on the payment mad by the PE.

Part 2

In order to determin whether an entity is opaque or not we need to consider various factors:

Does the entity have share capital (or something similar)?
Is the entity a legal body in its own right?
Does it havea distinct lgal personality from its owners?
Does the entity own its own assets?

From the information to hand, it appears that the UK authorities would consider that the entity is transparent and so the profits or losses can be attribtued to the partners.

By opaque, this means that the profits would be taxable on the entity itself and not own the owners/partners.

The entity would be considered transparent because it does not have share capital.

This would pose the questions as to what dividends were voted on, or would it be the case that the partners simply get a profit share, a they would with a partnership (which is considered transparent).

As the assets are owned by the members and not the RP then it appears that the RP cannot hold assets in its own right and is not a distinct and separate legal entity form its memebers - thus pointing to being transparent.

(THROUGHTOUT THIS EXAM I HAVE USED MY LEGISLATION TOLLEYS YELLOW AND ORANGE BOOKS AND THE KEES VAN RAAD BOOK - ALL PERMITTED TEXTS)