THE ADVANCED DIPLOMA IN INTERNATIONAL TAXATION

June 2022

MODULE 2.09 – UNITED KINGDOM OPTION

SUGGESTED SOLUTIONS

PART A

Question 1

Part 1

To: Finance Director
From: Tax Adviser

The purpose of this memo is to set out the UK corporation tax implications of the proposed:

- £100m loan from Planet Bank to Innovation Ltd;
- £20m loan from Innovation Ltd to Newness Ltd; and
- acquisition of Newness Ltd by Innovation Ltd.

Plant Bank loan to Innovation Ltd

Interest is allowable as a tax deduction, if it is incurred wholly and exclusively for the purposes of the business. Usually, where the borrowed money is used to finance the acquisition of business assets or to provide working capital for the trade, the interest is then incurred wholly and exclusively for the purposes of the business. As the loan provided by Planet Bank is to fund the acquisition of shares, the interest should be treated as tax deductible. In addition, as the loan is being provided by an external bank, there should be no thin capitalisation issues or anti-hybrid mismatches arising on the deduction in Innovation Ltd.

Loan from Innovation Ltd to Newness Ltd

The interest charged by Innovation Ltd to Newness Ltd should be calculated using the arm's length principle, to ensure that the intercompany interest is appropriate for transfer pricing purposes. Where the interest charged is not deemed as arm's length, an adjustment may be required to increase the interest received to ensure the correct profits are being taxed in the UK. The interest received will be taxed in Innovation Ltd on an accruals basis and chargeable to tax at a rate of 19%

Corporate Interest Restriction

Due to the level of new funding in Innovation Ltd, we need to consider the Corporate Interest Restriction ('CIR'), which is the UK's legislation for implementing the Organisation for Economic Cooperation and Development's best practice recommendations for limiting base erosion and profit shifting by means of excessive tax deductions for financing costs.

The CIR rules restrict the interest expenses deductible for UK corporation tax purposes within UK groups who have a net interest expense over the threshold of £2m.

The rules seek to restrict a group's deductions for interest expense and other financing costs to an amount which is commensurate with its activities taxed in the UK, taking into account how much the group borrows from third parties. Where amounts are disallowed in one accounting period they may be carried forward and be deducted in a subsequent period.

Groups with a net interest expense above the de minimis of £2m will be subject to a cap on interest deductions under the CIR.

Where a group's net interest expense is greater than its interest capacity in an accounting period, the excess (the 'total disallowed amount') will be disallowed. The interest capacity can be worked out using either the 'fixed ratio' method or the 'group ratio' method, depending on which gives the largest allowance. Under the fixed ratio method, the interest capacity is the lower of:

- 30% of the group's UK taxable EBITDA; and
- the group's worldwide net interest expense

Any restriction is given effect by allocating the disallowed interest to companies in the group that are within the charge to UK corporation tax and which have a net interest expense in that period.

The interest on the excessive part of the loan will be disallowed as a deduction in arriving at the assessable profits or allowable losses of the borrower.

The restriction is given effect by allocating the disallowed amount to companies in the group that are within the charge to UK corporation tax and which have a net interest expense in the period of account.

A disallowance allocated to an individual company reduces that company's deductions for debits in the accounting period or accounting periods that overlap the period of account.

Amounts that are disallowed under the corporate restriction are carried forward indefinitely for relief as a deduction in a later period in which there is sufficient capacity for the deduction to be made.

As the annual interest expense will exceed £2,000,000 de minimis, the CIR rules will apply to Innovation Ltd.

Total interest expense = £5,400,000 (£5,000,000 plus current £400,000)

Total interest income = £80,000 (£20,000 per quarter)

Net interest expense = £5,320,000

30% of Tax EBITDA = £12,000,000

However, as the group’s tax EBITDA exceeds the net interest expense, there should be no restriction for Innovation Ltd applying the fixed ratio method. However, a CIR return will need to be submitted to HMRC.

<u>Acquisition of Newness Ltd</u>

The Controlled Foreign Company (‘CFC’) rules are anti-avoidance provisions aiming to prevent diversion of UK profits to overseas territories with lower tax rates. A foreign company will be a CFC if it is a non-resident UK company that is controlled by UK resident persons. The controlling persons can be corporate entities or individuals.

Innovation Ltd will have control of Newness Ltd.

There are a number of exemptions in place to prevent profits from genuine commercial arrangements falling into these rules. The exemptions are:

- Exempt Period Exemption - this provides an initial 12 month temporary exemption when the CFC first comes under UK control.

- Excluded Territories Exemption – if the CFC is resident in an excluded territory (defined by regulations) and other conditions are met.

- Low Profits Exemption – where profits are below £50,000 or below £500,000 with less than £50,000 of non-trading income.

- Low Profit Margin Exemption – applies where the accounting profits before interest are less than 10% of operating expenditure.

- Tax Exemption - provides an exemption where the local tax amount is at least 75% of the corresponding UK tax.

As the tax rate in Huginnland is 20% and higher than the UK tax rate of 19%, the Tax Exemption should apply.

<u>Part 2</u>

As Newness Ltd is not UK tax resident, then based on the double tax treaty in place, Newness Ltd would need to withhold tax on the interest payments made to Innovation Ltd at a rate of 30%.

We note that there is annual interest paid of £80,000, therefore there would be withholding tax each year paid to Huginnland of £24,000.

The interest of £80,000 received by Innovation Ltd would be taxed in the UK at a rate of 19%. As the withholding tax rate is higher than the UK rate of tax, the double tax relief is required to be restricted the lower of the withholding tax paid or the UK tax charge in respect of that income. As a result, the double tax relief would be restricted at £15,200 per annum for Innovation Ltd.

When Newness Ltd pays dividends to Innovation Ltd, it will be required to withhold tax at a rate of 20% based on the double tax treaty. The receipt of dividends by Innovation Ltd in the UK should be exempt from tax.

Question 2

Part 1

Emma intends to spend 115 days in the UK in 2021/22 and 150 days in the UK in 2022/23. Emma's residence will be determined by reference to the statutory residence test, which is set out in FA 2013 Schedule 45 Part 4. Under the SRT a day is counted as a UK day if the person is in the UK at midnight. There are very limited exceptions where days in the UK do not count.

Within the SRT 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 Emma satisfies any of the automatic overseas tests then she is not UK resident for that tax year. The SRT also distinguishes between "leavers" and "arrivers" to the UK. As Emma has not previously been UK resident she is treated to be an "arriver" under the SRT, for the purpose of applying the tests.

The first automatic overseas residence test applies to "leavers". As Emma is not a "leaver", this test is not applicable. The second automatic overseas test applies to "arrivers", i.e. those who have not been UK resident in any of the three prior years; it provides that where an "arriver" spends less than 46 days in a tax year in the UK, they are automatically non-resident. Clearly Emma does not meet this condition in either 2021/22 or 2022/23. The third automatic overseas test applies where a person leaves the UK to take up full time employment abroad, which would not apply to Emma.

As Emma has 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 a taxpayer will be UK resident for the tax year if they spend 183 days or more in the UK in the tax year. If Emma spends 115 days in the UK in 2021/22 and 150 days in the UK in 2022/23 she will fail this test for both years. Turning to the Second automatic UK test; a taxpayer will be UK resident for the tax year if they 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 they had a home in the UK;
- at least 30 of these 91 days fall in the tax year when they have a home in the UK and are present in that home for at least 30 days at any time during the year; and
- at that time either, the taxpayer had no overseas home, or if they had an overseas home, they were present in it for fewer than 30 days in the tax year. As Emma intends to spend 35 days in France at her apartment on the Cote de Azure she will not meet this test in either tax year.

The Third automatic UK test relates to full-time working in the UK. As Emma is not planning to work full time in the UK we do not need to consider this test. As Emma does not satisfy any of the automatic non-resident tests or the automatic UK resident tests, her tax resident status will be determined by the sufficient ties tests. As explained above Emma is classified as an "arriver" for the purpose of applying these tests. The number of UK ties she has, will determine how many days she may spend in the UK in the tax year without being UK resident. As Emma is an 'arriver' 4 ties are relevant.

Accommodation

Any accommodation that is available for a taxpayer'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 must actually be used for at least one night during that tax year, before it counts as a tie. As Emma will rent a UK home she will have an accommodation tie.

Family

As her partner Geoff will spend at least 183 days in the UK each tax year and thus be UK tax resident, he will constitute a family tie.

90 Day tie

As Emma has not spent any time in the UK in either of the past two years she will not have a 90 day tie for 2021/22.

However, for 2022/23 if she spends 115 days in the UK in 2021/22, she will have a 90 day tie in that year.

Work tie

While Emma is likely to do some work in the UK, it is unlikely she will work for more than 3 hours on more than 30 occasions per tax year. Emma will therefore not have a work tie in either year.

Thus for 2021/22 Emma has two UK ties, being accommodation and family. For 2022/23 she will gain a third tie being the "90 day" tie.

The following table applies to "arrivers" and explains the relationship between the number of ties an arriver has with the UK and the number of days they may spend in the UK without becoming resident here.

Days spent in the UK in the tax year	UK ties needed
46 - 90	All four
91 - 120	At least three
Over 120	At least two

As Emma has only 2 UK ties in 2021/22 and intends to spend only 115 days in the UK in that year she will not be UK resident in 2021/22. For 2022/23 she will have 3 ties and intends to spend 150 days in the UK so will therefore be UK resident under the SRT for 2022/23.

Geoff will be UK resident under the first automatic UK resident test for both 2021/22 and 2022/23 as he intends to spend at least 183 days in the UK in each of those years.

Split Year: Geoff's UK Dividend

Section 368(2A) ITTOIA states:

If income arising to an individual who is UK resident arises in the overseas part of a split year, it is to be treated as arising to a non-UK resident.

As UK dividend income, is 'disregarded income', if received by a non-resident, the large dividend Geoff will receive in May 2021 would effectively constitute pre-arrival capital provided Geoff qualifies for split year treatment.

Geoff is planning to arrive in the UK on 6 July 2021 and will spend 183 days in the UK in the period 6 July 2021 – 5 April 2022.

The SRT sets out 8 cases where split-year treatment may apply. 5 of these cases apply to "arrivers"

Case 4: Start to have only home in the UK

Para 47(5) Sch 45 FA 2013 states:

The "only home test" is met if:

- *the taxpayer has only one home and that home is in the UK, or*
- *the taxpayer has more than one home and all of them are in the UK*

As the family home in Australia is to be retained clearly this test will not be met.

<u>Case 5: Start work in the UK.</u>

Clearly Geoff fails this test.

<u>Case 6: Stop Work Overseas</u>

Para 49(2) Sch 45 FA 2013:

The taxpayer:

- *Was not resident in the UK for the previous tax year because the taxpayer met the third automatic overseas test for that year, but*

- *Was resident in the UK for one or more of the 4 tax years immediately preceding that year*

Geoff fails this test as he does not meet condition b) since he was not resident in the UK in any of the 4 preceding tax years.

<u>Case 7: Partner stops work overseas</u>

Clearly this test is failed.

<u>Case 8: Start to have a UK home</u>

The conditions are:

- At the start of the year there is no UK home but a UK home is acquired and the taxpayer continues to have a home in the UK for the rest of that year and the whole of the next.

- The taxpayer must also not have sufficient ties in the period prior to becoming UK resident.

- The taxpayer must also be UK resident in the following year.

As Geoff will only start to have a UK home during the tax year which will be retained for the entire following tax year he satisfies the first condition. He also satisfies the second condition as he does not visit the UK until 6 July, so cannot satisfy sufficient ties in the period 6 April 2021 to 6 July 2021. Geoff satisfies the final condition as he will be UK resident for 2022/23.

Geoff therefore satisfies the split year treatment and the dividend he receives in May 2021 from the UK company will fall in the overseas part of the split year and will therefore not be chargeable to UK tax.

Turning to the planned disposal of a substantial foreign shareholding; Section 1G TCGA 1992, provides the usual split year rule. Therefore gains of the overseas part of a split year are in principle not subject to CGT.

<u>Part 2</u>

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 both the sale of UK commercial and residential property. 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.

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

The Jetson Discretionary Trust

The Jetson Discretionary Trust holds foreign property assets, shares in non-UK trading and investment companies and valuable artwork.

If distributions are made from this trust whilst Emma is UK resident, these will be taxable if remitted to the UK. Likewise if benefits are provided to Emma in the UK, the tax value of these benefits may be assessed on Emma.

The Trust is an excluded property trust, so is not chargeable to UK inheritance tax.

Planning

As Emma will not become UK tax resident until 6 April 2022, she has significant time to plan her affairs to benefit from the remittance basis.

Any amounts Emma brought to the UK from 6 July 2021 to 5 April 2022 will not be subject to UK taxation as Emma only became UK resident from 6 April 2022.

If possible, cash should have been generated whilst Emma 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 Emma is UK resident. The preserved capital would then be available to be utilised by Emma, after she becomes UK resident to fund UK expenditure.

Emma'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 could have been undertaken to rebalance the portfolio to exclude UK assets.

PART B

Question 3

Under s1141 CTA 2010, the UK legislation provides that an overseas company such as Ozark Ltd ('Ozark') will have a PE in the UK if:

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

Under s1141 (2) CTA 2010, 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 under s1143 CTA 2010 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;

- Purchasing goods or merchandising, or collecting information, for the company.

Based on the information provided, we have outlined below the potential risks of creating a UK PE in the proposed scenarios:

- There is no fixed place of business available to Ozark in this scenario. The distributor would be operating an independent business from Ozark, therefore the agency rules would not become relevant, then no PE should arise.

  In addition, the advertisements proposed should fall under the exemption as preparatory or auxiliary activities from creating a UK PE;

- The attendance at the exhibitions should not trigger a fixed place of business in the UK, as the location would not be used by Ozark for significant period of time. The sales personnel would be deemed to be dependent agents, however due to the exhibitions only lasting five days, any sales made would not meet the habitually concluding condition required, therefore no PE should arise.

  The demonstration activities should fall within the preparatory and auxiliary exemption and no PE should arise;

- There is no fixed place of business, as there is no office being provided to Silvia. Whilst Silvia would not be an employee, as she would not be undertaking any other work for other companies, the engagement between Ozark and Silvia would be treated as that of a dependent agent. However, as Silvia is unable to conclude contracts and they need to be sent to Ozark for approval there should be no PE arising;

- When Ozark enters a lease, the use of the office in the UK would trigger a UK fixed place of business and a UK PE would arise;

- The use of online marketplace / website would not be considered as a fixed place of business, as the above conditions are not met, therefore no PE arises. Whilst a warehouse is a fixed building that Ozark has at its disposal, the use of a warehouse is explicitly excluded and would fall within the auxiliary exemption with no PE being created.

Question 4

Part 1

Business investment Relief allows remittances to be made to fund the acquisition of interests in UK trading companies subject to certain conditions. It should be noted that commercial investments into UK retail estate are specifically eligible for the relief. Therefore if Louis structures the proposed acquisition of the flats through a UK company it may be possible for Louis to claim BIR on the investment, subject to meeting the conditions for the relief.

The relief is explained in more detail as follows:

From 6 April 2012 non-domiciled, remittance basis taxpayers who bring their foreign income or gains to the UK and invest it 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:

    - Acquiring 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.

Reviewing the proposed investments it is strongly advisable that the flat intended for the use of his son Marcel is not acquired by the company which is intended to qualify for BIR. This is because it may cause risk that the investment fails the enjoyment of a benefit/ extraction of value rules, or alternatively does not qualify as a commercial letting business.

<u>4 Flats intended to be commercially let</u>

Turning to the 4 flats intended to be let commercially, Louis might therefore set up a company and fund it by way of a subscription for shares or shareholder loan, or a combination of both. The company could then acquire the 4 flats. Louis could also then provide further funds e.g. by way of shareholder loan to fund the refurbishment of the properties by the company. It is noted that the properties are to be renovated, however provided the renovations are completed within 12 months this would be well within the requirement to commence trading within 5 years.

To prevent the withdrawal of BIR on any future disposal, Louis must transfer the sale proceeds offshore within 45 days, or alternatively make another qualifying BIR investment within this period. The 45 day period starts from the date he receives the funds and not the date of the disposal. It should be noted that if the proceeds or deemed proceeds are greater than the amount originally invested the excess can remain in the UK. (s 809VI(3)).

<u>Flat intended to be used by Marcel</u>

Louis should acquire the flat intended to be made available to his son, Marcel, directly. This is to avoid the acquisition potentially jeopardising the claim for BIR on the 4 flats intended to be let out commercially.

Any funds used to acquire this flat would not qualify for BIR and would be taxable if untaxed foreign income or gains were remitted.

Any sale of this property would be the sale of a UK asset and not be eligible for the remittance basis. The normal capital gains tax rules would apply to compute the gain or loss arising.

<u>Part 2</u>

<u>ATED</u>

An annual charge applies to UK residential Property purchased through companies. The charge depends on the market value of the property.

Chargeable amounts for 1 April 2021 to 31 March 2022 Property value Annual charge:

- More than £500,000 up to £1 million – £3,700
- More than £1 million up to £2 million – £7,500
- More than £2 million up to £5 million – £25,300

Certain reliefs apply to ATED; these include Property Rental Businesses FA13/S133. Relief from ATED is available where a residential property is exploited as a source of rents or other receipts in the course of a qualifying property rental business. s133(1)(a). Where the single-dwelling interest is not currently generating receipts from the business, relief will be available where steps are being taken to rent the property without delay. This may apply where a taxpayer first purchases a property but requires time to find a tenant or if there is a period of nonoccupation between lettings. It might also apply if renovation work was required before letting s133(1)(b).

Qualifying property rental business

To qualify for relief the person must be carrying on a qualifying property rental business:

- The business must meet the criteria of a property rental business as defined in Chapter 2 of Part 4, CTA 2009; and

- It must be conducted on a commercial basis and with a view to a profit. Louis' investment may therefore be structured in a way that qualifies both for BIR and ATED.

Thus if the company also acquired the flat used by Marcel's son ATED relief would not be available.

SDLT

If UK residential property is acquired through a company a higher 15% rate of SDLT applies. However a similar relief to that applying to ATED applies if the company carries on a property rental business. FA03 s55 & Sch 4A: property rental businesses FA03 Sch 4A para 5. Where the acquisition of an interest in UK residential property is exclusively made for the purpose of exploitation as a source of rents, etc. in the course of a qualifying property rental business, the 15 per cent higher rate charge does not apply. Instead, SDLT will be charged at normal higher rates. A qualifying property rental business:

- Must fall within the definition of property rental business in Chapter 2 of Part 4, CTA 2009; and

- Must be carried on, on a commercial basis and with a view to a profit.

Thus if the company also acquired the flat used by Marcel's son SDLT relief would not be available.

IHT

On the assumption that a UK company is used, the inheritance tax provisions dealing with the offshore ownership of UK residential property would not apply. The investment either through subscription for shares or shareholder loan would be subject to UK inheritance tax, since these constitute UK situs assets. It is unlikely that investment in UK residential property would qualify for relief under the business property relief provisions which require there to be a trade, so therefore the investment is likely to fall within Louis' estate in the event of his death.

Income Tax and CGT

Any dividends or interest payments received by Louis from the UK company would be subject to tax on an arising basis. A future disposal of shares in the company would be subject to Capital Gains Tax.

PART C

Question 5

To: Luke
From: Tax Adviser

The purpose of this memo is to set out how the corporate residency status of Pillow Soft Ltd could be affected by your move to Zuterland and what the tax consequences of any change in residency may be.

Ordinarily, a company is resident in the UK if it is incorporated in the UK or the central management and control of its business is in the UK. The meaning of central management and control is based on case law and is broadly where the highest level of control of a company's business is undertaken. There have been many cases brought before the courts which have set various precedents which help to clarify the management and control of a company, however these are mostly based on the facts of each case. Some key cases include De Beers and Unit Construction.

As Pillow Soft Ltd was incorporated in the UK, the starting point is that it will be UK resident for corporation tax purposes. A company incorporated in the UK which is resident here under the incorporation rule of s14 CTA 2009 does not automatically cease to be resident if it transfers its central management and control out of the UK. However, if another country were also to claim that Pillow Soft Ltd were resident there, we would have to look to the relevant tax treaty to determine its residence.

Based on the Model Tax Treaty, under Article 4, there are provisions where a company could be deemed as double tax resident and the tie-breaker provision under Article 4 (3). Ordinarily, this relates to the effective place of management and control. The multi-lateral instrument ('MLI') included within the Model Tax Treaty outlines that any company which may be deemed as dual resident should seek agreement between the two Competent Authorities. The MLI, which came into force in the UK on 1 October 2018, is a complex document. It does not operate as an amending protocol but contains a number of optional and alternative provisions that signatories can choose between. The change to the residence tie breaker has been integrated into most of the UK's Treaty network, however the commentary will consider the country of incorporation, place of effective management and control and other relevant factors to the case.

Based on country of incorporation, Pillow Soft Ltd's residency should remain in the UK, however as the Managing Director and another Director have become tax resident in Zuterland along with core activities of the business being undertaken in Zuterland, the tax authorities in Zuterlland may claim that Pillow Soft Ltd should be tax resident in Zuterland. As a result, consideration of the double tax treaty is required.

Under the MLI, the competent authorities shall determine which country the company is tax resident by mutual agreement, taking into account management and control, incorporation and other relevant factors. This usually includes the location of board meetings, where the senior executives carry out their business, where the day-to-day management is carried on and where the true headquarters of the business is located.

As it would appear that Daisy and yourself would hold the management and control of the company and are likely undertake board meetings and operational decisions in Zuterland, the competent authorities are likely to conclude that Pillow Soft Ltd is treaty resident in Zuterland. However, we would need to see the following additional information to be able to conclude in detail:

- How often will Daisy and yourself be travelling back to UK?

- Where are Board meetings now being held?
- Are you proposing to appoint more Directors and would they be based in the UK?

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If Pillow Soft Ltd were to no longer be UK tax resident a corporate migration will be required. On migration, Pillow Soft Ltd will have possible 'exit charges' as it will effectively be disposing of its assets resulting in potential chargeable gains and profits / losses arising on loan relationships, derivative contracts, corporate intangibles and trading stock. It must also notify HMRC of its intention to cease to be resident, and migration time; provide a statement of its tax liabilities, make arrangements for the settlement of these liabilities in due course and obtain HMRC's approval of the arrangements.

Under Article 5 of the Model Tax Convention, a permanent establishment in UK should arise on the basis that a fixed place of business, being the office and warehouse is located in UK The profits arising in the branch should be taxed in UK and double tax relief should be available in the Zuterland.

Question 6

To: Chief Finicial Officer, Logisitcs Inc
From: Tax Manager

Following your request, I have outlined below the UK tax requirements following your acquisition of Trucks Limited.

Part 1

As a UK tax resident company, Trucks Limited is required to file annual corporation tax returns to HMRC, which are due 12 months following the accounting period. For the accounting period ended 31 December 2021, the return is due for filing to HMRC by 31 December 2022.

Trucks Ltd will be liable to pay UK Corporation tax at a rate of 19% on its taxable profits for the year. Ordinarily, the corporation tax liability is due for payment nine months and one day following the end of the accounting period. For Trucks Ltd, this would be 1 October 2022. Following the inclusion of Trucks Ltd within the Logistics Inc Group, the payment of UK corporation tax will likely fall within the quarterly instalment payments regime, where the UK corporation tax payments are made on a quarterly basis and calculated based on the levels of profits within Trucks Ltd.

There are two thresholds for the regime, with the thresholds being reduced by dividing them by the number of related 51% group companies plus one. Firstly, if Trucks Ltd has taxable profits between the adjusted thresholds of £1.5 million and £20 million, the payments are due 6 months and 13 days after the first day of the accounting period, 3 months after the first instalment, 3 months after the second instalment (14 days after the last day of the accounting period) and 3 months and 14 days after the last day of the accounting period. Secondly, where Trucks Ltd exceeds the adjusted £20 million threshold, equal payments are due 2 months and 13 days after the first day of the accounting period, 3 months after the first instalment, 3 months after the second instalment and 3 months after the third instalment.

As Trucks Ltd is now part of a group, a Country by Country Report ('CbCR') will required in the UK if the company is in a Group with at least one company based in the UK and at least one company in another country and the consolidated group revenue is at least €750 million. When Trucks Ltd joins the Logistics Inc Group, these conditions will be met. A UK Entity that is required to file can apply an exception where, by the filing deadline, the information it would be required to file has already been included either a CbCR which has already been received by HMRC or a CbCR filed with a jurisdiction that will exchange information with HMRC.

As there is a Double Tax Treaty in place, Trucks Ltd can avail of the CbCR exception, however it will be obliged to notify its exception to HMRC by the filing deadline to confirm that the CbCR is being filed in the US, the date of the CbCR filing in the US and which entity in the Group made the CbCR filing. The deadline for filing a CbCR is 12 months after the end of the period to which it relates.

In addition, when Trucks Ltd joins the Logistics Inc Group, they will be deemed large for UK transfer pricing purposes. The UK transfer pricing rules (TIOPA 2010 Part 4) require that transactions undertaken between connected persons should be undertaken at an arm's length price (ALP). Transfer pricing legislation not only relates to cross border transactions, but also to transactions between connected UK entities. The legislation applies to large enterprises which have more than 250 employees, greater than €50 million turnover or a balance sheet total of greater than €43 million. There are exemptions for SMEs where the company has no more than 50 staff and either an annual turnover or balance sheet total of less than €10 million. Prior to the acquisition, Trucks Ltd would have met the conditions for this exemption, but will no longer following its acquisition.

We note that the Logistics Inc Group is drafting an intercompany agreement and a Master File in the US, which is not sufficient from a UK compliance perspective. The intercompany transactions between Logistics Inc and Trucks Ltd will include a license fee for use of IP and management fees. In order to be compliant and to support the arms' length principle, it should finalise intercompany agreements for each of these transactions, carrying out a benchmarking survey in order to determine the best method to use for setting an arms' length price for each transaction. The Logistics Inc Group should also update the current Master File for the Group to include Trucks Ltd. The Master File is a high level global review of the Group and will include the Group structure, geographical locations in which it operates, overview of its supply chain, a general description of the transfer pricing policy, the types of intercompany transactions it has and its consolidated financial statements, etc.

Trucks Ltd should also prepare a Local File in respect of its operations and intercompany transactions in the UK. This file will include a more detailed, country specific analysis of the intercompany transactions and will include the local organisation structure, key competitors, details of the controlled transactions, a detailed comparability and functional analysis, details of the transfer pricing method used and the local entity financial statements. The Master File and Local Files do not need to be submitted to HMRC as part of the Corporation Tax Return, however there are penalties for failing to have any documentation in place and tax geared penalties could be charged.

Part 2

Whilst Logistics Inc is not a UK tax resident entity, as Trucks Limited is a UK incorporated entity, the shares would be treated as UK shares and within the scope of UK Stamp Duty. Logistics Inc would be liable to UK Stamp Duty on the acquisition of shares in Trucks Ltd. The rate of Stamp Duty on shares is 0.5%, therefore Logistics Inc would be liable to Stamp Duty of £125,000. The Stamp Duty forms and payment should be submitted and paid to HMRC within 30 days of the transaction.

Question 7

Part 1

The legislation sets out five steps to identify the order of priority in which income, gains and amounts of capital are treated as having been remitted to the UK (2007 ITA section 809Q(3) and (4)).

When income, capital or gains enters a mixed fund it is usually considered to lose its 'identity' within that fund. Rules are therefore required to determine what any subsequent remittance from that fund is comprised of. These rules prevent a taxpayer avoiding tax by contending, that a remittance from a mixed fund was made out of capital within the fund (and therefore not taxable) rather than out of foreign income in the same fund.

These rules only apply to foreign income or gains that arose or accrued after 6 April 2008.

The rules contain a strict ordering hierarchy, UK taxed employment income is treated as remitted first. After this untaxed foreign income is treated as being remitted in priority to untaxed foreign gains, which are both deemed to be remitted in priority to foreign taxed income and gains. Amounts of capital of a tax year are taken into account last. These ordering rules are applied on a year by year basis using the Last In First Out' (LIFO) principle. Therefore, Income and gains, etc. of a later tax year are treated as remitted before those of an earlier tax year.

Each transfer is separately identified and 'matched' against the amounts of income and capital that were in the fund immediately prior to the transfer.

It should be noted that a special rule applies where a mixed fund makes an overseas transfer, e.g. to another overseas bank account. In this case the amount transferred is treated to be a proportionate slice of the mixed fund immediately before the transfer. There is an anti-avoidance rule to ensure the mixed fund rules cannot be manipulated.

The effect of these rules may be minimised by carefully operating segregated accounts. Thus Jason should open up separate accounts for (a) Foreign income (b) foreign capital gain (c) capital. Going forward he should ensure that these new accounts are strictly operated. He should not add any further funds to his current mixed fund account. In the event that future remittances will be required these should first come from the new Capital account and then from the existing mixed fund account as when the remaining untaxed foreign income is remitted the balance will be pure capital.

Part 2

French painting £100,000

The mixed fund is treated as remitted on a LIFO basis. No transfers were made into the mixed fund for the 2021/22 tax year. In 2020/21 an inheritance of £100,000 was paid into the account, this will be treated as remitted to the UK. As an inheritance is capital, Jason may bring the painting into the UK without creating a taxable remittance.

Sports Car £250,000

The mixed fund is treated as remitted on a LIFO basis. No transfers were made into the mixed fund for the 2021/22 tax year. In 2020/21 an inheritance of £100,000 (Capital) was paid into the account, this will be treated as remitted to the UK. This leaves a balance of £150,000, which will be treated as remitted from transfers made into the account in 2019/20.

Transferred in y/e 5 April 2020:

£270,000 (Comprising £50,000 capital, £20,000 UK taxed employment income, £100,000 Foreign untaxed Income, £100,000 Foreign capital gain)

Applying the ordering rules:

£20,000 UK taxed income will be treated as remitted first.

£250,000 – (£100,000 + £20,000) = £130,000.

Foreign untaxed income will then be treated as remitted £130,000 -£100,000 = £30,000.

The 'final' £30,000 will be treated to be Foreign capital gain.

If the sports car is brought to the UK, Jason will therefore be treated as making the following remittance:

20/21	£100,000 capital
21/22	£20,000 taxed UK employment income)
	£100,000 Untaxed foreign income
	£30,000 Foreign capital gain
	£250,000

<u>Both Car and Painting</u>

If both the car and painting were purchased and brought to the UK, at the same time:

Total remittance £100,000 + £250,000 = £350,000

The mixed fund is treated as remitted on a LIFO basis. No transfers were made into the mixed fund for the 2021/22 tax year. In 2020/21 an inheritance of £100,000 (Capital) was paid into the account, this will be treated as remitted to the UK first. This leaves a balance of £250,000, which will be treated as remitted from transfers made into the account in 2019/20.

Transferred in y/e 5 April 2020:

£270,000 (Comprising £50,000 capital, £20,000 UK taxed employment income £100,000 Foreign untaxed, Income £100,000 Foreign capital gain)

Applying the ordering rules £20,000 UK taxed income will be treated as remitted first.

£350,000 – (£100,000 + £20,000) = £230,000.

Foreign untaxed income will then be treated as remitted £230,000 -£100,000 = £130,000.

£100,000 will be treated to be Foreign capital gain.

£130,000- £100,000 = £30,000

£30,000 will be treated as capital.

If the sports car and painting are brought to the UK, Jason will be treated as making the following remittance:

20/21	£100,000 capital
21/22	£20,000 taxed UK employment income)
	£100,000 Untaxed foreign income
	£100,000 Foreign capital gain
	£30,000 Capital
	£350,000

Question 8

Gina's domicile status

Domicile is a concept distinct from residence, and in essence refers to the jurisdiction an individual considers to be their permanent home. Domicile status is decided under general law, which means it must be interpreted according to case law. There are various factors which affect your domicile. Key points include:

- You will normally be regarded as domiciled in the country in which you have your permanent home;
- You cannot be without a domicile;
- You can only have one domicile at any one point in time;
- Your existing domicile continues until you acquire a new one; and
- Domicile is distinct from residence status, nationality, and citizenship although these can have an impact on domicile.

HMRC state that in their view, the fact that an individual registers and votes as an overseas elector is not normally taken into account when determining domicile.

There are 3 types of domicile:

Domicile of origin

Individuals acquire a 'domicile of origin' at birth. Broadly, an individual's domicile will be that of their father if their parents are married, or their mother if their parents are not married.

The 'domicile of origin' may be supplanted where a domicile of dependency or choice is acquired. However, the 'domicile of origin' will automatically revive where a domicile of choice or dependency is acquired and later lost.

Domicile of dependency

Until a child reaches the age of 16, their domicile generally follows that of the person on whom they are legally dependent. If the child's parents are married, the child's domicile will usually follow that of the father. However, where the child's parents are living apart and the child lives solely with the mother, the child's domicile will follow that of their mother.

Domicile of choice

From the age of 16 upwards, an individual can acquire a 'domicile of choice'. The previous domicile of dependency is in general retained as a domicile of choice. In order to establish a different 'domicile of choice', the individual must (1) settle in a new jurisdiction and (2) intend to reside there permanently or indefinitely (Henwood v Barlow Clowes International Ltd). The individual must also sever ties with the jurisdiction in which they were hitherto domiciled.

Turning to your personal circumstances it looks likely that although you were born in the UK, you inherited an Italian 'domicile of origin' from your father. This is because when you were born your parents harboured a wish to return to Italy, as evidenced by the fact that they had retained a burial plot in Italy. They also visited Italy frequently and at some point, the family had an Italian apartment. While the better view may be that you have an Italian domicile of origin, the position is not entirely clear cut as you describe your family as having settled in London, where your parents ran a successful business. It is also not ideal that your father did not appear to have an intention to leave the UK on the occurrence of a specific event (IRC v Bullock).

To determine the position conclusively it would be necessary to carry out a more detailed analysis.

Where a domicile is challenged, it is the person asserting a change of domicile who must establish that the change has occurred. Thus if HMRC were to argue your father had an English domicile at the date of your birth the onus would be on HMRC to prove it. Determining, domicile involves an exhaustive examination of an individual's background, lifestyle, habits and intentions over the course of the period being contested, i.e., regarding your domicile of origin, at the period up until the date of your birth. (Actions after that date may also be relevant to the extent that they infer the true position at that date).

The factors enquired into during a domicile enquiry are set out in RDRM23080. These include among many other things; length of UK residency; Holliday v Musa, location of family; nationality; citizenship; F v Fry the individual's relationship history; business and social interests; the law governing an individual's will; and burial arrangements. It should also be noted that any changes in the individual's parents' domicile or marital status prior to the individual attaining the age of 16 is also relevant.

While it is accepted that your parents both are likely to have acquired a domicile of choice in England before their deaths in the 1990s there is no suggestion in the question that they had made a decision to remain permanently or indefinitely in the UK prior to you turning 16 years old in 1976.

In view of the above it is likely that you had retained your Italian domicile of origin up until the age of 16. However, HMRC will be very interested to look closely at your personal circumstances for the years from 1976 -1990 to determine whether they can establish that you acquired a domicile of choice in the UK during that period. In order to determine this it would be necessary to closely examine your personal circumstances (including those factors set out above) during that period to establish whether you at any point established an intention to reside in the UK either permanently or indefinitely.

It should be noted that HMRC will examine closely the reasons for your return to the UK, particularly as it took place on your retirement and the fact that you wish to sell your apartment in Rome and acquire a property to live in London. Unless you can provide strong evidence that this is not intended to be a permanent move, Re Clore, Official Solicitor V Clore (No 2), it is likely your domicile status will be challenged at some point. In order to strengthen your position, if possible you should retain your Italian apartment and continue to maintain close ties with Italy, by visiting regularly and keeping personal, financial and cultural ties in Rome. Gaines-Cooper v HMRC.

<u>Inheritance Tax implications of the Gina No 1 Discretionary Trust</u>

The Finance (No.2) Act 2017 introduced provisions applying to returning previously UK domiciled persons (FDR). These provisions only apply to individuals who were born in the UK, who had a UK 'domicile of origin' at birth. If these provisions apply then Gina would be deemed to be UK domiciled for inheritance tax purposes. There is a one year grace period, and these provisions would only apply after the first year of residence. If Gina were deemed to be a FDR the trust would not be treated as an excluded property trust and would therefore be subject to the ten year anniversary charge. Further, as she retains an interest as a beneficiary the property within the Trust would fall into her estate at death for inheritance tax purposes under the gift with reservation rules.

Although as explained above, the position is not entirely clear, it seems likely that Gina's domicile of origin was Italian at birth. If this is the case these provisions would not apply.

Therefore, provided Gina did not acquire a domicile of choice in the UK in the period from the age of 16, until she left the UK in 1990 (which was retained at the date of settlement), the trust would be an excluded property trust and not be subject to UK inheritance tax.

Question 9

Part 1

An obligation to deduct UK withholding tax may exist even where interest is paid from one non-resident company (borrower) to another non-resident company (lender). The source of interest is determined under a multi-factorial approach. Ardmore Construction Limited v HMRC identified the following relevant factors:

- The residence of the debtor;
- The residence of any guarantor;
- The location of any security; and
- The substantive source of discharge of the debtor's obligation.

Given a multi-factorial approach applies it is not certain that withholding tax is applicable, however clearly there is a risk that withholding tax may apply since the debt is secured on UK property and the interest will be paid from UK rent. If the interest is deemed to have a UK source, UK withholding tax applies.

Part 2

The ToAA provisions at Part 13, Chapter 2 ITA 2007 are anti-avoidance provisions intended to prevent the avoidance of income tax by individuals. The legislation counteracts avoidance by the use of overseas companies, trusts or other entities to reduce their UK tax liability.

S721 and 727 may result in an "Income Charge" and apply to an individual who transfers assets, or who procures or is associated with a transfer by somebody else.

The rules apply to all UK residents, they will therefore apply to Ruth. It should be noted that in this case, the remittance basis will not apply to prevent the charge under the ToAA legislation, since the rental income is UK source and the remittance basis only applies to foreign income.

The broad conditions for the Income Charge are:

- There must be a transfer of assets by (or procured by) an individual;
- As a result of the transfer, income becomes payable to a person abroad;
- The individual has the power to enjoy that income in some way; and
- The individual is resident in the UK in the year of liability.

Ruth is proposing to incorporate a foreign company, Jersey Co, and transfer funds to it, as a result of this transaction Jersey Co will become entitled to receive UK rental income.

The subscription for shares is regarded as a transfer of assets.

The first two conditions will therefore be met.

As Ruth will be the shareholder of the overseas company, and so will control the income received by it, she will be regarded as being entitled to enjoy the income. It is not necessary for Ruth to receive the income for this condition to be met.

Exemption

The above charges would apply unless Ruth can show that either:

- It would not be reasonable to draw the conclusion from all the circumstances of the case, that the purpose of avoiding liability to taxation was the purpose or one of the purposes, for which the relevant transactions were effected; or

- The transfer and any associated operations were genuine commercial transactions and any tax avoidance motive was merely incidental.

Here the motive for the transfer is to avoid paying UK tax on the rental income, so that the motive defence would not apply.

Effect of the Income Charge

If all the conditions are met and the exemption does not apply, then Ruth would be treated as receiving the UK rental income.

The nature of the income is not altered – accordingly Ruth will be treated as receiving UK rental income. It is likely HMRC may argue that the interest paid by Jersey Co to BVI Co, would also be assessed on Ruth as having a UK source.