THE ADVANCED DIPLOMA IN INTERNATIONAL TAXATION

June 2024

MODULE 2.09 – UNITED KINGDOM OPTION

SUGGESTED SOLUTIONS

PART A

Question 1

Part 1

2023/24

Gabriel will only spend 90 days in the UK in 2023/24. Gabriel does not satisfy any of the Automatic Overseas residence tests: He will spend more than 46 days in the UK. He will not work full time overseas. Turning to the automatic UK residence tests. He fails the 183 day test and the Full time Work in the UK test, since he will not work for at least 75% of his time in the UK. He also fails the UK home test, since while he will commence to have a UK home from 1 July 2023, in which he will spend sufficient time i.e. he will be present in that home on at least 30 days, he will retain his foreign home, at which he will spend more than a permitted amount of time (more than 29 days).

As Gabriel has failed both the automatic overseas tests and the automatic UK residence tests, Gabriel's residence status will be determined by applying the sufficient ties test. Gabriel will be an arriver under this test, since he will not have been UK resident in any of the three prior years.

Four ties are applicable to 'arrivers':

- Accommodation
  Any accommodation that is available for 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 must actually be used for at least one night during that tax year, before it counts as a tie. As Gabriel currently rented a UK home from 1st July 2023, this UK home will be treated as an accommodation tie for these purposes.

- Family tie
  There is no mention of Gabriel having a spouse, or a child under the age of 18. It is therefore assumed that he does not have a family tie.

- 90-day tie
  There is no mention of Gabriel having spent more than 90 days in the UK in either of the two previous tax years. It is therefore assumed that he does not have this tie.

- Work tie
  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 three hours in the UK. As Gabriel intends to work in the UK for at least 7 hours, for most of the 90 days he will spend in the UK, he 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 three 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

Gabriel will have two ties. This means he would be UK tax resident if he spends more than 120 days in the UK. As he only spent 90 days in the UK in 2023/24 he would not become UK tax resident, for that year.

2024/25

Gabriel will spend 140 days in the UK this tax year. Gabriel does not satisfy any of the Automatic Overseas residence tests: He will spend more than 46 days in the UK. He will not work full time overseas. Turning to the automatic UK residence tests. He fails the 183 day test and the Full time Work in the UK test, since he will not work for at least 75% of his time in the UK. He also fails the UK home test, since while he will have a UK home for that year, in which he will spend sufficient time i.e. he will be present in that home on at least 30 days, he will retain his home in Montreal, at which he will spend more than a permitted amount of time (more than 29 days).

As Gabriel has failed both the automatic overseas test and the automatic UK residence test, Gabriel's residence status will be determined by applying the sufficient ties test. Gabriel will be an arriver under this test, since he will not have been UK resident in any of the three prior years.

Four ties are applicable to arrivers:

- Accommodation
  Any accommodation that is available for Gabriel's 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 he must actually use it for at least one night during that tax year, before it counts as a tie. As Gabriel intends to have a UK home throughout 2024/25, this UK home will be treated as an accommodation tie for these purposes.

- Family tie
  The question does not mention whether Gabriel has a spouse, or minor child under 18. On the assumption, he has neither he will not have a family tie.

- 90-day tie
  The question mentions Gabriel intends to spend 90 days in the UK in 2023/24. On the assumption he spends no more than 90 nights in the UK in 2023/24 he will not satisfy this test.

- Work tie
  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 Gabriel intends to work in the UK for at least 7 hours, for most of the days he will spend in the UK, he 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 three 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

Gabriel will have two ties. This means he would be UK tax resident if he spends more than 120 days in the UK. As he intends to spend 140 days in the UK in 2024/25 he would become UK tax resident, for that year.

<u>2023/24</u>

Gabriel will not be UK tax resident in 2023/24, however, if he is held to be carrying on a trade through a UK permanent establishment, any profits that attach to that permanent establishment will be subject to UK tax.

It is noted that certain of his Canadian projects are at a very mature stage and he expects that no UK work will be done on these projects. It would be advisable to complete these projects prior to 5th April 2024, so that any income derived would not be subject to UK tax.

<u>2024/25</u>

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. As Gabriel performs services for UK based clients he would clearly be carrying out, at least part of his trade in the UK.

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.

<u>Non-UK domiciled tax regime</u>

- 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.

<u>Investment Portfolio</u>

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.

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

Gabriel's Canadian property portfolio will be subject to Canadian tax. If Gabriel remits this income into the UK, he should obtain a deduction for any Canadian tax suffered, against his UK tax liability arising on this income. Alternatively, he should segregate this income into a separate offshore bank account and retain this income offshore.

<u>Planning</u>

As Gabriel will not become UK tax resident until 6 April 2024, he has significant time to plan his affairs to benefit from the remittance basis.

Any amounts Gabriel brought to the UK from 1 July 2023 to 5 April 2024 will not be subject to UK taxation as he will only became UK resident from 6 April 2024. If possible, cash should have been generated whilst Gabriel is non-resident, which might then be earmarked and preserved as capital. Capital should be kept in separate offshore bank accounts and kept strictly segregated. In particular, there should be no addition to these accounts of offshore income and gains, arising during the time Gabriel is UK resident. The preserved capital would then be available to be utilised by Gabriel, after he becomes UK resident to fund UK expenditure.

Gabriel's listed portfolio should be reviewed to ensure that the income and gains arising on any UK shares and securities are taxed on the arising basis. Prior to coming to the UK an exercise may be undertaken to rebalance the portfolio to exclude UK assets.

Question 2

To Finance Director, DU Australia
From A Tax Advisor
Re: Expansion into the UK

Further to our recent discussions, we have outlined below the UK tax implications of your proposals:

Part 1

Firstly, under s5 CTA 2009, a UK resident company is subject to UK corporation tax on its worldwide income. A non-UK resident company can come into the charge of of UK corporation tax in respect of its income, where it carries on a trade of dealing in or developing land, carries on a trade by creating a permanent establishment, carries on a UK property business or it has other UK sourced income.

As a non-UK tax resident company where there are activities undertaken in the UK, we have considered the permanent establishment ('PE') risks in respect of the proposals. A PE is defined in Article 5 of the OECD Model Tax Treaty as having either:

- a fixed place of business, through which the business of an entity is wholly or partly carried on; or
- an agent who acts on behalf of the company and who habitually concludes contracts, or plays a leading role leading to the conclusion of those contracts.

A fixed place of business can be:

- a place of management;
- a branch;
- an office;
- a factory;
- a workshop;
- a mine, an oil or gas well, a quarry or other place of extraction of natural resources; or
- a building site or construction or installation project (if lasts more than 12 months).

For completeness, a company will not be regarded as having a PE if it carries on its business through:

- an independent agent acting in the ordinary course of their business; or
- if the activities are of preparatory or auxiliary nature, which are deemed by HMRC as:
    - use of facilities solely for the purpose of storage, display, or delivery of goods or merchandise belonging to the enterprise;
    - maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage, display, or delivery;
    - maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise or collecting information for the enterprise; or
    - maintenance of a fixed place of business solely for the purpose of carrying out any other activity of a preparatory or auxiliary character for the enterprise.

Contract

As DU Australia provide both equipment and the installation of the project, we need to consider the PE rules under a fixed place of business, where an installation project will create a PE where the installation lasts more than 12 months. We understand that the UK contract will only be for four months, therefore a fixed place of business should not be created under proposal one or two.

Under proposal two, there will be employees of the DU Australia. As employees, they would automatically be deemed as agents of DU Australia, thereforeand could create an agency PE. The first employee will be assisting with the installation and will only be present in the UK for four months, therefore no PE is created in respect of this employee as their activities are likely to be auxiliary activities and are not in the UK on a permanent basis, being there less than 12 months.

The sales manager will remain in the UK and have authority to conclude on contracts, therefore a PE will be created by DU Australia in the UK.

Under proposal three, DU Australia will create a PE as they will have a fixed place of business in the UK when they acquire a UK property.

As a result under proposal two and three, DU Australia will need to register for UK corporation tax and submit an annual corporate tax return each year. The profits attributable to the PE will be subject to UK corporation tax. UK corporation tax is due for payment 9 months and one day following the accounting period end date.

Part 2

The UK Corporate Interest Restriction (CIR) rules limit the tax deduction that groups can claim for interest expense, thereby preventing erosion of the UK tax base through excessive interest deductions. The CIR rules apply to the UK resident entities of groups that have both UK and non-UK resident members and apply to interest expenses and other financing costs, including related party and third-party interest. Certain groups and entities are exempt from the CIR rules, including groups with annual interest expense below £2 million and certain public infrastructure projects.

Under the CIR rules, a group's net interest expense deduction is generally limited to 30% of its UK taxable earnings before interest, tax, depreciation, and amortisation (EBITDA). The fixed ratio can be adjusted for groups with significant third-party debt, allowing for higher interest deductions in certain cases.

Groups can elect to apply the group ratio rule instead of the fixed ratio rule. This rule allows for a higher interest deduction based on the group's net third-party interest expense to EBITDA ratio.

We will need to understand the interest receivable by DU Australia in the UK, to compute whether the net interest expense for the year exceeds £2M. On the basis that there is no other interest income or expenditure in the period, the interest paid to DU Australia exceeds the £2M de minimis limit, therefore will fall within the CIR restrictions. Whilst the interest would relate to the acquisition of a property, because it is not being let to a third party the public infrastructure exemption would not apply.

Yours sincerely
ADIT Candidate

PART B

Question 3

Part 1

Mr Pedersen has been UK resident since July 2000, and clearly meets the condition to be treated as deemed domiciled, i.e., he has been UK resident for at least 15 of the 20 tax years immediately before the relevant tax year (2023/24). Mr Pedersen is therefore taxable on the arising basis, in respect of the disposal of artwork.

As Mr Pedersen had been UK tax resident for 17 tax years prior to 6TH April 2017, Mr Pedersen would have become deemed domiciled on that date. He would therefore qualify for an automatic uplift to his directly held assets, as at 6th April 2017, since he met the conditions of:

- Becoming deemed domiciled at 6/4/2017
- Paying the remittance basis charge in a prior period

Computation

	£
Sale of Artwork	2,100,000
M.V 5/4/17	1,500,000
Net gain	600,000

Mr Pedersen is assessable on a gain of £600,000 on an arising basis, which must be included in his 2023/24 tax return.

Part 2

Candidates can make a reference to the notification issued under Section 115JH:

Mr Pedersen remits £1,350,000

The Last in First out mixed fund rules apply. Therefore the composition of each year's pool must be identified. (S809Q)

The mixed fund rules apply a Last in First Out basis.

	£
Sales proceeds	2,100,000
Cost	1,000,000
Actual gain	1,100,000
Gain: arising basis (2023/24)	600,000 (See above)
Gain non chargeable (2023/24)	500,000 (Deemed to arise in 23/24)
Inheritance (2010/11)	250,000
	£1,350,000

As the amount remitted by Mr Pedersen of £1,350,000 is treated as not including any income, the remittance of £1,350,000 will be treated as capital and therefore not subject to tax. (Any amounts remitted in excess of £1,350,000 would be treated as income up to the extent of Mr Pedersen's 2009/10 offshore dividend income of £750,000).

Part 3

Mr Pedersen incorporated Ocean BVI Ltd a foreign trading company, and transferred funds to its foreign bank account. The company was incorporated abroad, to avoid incurring UK corporation tax on trading profits. In these circumstances anti-avoidance legislation known as Transfer of Assets Abroad legislation must be considered.

HMRCs manual explains in broad terms that there are certain basic features which must be present before a charge can arise under the transfer of assets abroad legislation:

- there must be a relevant transfer;
- there must be income that becomes payable to a person abroad as a result of the transfer and/or one or more associated operations;
- there must be an individual who is the subject of a potential charge; and
- the individual must be UK resident.

The ToAA legislation broadly does not assess underlying income directly on the transferor where that income qualifies as protected foreign source income (PFSI).

Income arising in an offshore trust, created by a non-domiciled settlor may qualify as PFSI. Income arising in companies held by such offshore trusts may also be treated as PFSI. Broadly where PFSI income arises, the income is not directly assessed on the settlor (‘transferor’) under the Transfer of Assets Abroad Provisions. Instead the transferor is assessed on benefits received, subject to relevant income arising. However, as it is made clear that Mr Pedersen directly holds the share capital of Ocean BVI Ltd, the income arising in that company cannot be PSFI.

As explained above, where income is not eligible to be treated as PFSI, it may be assessed on the Transferor if the ToAA conditions are met, so that income arising in Ocean BVI Ltd might be assessed directly on Mr Pedersen on an arising basis.

The ToAA provisions broadly apply where income arises on assets transferred abroad, if the transfer was made with the intention of avoiding UK tax, and the transferor satisfies ‘power to enjoy’ conditions. Given that we are told that Mr Pedersen remembers meeting with his previous taxation advisors at that time, who recommended incorporating a Cypriote company, and transferred funds abroad, to avoid incurring UK corporation tax on trading profits, it would appear that Mr Pedersen has made a transfer of assets abroad with the intention of avoiding UK tax.

It would therefore not be possible to rely on the ToAA motive defence to prevent the charge, since the company was incorporated abroad to avoid UK tax. Given that Mr Pedersen directly owns the entire share capital of Ocean BVI Ltd, he would also appear to satisfy the ‘power to enjoy’ requirement.

Thus both trading income and investment income arising in Ocean BVI Ltd may be assessed on Mr Pedersen on an arising basis, even if that company does not pay dividends.

Question 4

To Tax Partner
From Tax Associate
Trees Ltd – Thin Capitalisation & ATCA
Thin Capitalisation

A company is thinly capitalised when it has more debt than it either could or would borrow without group support and acting in its own interests. This leads to the possibility of "excessive" interest deductions i.e. a greater quantum of finance costs than would arise if the parties to the loan were acting on arm's length terms. This usually happens where a company is:

- borrowing from connected companies; or
- borrowing from third parties on the strength of group support, usually in the form of guarantees.

Thin capitalisation applies the arm's length principle to company borrowing and lending, taking into account all the terms and conditions and other factors affecting the borrowing, including the amount of debt, the interest rate, repayment terms. The "arm's length" amount which a company is able and willing to borrow at any given time is affected by a number of factors, including what it can offer to a lender as security, the strength of its cash flow, its appetite for risk, the state of the economy.

The legislation says consider "all the factors", including some of the following:

- the borrower is carrying a greater quantity of interest-bearing debt than it could or would reasonably sustain on its own;
- the interest charged is in excess of the commercial rate for the loan(s) it has borrowed;
- the company has trouble servicing its debt (interest and repayments);
- the duration of the lending is greater than would be the case at arm's length;
- repayment or other terms are disadvantageous to the borrower, compared with what it could obtain at arm's length (e.g. debt is retained beyond the time when at arm's length it would be repaid); and
- an adverse lending climate existed at the time the loan was made.

All terms and conditions merit consideration, not just the amount of debt and rate of interest.

The arm's length approach assumes that borrowing will be on a sustainable basis, so that the business must be able to trade, invest and meet its other obligations as well as servicing the debt. The consideration is not just what it could have borrowed, but what it would have borrowed.

As Trunks BV owns 58% of Trees Limited, the ownership meets the participation condition and results in any intercompany loans requiring consideration under the thin capitalisation rules.

Scenario A

The provision of a loan from the bank is not a connected party loan, therefore does not fall within the thin capitalisation rules and no adjustment to the UK corporation tax return is required in this regard. The terms of the bank loan provide Trees Ltd an external benchmark to determine whether the connected loans should be deemed as thinly capitalised.

Scenario B

The additional funds provided of £3M by the bank by virtue of Trees Ltd being provided with a guarantee because of its special relationship with Trunks BV, results in the differential being treated as thinly capitalised. Therefore the pro-rated interest in relation to the £3M should be treated as disallowable in Trees Ltd corporation tax calculation.

Scenario C

The provision of a loan from a connected party needs to be considered under the thinly capitalised rules. In comparison to the third party loan provided by the bank, there are two thinly capitalised events, one the reduced rate of interest and the quantum of the loan. As a result, there should be a restriction on the pro-rated interest, being the reduced interest and pro-rated to the £9M quantum of the loan.

Trees Ltd can apply for an advanced thin capitalised agreement to agree the restriction with HMRC. Trees Ltd needs to submit the following information to HMRC to form part of the application process:

- a description of the financing structure being put in place, setting the context within which it has come into being;

- a description of the trading strategy of the business/company/group;
- copies of loan agreements and other relevant documents;
- a clear identification of the source of the funds, outlining the purpose for which they were borrowed and any repayment terms;
- a description of the business, and the plans of the principal trading operations, showing how capital is allocated and the relationship between capital and cash flows from operations;
- an analysis of the financial strategy of the business, identifying the principal cash flows and the sources of repayment of debt;
- a group structure covering all companies playing any part in the trading activities, funding and control of the borrower;
- a summary of financial forecasts; and
- a draft Advanced Thin Capitalisation Agreement, based on HMRC's template provided online.

PART C

Question 5

Part 1

Domicile is a central concept for determining the liability of an individual to UK income tax, capital gains tax and IHT. 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. Common law domicile does not, however, equate to habitual residence and the place where a person is domiciled is not automatically simply the jurisdiction of their habitual residence or their citizenship.

There are three types of domicile:

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.

"Deemed" domicile ("15 out of 20 rule")

The definition of domicile has been extended for certain UK tax purposes. From 6 April 2017, an individual will become deemed domiciled if they have been resident for 15 out of the 20 years ending with the tax year immediately preceding the relevant tax year. The individual becomes deemed domiciled at the beginning of the 16th tax year (whether resident or not in that year).

Losing UK domicile

The "three year rule" applies to individuals actually domiciled in the UK. In the case of an actual UK domicile, an individual is deemed to remain UK domiciled for three calendar years after they have in fact lost their UK domicile. In addition, the "long-stayer rule" imposes deemed domicile on such individuals for the three tax years following departure. The effect of applying both these rules means that generally domicile for IHT purposes is not lost until the fourth tax year of non-UK tax residence.

Part 2

To acquire a foreign domicile of choice Jessica would need to:

- demonstrate that she has settled permanently in the country in which she considers herself domiciled;
- intend to stay there for the rest of her life; and
- break her ties with the UK.

Jessica would become non-resident if she sells or rents her UK home and only spends 30 days a year in the UK.

However, she would fail to break her ties to the UK, as she:

- Wishes to remain an enthusiastic patron of the UK arts and to continue to attend artistic events on her visits to London;
- retains her UK medical team;
- uses her daughter's home as accommodation while visiting London; and
- retains her furniture in the UK.

In addition Jessica would also perhaps fail to demonstrate an intention to settle permanently in a new jurisdiction. This is because she wishes to spend any time she is not travelling between her Spanish Villa and her apartment in Cyprus, i.e., she has not selected a new domicile of choice.

Recommendations are as follows:

- Resign UK patronages.
- Do not attend artistic events in the UK, particularly to the extent she previously supported specific events.
- Choose between Spain or Cyprus and demonstrate clearly a particular jurisdiction as her new permanent home.
- When visiting the UK, stay exclusively at hotels.
- Cut the amount of days spent in the UK to the extent possible.

Question 6

Part 1

When a UK resident, non-domiciled taxpayer, has been UK resident for at least 15 of the 20 years prior to the relevant year, they fall to be treated as deemed domiciled. As 2024/25 is David Walters' 15th year of UK residence, he will become deemed UK domiciled in 2025/26 if he remains UK resident for that year. A UK resident deemed domiciled taxpayer is no longer eligible for the remittance basis. Thus in 2025/26 David Walters will be fully subject to UK income tax and capital gains tax on his worldwide income and gains on an arising basis. Therefore, from 2025/26 any income or gains arising on Mr Walters' foreign directly held assets will be subject to tax on an arising basis, e.g. dividends paid by his non-resident family investment company, and foreign rental income arising from his commercial property.

In addition, any unremitted income and gains arising during the period Mr Walters was non-domiciled will continue to be subject to tax if remitted to the UK. Subject to the usual qualifying conditions, Business Investment Relief would also continue to be available.

Special rules apply to settlements created prior to a taxpayer becoming UK deemed domiciled, which qualify as 'protected' settlements (See answer "rules applying to protected trusts" below). Thus provided the Walters Trust retains protected status, income or gains arising in the Walters Trust would only be taxable to the extent of distributions and other benefits made to Mr Walters.

Part 2

In 2025/26 Mr Walters will become UK deemed domiciled for inheritance tax purposes and will be subject to UK inheritance tax on his worldwide assets. Thus from 2025/26 his shares in his non-resident family investment company, and foreign commercial property would be subject to inheritance tax. Assets held by the Walters Trust would continue to be treated as excluded property, and not subject to inheritance tax.

Prior to becoming UK deemed domiciled, Mr Walters should consider transferring his foreign commercial property and the shares in his non-resident family company into an offshore trust. This would then continue to constitute "excluded property" after Mr Walters becomes deemed domiciled and therefore continue to be outside the charge to inheritance tax.

Part 3

A "protected trust" is a settlement created by an individual before they acquired a UK deemed domicile. Broadly, from 6 April 2017 foreign income and capital gains of protected settlements cannot be taxed on the settlor of a settlor-interested trust as they arise, unless the protected status is lost.. The Walters Trust would therefore currently qualify as a "protected trust".

Protected trust status is lost, if additions of value are made to the trust by the settlor, after the settlor becomes deemed domiciled. This is known as tainting the trust. Thus from 6th April 2025, Mr Walters must ensure he does not add value to the Walters Trust. Mr Walters must therefore not settle any further assets on that trust, nor must he add value. It is therefore imperative interest is charged on the loans due by the trust to Mr Walters. HMRC have made clear that provided the official rate of interest is paid on loans, HMRC will accept that no value has been added.

Question 7

Dear CFO

Further to your recent meeting with our tax partner, we have outlined below the withholding tax implications for the Doors Ltd group.

Royalties

The standard rate of withholding tax on royalty payments made by a UK company to a non-UK entity is 20%. This rate applies unless reduced or eliminated by an applicable tax treaty between the UK and the country of residence of the recipient.

Doors Ltd is paying a licence fee to GTS Global, which is classified as a royalty, therefore as the royalty is being paid to a non-UK resident company, Doors Ltd is obliged to withhold tax at a rate of 20%. Based on the royalties being paid of £425,000 per annum, Doors Ltd must withhold £85,000 of tax. Doors Ltd will need to complete form CT61 within 14 days of the end of the return period in which the royalty payment is made, and remit the withholding amount to HMRC. On the assumption that there is no Double Tax Treaty between the UK and Monaco, the full 20% rate must be withheld by Doors Limited.

Interest from Doors France SAS

Doors Ltd will receive interest from Doors France SAS each year of £280,000. Doors Ltd will be subject to UK corporation tax on the interest income. As there is a Double Tax Treaty between the UK and France, interest which reduces the withholding tax to 0%.

Dividend

Doors Ltd will receive a dividend of £3M from Germany, however due to the DTT there will be 5% WHT deducted from the dividend received, resulting in a net payment of £2,850,000. Dividends received by corporate entities in the UK are usually not subject to tax where the recipient is in control of the payer.

We understand that as Doors Germany GmBH is a wholly owned subsidiary of Doors Ltd this condition should be met and no UK corporation tax would be due on the receipt As a result, here would be no double tax relief available to Doors Ltd in respect of the withholding tax of £150,000.

Interest from Doors US Inc.

There should be no withholding tax requirement on the US loan, as withholding tax is only deductible from interest that is paid.

Yours sincerely
ADIT Candidate

Question 8

To: All Tax Staff
From: Tax Adviser
Re: Overview of the UK Profit Fragmentation Rules

The profit fragmentation rules are designed to apply broadly and includes UK-resident individuals, companies, and partnerships. The rules particularly focus on arrangements involving cross-border transactions where profits are shifted to low-tax jurisdictions.

The rules are part of anti-avoidance and can cover a a wide range of arrangements or transactions that could lead to profit fragmentation for tax purposes. For example, these include service agreements, intellectual property licenses, and transfer pricing arrangements where the UK entity pays a related entity in a low-tax jurisdiction for services or rights.

The key indicators of profit fragmentation are where significant fees or royalties paid to a related party or where there is a disproportionate allocation of profits compared to economic activity and substance.

The rules apply when two main conditions are satisfied:

- Effective Tax Mismatch Test. There is an effective tax mismatch if the tax paid by the recipient of the profit is less than 80% of the tax that would have been paid if the profit had been taxed in the UK.
- Tax Avoidance Purpose Test. The arrangement must have as one of its main purposes the obtaining of a tax advantage.

When the rules apply, HMRC has the authority to adjust the profits and reallocate the profits from the low-tax entity back to the UK entity. These reallocated profits are then taxed as if they were originally earned by the UK entity, negating the tax advantage. The adjustments must:

- relate to the expenses, income, profits or losses of the resident party for the tax period in which value is transferred as a result of the material provision;
- be based on what those amounts would have been if the value transferred had resulted from a provision made or imposed as between independent parties acting at arm's length; and
- be just and reasonable.

Taxpayers must notify HMRC of arrangements that fall within the scope of the rules. Detailed information about the arrangements, including the parties involved, nature of the transactions, and tax implications, must be provided. The rules are not subject to any exemptions, meaning that SME's could also be impacted.

The UK's profit fragmentation rules are in place to prevent tax avoidance through artificial profit shifting. All staff must consider these rules when assessing cross-border transactions, maintaining comprehensive documentation, and ensure compliance.

Question 9

To: Misty Group
From: Tax Adviser
Re: Controlled Foreign Companies

The Controlled Foreign Company (CFC) rules under Part 9A TIOPA10 are designed to prevent UK-based multinational corporations from shifting profits to low-tax jurisdictions to avoid paying UK corporation tax. A CFC is a non-UK resident company controlled by UK residents, where control is:

- holding more than 50% of the shares or voting rights; or
- having the power to control the company's affairs.

Where a company falls within these rules, there is a potential tax charge on the profits of the CFC if those profits are seen as artificially diverted from the UK. The CFC rules contain several exemptions to ensure that only artificially diverted profits are taxed, which include:

- Excluded Territories Exemption. If the CFC is resident in a territory listed as having a low risk to the UK corporate tax base.
- Exempt Period Exemption. If the CFC's accounting period ends during an exempt period, and the subsequent period and chargeable company conditions are met.
- Low Profit Exemption. If the CFC's profits do not exceed £500,000, of which no more than £50,000 is non-trading income.
- Low Profit Margin Exemption. If the CFC's accounting profits are no more than 10% of its relevant operating expenditure.
- Tax Exemption. If the CFC pays foreign tax, at least 75% of what would have been paid if the profits were taxed in the UK.

In addition, profits arising from genuine economic activities conducted in the CFC's territory are generally exempt, where there is a substantial economic presence in its territory of residence. There are Gateway Tests which are designed to filter out profits that should not be taxed under the CFC rules. If profits pass through these gateways, there is no CFC charge arising from these activities. The gateways are:

- Chapter 4: Profits from UK Activities. Considers if the CFC's profits are derived from significant people functions (SPFs) or UK managed assets and/or risks.
- Chapter 5: Non-trading Finance Profits. Excludes certain non-trading finance income, which is defined as non-trading profits from loan relationships and non-exempt distributions.
- Chapter 6: Trading Finance Profits. Applies to trading finance profits, focusing on income from intra-group lending or financial activities connected to trading activities.
- Chapter 7: Captive Insurance Business. Assesses profits from captive insurance arrangements, which are often structured to avoid UK tax.
- Chapter 8: Solo Consolidation. Only relevant for banks and financial institutions, this test looks at whether profits are included in the UK's solo consolidation, which is a regulatory requirement for some financial institutions.

Misty Group Ltd is UK-resident, has 100% ownership of its subsidiaries and is in control of its subsidiaries for CFC purposes, therefore is within the scope of the CFC rules.

Based on the information provided on the subsidiaries, we have assessed Misty Group Ltd's CFC exposure as follows:

Glass Ltd

With Glass Ltd being resident in Malaysia, if this is an excluded territory then the excluded territories exemption will apply.

The period in which Glass Ltd became a CFC is not stated, so it cannot be definitively confirmed whether or not the exempt period exemption applies; however, if we assume from the context of the information presented that Glass Ltd has been trading as a CFC of Misty Group Ltd for two years then the exempt period exemption will not apply (the threshold being one year).

The profits are £200k for the period, under the low profits exemption threshold of £500,000, while non-trading finance profits are under the threshold of £50,000. Therefore the low profit exemption should apply.

The tax exemption can also be applied, as Glass Ltd would not benefit from this exemption.

Screen Ltd

With Screen Ltd being resident in Morocco, if this is an excluded territory then the excluded territories exemption will apply.

There is no mention of Screen Ltd having become a CFC of Misty Group Ltd within the last year, while Screen Ltd's profits exceed the low profits exemption threshold and the tax rate of 16% is less than 75% of the UK corporation tax rate, so we may assume that the remaining exemptions do not apply to Screen Ltd.

In the event that none of the exemptions apply, the gateways should then be considered. Under Chapter 4, profits attributable to UK activities require four conditions to be met:

- Condition A. The CFC does not hold any assets of bear any risks under any arrangement aimed at avoiding UK tax;
- Condition B. During the accounting period, the CFC does no have any UK managed assets or risks;
- Condition C. Applies if Condition B is not met (i.e. key management activities are in the UK) and asks whether the CFC would have the capability to run its business effectively, on a stand- alone basis or with third party support, without the UK management activity;
- Condition D. Excludes CFCs that have only non-trading finance profits and/or property business profits.

Only one condition needs to be met in order to exclude the subsidiary from the CFC charge. In the case of Screen Ltd, the entity may be deemed to be operating independently from Misty Group Ltd, with its own factory and employees, in which case condition C should apply and there should be no CFC charge in respect of Screen Ltd.

Glaze Admin Ltd

With Glaze Admin Ltd being located in Mauritius, if this is not an excluded territory and has a tax rate of 9% (less than 75% of the UK corporation tax rate), neither the excluded territories nor tax exemptions will apply.

Glaze Admin Ltd is operating at a 10% profit margin – if we assume that this profit margin amounts to 10% of relevant operating expenses, it therefore falls within the low profit margin exemption and is excluded from the CFC charge.

Screen Inc.

Screen Inc. is resident in the US, a country that is listed on the excluded territories list, and furthermore it is likely that a company resident in the US would qualify for exemption due to the modified excluded territories exemption.

Reporting requirements

As Misty Group Ltd has overseas subsidiaries it must list each subsidiary, the jurisdiction it is resident in, and outline the relevant exemption or gateway on the annual CT600B corporation tax return. The company must undertake an annual review and records of how the exemption or gateway applies.