Answer-to-Question-_1_

**Question 1:**

Memo
To: Finance Director
From: ADIT
Date: 8 June 2022
Subject: UK CT implications for Newness acquisition

2) Withholding Tax

Under ITA 2007 Ch3, UK law stipulates that withholding tax may apply to payments of yearly interest made by companies. This would apply at the basic income tax rate of 20% in respect of UK companies.

However, per the tax treaty with Huginland, the WHT on interest is 30%. Therefore, Newness should withhold tax at 30% when making interest payments to Innovation under the treaty.

Newness should also withhold at 20% in respect of dividend payments, under the treaty.

It is unclear whether any amounts should be withhheld in respect of capital repayments. This and the above should be clarified with local advisers.

1)UK CT implications

a) Dividends - taxation and relief

Prima facie, dividends are taxable in the UK, unless one of the exemptions applies. If Newness is a 100% subsidiary and a trading entity, it is likely that one of the exemptions under s931 would

apply.

If for some reason the dividend is taxable in the UK, it may be possible to claim DTR in respect of the underlying tax paid in Huginland on the profits of Newness at 20%. More detailed analysis and computations would be required.

b) Transfer pricing and hybrids

The transactions between Newness and Innovation are likely to be subject to transfer pricing and anti-hybrid rules due to being related parties and due to Innovation not being an SME for OECD purposes. Small entities may also choose to apply TP.

This means that any transactions between the entities should be conducted at arms length.

From that perspective, it is important to consider for CT purposes whether unrelated parties would lend the same amount of money, under the same conditions, with the applicable interest rate. If that is not the case, the amount of interest deductible, if any, may need to be adjusted for tax purposes to reflect TP and thin capitalisation rules.

TP would concern any other transactions and payments between the entities as well.

Anti-hybrid rules may also be applicable, as they seek to counteract any arrangements where there is a hybrid entity (viewed as transparent vs opaque in different countries) or a hybrid payment (viewed as cspital vs revenue in different countries)that may result in a tax mismatch. This should be investigated further.

c) Interest - taxation and relief

Prima facie, interest income arising as a result of lending money to Newness would be taxable in the UK. Capital repayments, due to their nature, are unlikely do be taxable.

Interest deductions in respect of both existing third party loans, new third party loans and loan to Newness, would be subject to the corporate interest restriction rules as well as unallowable purpose rules. This is in addtiion to TP (eg thin capitalisation) and anti-hybrids.

Innovation is likely to exceed the £2m de-minimis under CIR and therefore should calculate carefully what amount of deduction would be available.

In doing so, they should consider the interest capacity of the entity.

IC = higher of £2m and TIA

TIA = IA + BFIA

IA = BIA + ANTII

For BIA, there is a choice between Fixed ratio or Group ratio (by election)

if Fixed ratio applies, BIA is the lower of 30% Group tax EBITDA = 30% x 40m = 12m and ANGIE. Assuming ANGIE is not restricting (which should be verified), BIA is 12m. This is then the group's interest capacity as it is higher than 2m.

The group should then calculate their ANTIE. For this purpose only UK entities would count.

It is likely that their NTII is 20kx4 = 80k being taxable interest income in Innovation.

Their NTIE would be 400k + 5m = 5.4m being third party loan interest and interest from Newness.

The ANTIe would then be calculated as NTIE - NTII (restricted to 0 if negative) = 5.32m

The disallowance would then be calculated as ANTIE - IC = 5.32m - 12m <0; the group is therefore not restricted.

d) Interest payments - double tax relief

Double tax relief may be sought in the UK in respect of foreign withholding taxes suffered. This would be by way of either credit relief or expense relief in the computation of Innovation's tax liability. Credit relief would be available where the foreign tax paid exceeds the UK tax payable on the same amount. In calculating this, Innovation should consider applicable expenses eg those relevant to operating the loan. Prima facie, it appears that credit relief should be available as the WHT in Huginland is at 30% which is a higher rate than the UK CT rate of 19%. This is provided that the interest income is actually taxed at this rate in Innovation. Credit relief reduces the CT liability by the amount of foreign tax payable. If this is not available, then the foreign taxes may be deducted in the UK CT computation when arriving at taxable profits.

e) Controlled foreign companies

Profits of Newness may be apportioned to Innovation and subject to UK CFC charge due to Newness being a controlled foreign company for the purposes of TIOPA 2010 s 371.

More detailed analysis would be required to establish whether the company may qualify for an exemption or, alternatively, if any profits would flow through the gateways.

Given that the corporation tax rate is 20% in Huginland, it may be possible that the tax exemption could apply and then all profits of Newness would be exempt and not attributable to Innovation.

**Question 2**

To: Emma and Jeff
From: ADIT
Date: 8 June 2022
Regarding SRT implications and remittance basis

1)

Given that both Gemma and Jeff are not UK domiciles, it is important to establish whether they are UK resident to determine which income if any is subject to tax in the UK. If they are UK resident , they will be subject to UK tax on their worldwide income and gains on an arising basis unless they choose to be taxed on a remittance basis.

In considering this, we must apply in turn the automatic overseas test, the automatic UK test, and the sufficient ties test.

O/s automatic
Emma and Jeff both spend more than 16, 46 and 91  days in the UK

and therefore automatic o/s test won't be met.

UK automatic
Geff is likely to meet the automatic UK test as he expects to spend more than 183 days in the UK in each year. He is therefore likely to be UK resident in both years. We will consider split year rules in respect of the first year below.

Sufficient ties

Given that neither of the automatic tests are met, we must consider whether Emma might be resident under the last test.

It appears that Emma has not previously visited UK before 2021/22 and therefore in order for her to be considered UK res in the first year and year after, she would need to consider 4 ties - family, accommodation, work and 90 day tie.

She spent 115 days in UK in 2021/2022 and therefore needs to have at least 3 ties to be considered UK resident.

- She is likely to have a family tie as Geff, her husband, is UK resident and her young children are also likely to be UK resident due to living in UK and being in school.

- She is also likely to meet the accommodation tie, as she rents out a flat that is available to her for more than 91 days in a tax year and she spent at least 1 night there during that tax year.

- She is unlikely to meet the 90 day tie on the basis that she has not been in the UK in either or both previous tax years before 2021/2022.

- Emma works <3 hrs/day on more than 30 occassions in a tax year.

She therefore is unlikely to meet the work test as this is less than 3 hours a day, 40 days in a year.

Emma is therefore unlikely to be UK resident in 2021/2022.

In respect of 2022/2023, both family and accommodation ties continue to be met, but Emma would also meet the 90 day tie due to having spent more than 90 days in the UK in 2021/2022. She would therefore be considered UK resident in 2022/2023.

In respect of the years when Emma and Geff are UK resident, split year rules may apply.

Emma and Jeff have no overseas employment and therefore are unlikely to meet cases 1 or 2 for the split year rules to apply. The also intend to keep their rented home in the UK so cases 4 and 5 are unlikely to apply. Cases 6 and 7 are also unlikely to apply as neither Geff nor Emma appear to be in full time employment. Case 8 may therefore be considered.

This applies where a person has not previously had a home in the UK but that changes during a tax year.

In order for this to apply, the following must be met:

- UK resident in tax year - met for Emma in 2022/23 and Geff for 2021/2022
- non-UK resident in previous tax year - met for Emma in 2022/23 and Geff for 2021/2022
- be UK resident for the following year - likely to be the case
- have no home in the UK at the beginning of the tax year but start to have a home during the year and continue to do so for the rest of the year and following tax year - met for Jeff in 2021/2022

- not have sufficient UK ties make them UK resident in the period from 6 April until a home is acquired (6 July 2021) - this should be considered further but may potentially be met for Jeff.

Jeff may therefore potentially be considered UK resident only for the part of the tax year from 6 July when they rented a home in the UK.

2) Remittance basis

Under this regime, individuals may elect to be taxed on a remitted basis in respect of their foreign income. Their UK income would continue to be taxed on an arising basis unless they also qualify for overseas workday relief in which case some of the income that relates to activities performed outside of the UK may also be taxed on a remitted basis.

If remitted basis applies, provided that foreign income exceeds £2k, the individuals would lose their annual exempt amount for CGT purposes and their personal allowance. Once the individual has been resident for over 7 years, they would also be subject to a remittance basis charge of £30k, which would further increase to £60 after they have been resident for 12 years.

The invidual must make a claim in advance of the tax year to which they want remittance basis to apply; otherwise they can make a claim within 4 years of the end of the period to which the claim applies. The election is to be made in respect of each year individually.

The conditions for remittance basis is that, in the desired year, the individual must be UK resident but non-domiciled. Note that the individual may be deemed domiciled for UK tax purposes but

this is unlikely to apply given that Emma has never been UK domiciled and has not yet spent more than 15 years as UK resident.

Pre arrival planning may include ensuring that any money that Emma does not wish to remit to UK are paid to an offshore bank account. Arrangements should be made for the trust to not make any discretionary payments to Emma. The shares listed on the London stock exchange are likely to be considered UK based as the register of these companies is likely to be in the UK.

Artwork should be kept overseas and disposed of overseas to prevent a chargeable gain arising in the UK.

Shares in non-UK companies are unlikely to be considered UK unless the proceeds of their sale or dividends are paid to a UK account.

**Question 3**

Note
From: ADIT
Date: 8 June 2022
Subject: UK PE considerations for Ozark Ltd

Under UK law, an entity would be considered to have a UK PE if:

- there is a fixed place of business in which the business of the enterprise is wholly or partly carried on; and/or

- an agent acting on behalf of the company has and habitually exercises an authority to conclude contracts in the name of the enterprise.

For the purposes of the above a fixed place of business may include but is not limited to a place of management, a branch, an office, a factory, a workshop, a mine/quarry/other place of extraction, a building site or construction than exists for >12 months.

The above would not be met if certain exemptions / exvlusions are met which are considered further below as relevant.

You should also consider the avoided PE case of the diverted profits tax when assessing how to structure your operations in the UK.

If there is a PE, the PE's profits would be subject to UK corporation tax at 19% under briadly the same rules as those for UK resident companies.

a) An independent distribution centre does not appear to be concluding contracts on behalf of Ozark and does not appear to be dependent on Ozark. Even if that is the case, the legislation specifically mentions that activities limited to purchase of goods or merchandise for the enterprise would not lead to there being a dependent agent.

Therefore there would only be a risk of creating a UK PE if it can be considered that there is a fixed place of business.

If activities are classed as being of preparatoty or auxilliary nature and there is no fragmented business operations, there would be no fixed place of business. These include:

- use of facilities for the purpose of storage, display, delivery

or goods belonging to the company
- maintenance of stock of goods or merchandise for display, storage or delivery
- maintenance of goods for the purpose of processing by another person
- purchasing goods or collecting information for the company.

Acquiring stock at discount might potentially be classed as auxilliary activities. However, it should be assessed further whether advertising might not meet the criteria and create a risk of a UK PE.

b) The sales personnel should not conclude any contracts. Attending exhibitios for 5 days should not, per se, create a risk of a UK PE. This argument would further be strengthened if there are no sales resulting from the attendance.

c) It is helpful that Silvia would not be concluding any contracts and that she would be a subcontractor as opposed to employee. However, she is unlikely to be considered an agent of independent status. There is therefore still a risk of there being a PE due to her being paid on a commission basis and the fact that she is not providing similar services to other companies.

d) This would likely constitute a PE due to there being a fixed place of business (office and shop). This argument would further be strengthened if the staff conclude contracts (eg sales) on behalf of Ozark.  If you would like to pursue this model, you should consider setting up a UK entity instead.

e) Similar to the above, third party warehouse provider in itself might not constitute a PE. However, you should consider application of digital services tax and offshore receipts of

intangible propety (ORIP) in respect of any UK online sales / sales to UK individuals and businesses. If this applies, there might be a significant tax charge in the UK, as DST is charged on revenues above a certain (threshhold) at 2%. If you would like to pursue this model, you should consider setting up a UK entity instead, to avoid any risks of being subject to DST.

**Question 5**

Memo
To: Luke
From: ADIT
Date: 8 June 2022
Subject: corporate residency of Pillow Soft

Background:

Under UK law, a company would be resident in the UK for tax purposes if it is either

- incorporated in the UK; or
- centrally mananged and controlled in the UK.

The latter is a question of fact and is established by reference to case law.

If a company is found to be resident in more than 1 jurisdiction, its residence status is established by reference to a double tax

treaty between the relevant jurisdictions. Under the OECD model treaty, there is a tie-breaker clause / non-discrimination clause that establishes that, if that is the case that a company is resident under both contries' domestic law, the competent authorities (eg HMRC in the UK) should endeavor to determine by mutual agreement (MAP) the country in which the company should be deemed resident, and this would be done with reference to its place of effective management, place of incorporation(UK)and other relevant factors.

It is noted that place of effective management is not necessarily the same as place of central management and control. The latter usually refers to the highest level of strategic decision making for a company whereas the former (POEM) usually relates to where the company's day-to-day activities are performed.

Appilcation:

Pillow Soft prima facie is likely to be considered UK resident for tax purposes as it was incorporated in the UK. However, if Zuterland law is similar to UK, it may be considered resident in Zuterland if its central management and control are exercised there.

As explained above, where CMC is exercised is a question of fact and is established by reference to historical case law (eg De Beers, Unit Construction, Laerstate).

The fact that Luke and Daisy are both directors of the company and are both moving to / becoming resident in Zuterland in itself does not indicate the residence of the company. It is a question of  whether Luke and or Lucy are exercising CMC in Zuterland (as opposed to UK or any other country). For establishing this, it may be helpful to understand what decisions Luke and Lucy are

making, where they are making these, and what the other directors (if any) contribute to management of the company and where. If Luke as a managing director abuses his power and dictates the company what it should do (even if unlawfully so), this would point to CMC being exercised where Luke is making those decisions, e.g. Zuterland and not UK

If directors exercise their powers jointly and according to the company's articles, if board meetings take place in Zuterland, this would strongly indicate that CMC is exercised there and not in the UK.

If a company is found to be resident in both UK and Zuterland, the ultimate residence is decided by reference to the treaty tie breaker clause, i.e. through MAP. When establishing this, the tax authorities will consider POEM.

Despite the fact that all manufacturing occurs in Taiwan, it is unlikely to be considered the POEM in and of itself. However, you should monitor the risk of these activities leading to the company creating a PE in Taiwan and/or becoming resident in Taiwan according to local law.

The fact that the company's head offices and warehouse will be located in Zuterland may indicate that some of the POEM is exercised there, although it would be helpful to understand what activities exactly will be undertaken there. E.g. will it be where the company records are held.

The fact that the UK offices and warehouses would remain open also suggest that some POEM would continue to be exercised there.

<u>Consequences:</u>

If a company continues to be UK resident either under domestic law or the tax treaty, UK, it will continue to be subject to UK

corporation tax.

If the company is no longer UK resident, it will cease to be subject to UK corporation tax on its worldwide income and gains.

The fact that it would continue to have presence in the UK might mean that it would have a UK branch. The branch's profits would then continue to be subject to UK CT.

Zuterland does not appear to be in the EU. As such, exit charges may arise if the company ceases to be UK resident. The company should ideally have notified HMRC in advance of ceasing to be UK resident, detailing the applicable dates and outlining how it would pay any outstanding tax and interest, relating to both historical periods as well as any exit charges.

The exit charges become payable 9 months and 1 day after the end of the accounting period. Payment plans may be available if Zuterland is in the EU. Certain events, such as appointment of a liquidator or disposal of certain assets, might trigger immediate payment of the tax liability in full or in respect of the particular asset.

The cessation of being UK residence triggers the end of an accounting period.

**Question 6**

Email

To: CFO of Logistics Inc
From: ADIT
Date: 8 June 2022

Re: UK implications of purchasing Trucks Ltd

1) UK Filing and compliance obligations on intercompany charges

Background and administration

Trucks appears to have previously been a medium enterprise and therefore had a choice whether to apply transfer pricing in respect of transactions with related parties. This is due to a small number of employees (86 <250), assets (<43m EUR) and revenues (<50m EUR).

Logistics appears to clearly be a large MNE as it is in excess of the above named threshholds and therefore must apply TP.

Following the acquisition by the Logistics Group, it must appy transfer pricing in respect of any transactions with related parties (eg Logistics), maintain transfer pricing documentation (including but not limited to policy doucuments, master file and local file) and submit country by country reports. There is no requirement to submit the local and master file in the UK but they should be maintained in respect of each accounting period and produced on an annual basis (contemporaneously). HMRC may request to see this documentation. These documents must then be retained and updated on a periodic basis to ensure accuracy. The transfer pricing policies should ideally also be supported by appropriate intercompany legal agreements.

Given that country by country reports are being filed in the US, according to the tax treaty, there is no requirement to

additionally submit these reports in the UK. However, Trucks must submit a notification to HMRC which would detail where the report is being submitted and by which entity. This must be done within 12 months of the end of the accounting period and is often provided alongside the CT return.

<u>Transactions</u>

Trucks should apply transfer pricing in respect of all transactions with related parties, which includes Logistics. The Group should set an appropriate transfer pricing policy for remunerating Trucks fairly on an arm's length basis for the activities it performs.

For doing so, Group must delineate the transactions between Trucks and any other group entities, characterise them and set an appropriate transfer pricing policy for remuneration. In doing so, it may be helpful to conduct economic and functional analysis, including interviews with key personnel where it would be establish who is doing what where, such that those parties could be appropriately remunerated. It is noted that there may be a difference between accounting and tax figures as a result of applying transfer pricing policies. E.g. there may be no accounting charge for provision of certain services but for tax purposes an amount may be imputed.

Transactions requiring the above analysis would likely include access to transport tracking and planning software, as well as any management recharges from Logistics to Trucks and any provision of goods or services between the companies.

When considering transactions in relation to intangibles and the license agreement specifically, the Group should refer to the DEMPE principles (Development, Enhancement, Maintenance, Protection and Exploitation). This is because it is not always appropriate to simply reward the legal owner of the IP with the

profits arising from it. Consideration must be given to other parties participating in the DEMPE activities and establishing economic ownership of the IP, which may be in a different jurisdiction to that of legal ownership.

Methodologies

The group should use appropriate methodologies for determining which level of remuneration may be appropriate for the transactions.

Given the nature of the IP, unless there is readily available information on third party comparable software or this same software is also being provided to third parties, it is unlikely that CUP would be an appropriate method. Resale price method is also unlikely to be appropriate for software licensing transactions. Therefore the Group might consider transactional profit methods for pricing the IP license.

2) Stamp duty implications

Stamp duty may be payable on the purchase of shares in UK companies. If so, it would be payable at 0.5% and a stamp duty return must be shared with HMRC within 30 days of the sale; otherwise penalties and interest may apply.