Question 1

From: Tax Manager

To: FD of Wheels

Subject: Analysis of likelihood of creation of Canadian permanent establishment

Following our conversation regarding Wheels' planned expansion into the Canadian market, below is an analysis of Wheels' planned operations in Canada and whether that will constitute a permanent establishment there.

1) Analysis of Canadian activities:

OECD definition of permanent establishment:

The OECD defines a permanent establishment (PE) as a "fixed place of business through which the business of an enterprise is carried on." A PE is also created when there is an agent who has, and habitually exercises the authority to conclude contracts in the company's name.

There are two exceptions to the above rules, which are:
- if the activities carried on are of an auxiliary or preparatory nature
- if the agent is independent and acting in the normal course of its business.

Preparatory or auxiliary activities are activities which do not form an integral part of the trade carried on by the enterprise.

A fixed place of business includes a place of management, a branch, an office, a factory and a workshop.

Analysis of Spokes:

As Spokes is a corporate entity incorporated and resident in Canada, it will not constitute a PE of Wheels in Canada because it is resident in Canada.

However, under the OECD treaty, Article 9 - "Associated Enterprises", where an entity participates in the management, capital or control of another entity, any transactions between the two entities which are not on the same basis as would be made between independent entities, shall for tax purposes be deemed to be made on that basis (i.e. an arm's length basis).

Therefore, there may be transfer pricing adjustments to be made for transactions between Wheels and Spokes.

Analysis of UK staff sent to Canada:

The staff sent to Canada will clearly not be independent agents, due to being employed by Wheels. Therefore they will not fall within the "independent agent" exception to the creation of a permanent establishment.

Fixed place of business of staff:

The "fixed place of business" does not necessarily need to be owned by Wheels in order for it to be regarded as a PE, all that is required is that it is at the disposal of Wheels.

Further detail of how the assistance of the UK staff will be provided. If the staff are based in the Spokes factory and have an office at their disposal, that will be a fixed place of business.

Similarly, if the staff have their own office, separate from Spokes' factory, that would likely constitute a fixed place of business.

Fixed place of business of Wheels:

Under the OECD commentary, which although not legally binding, can be useful in providing examples and clarifying the meaning of articles in the OECD model treaty, it is stated that the fixed place of business can belong to another group company if it is at the company's disposal.

Therefore, the question arises as to whether or not Spokes' factory is at the disposal of Wheels. A factory is specifically listed as a fixed place of business and the activities carried on at the factory of assembling the cars are not of a preparatory or auxiliary nature.

Further details of the arrangement between Wheels and Spokes would be needed before concluding as to whether or not the factory is at Wheels' disposal. However, the price charged by Spokes to Wheels for operations carried on at the factory would likely be significant. If the terms are on an arm's length basis, then that would suggest that the factory is not at Wheels' disposal. However, if a low amount is paid for Spokes' operations, that is more likely to suggest the factory is at Wheels' disposal.

Other factors that should be considered would be whether or not other activities are carried on at the factory and the degree of control that Spokes has over the way in which the operations at the factory are carried on.

Activities performed by UK staff:

The activities performed by UK staff may be of a preparatory or auxiliary nature if they merely provide advice to Spokes. However, the fact that Wheels wishes to be involved in every stage of the process at Spokes, suggests that the activities are likely to be of more than a preparatory or auxiliary nature.

If the seconded staff have the authority to conclude contracts and do conclude contracts in the name of Wheels, then that would likely make them dependent agents and they would constitute a PE.

Mitigations:

In order to reduce the likelihood of a Canadian PE being created, transactions between Wheels and Spokes should occur on an arm's length basis. This should not have an effect on the UK tax position of Wheels, because transfer pricing adjustments for tax purposes would be required anyway.

In addition, the staff sent to Canada should not be provided with any location which could be construed as a fixed place of business, so they should therefore not have offices of their own and not have offices located in the factory of Spokes.

Also, the staff seconded should not be permitted to conclude, or even negotiate the majority of any contracts on the behalf of Wheels.

2): Memo on UK tax implications for employees:

Memorandum

From: Tax Manager

To: Employees to be seconded to Canada

Subject: UK tax implications of move to Canada

The move to Canada will have various implications for the way in which UK employment income will be taxed. Further details are provided below.

Residence:

The residence status of the employees will depend on how long the employees are sent to Canada for. To determine the employee's residence status, the statutory residence test will need to be considered.

Further details of the statutory residence test can be provided on request, once more details of the secondment are known.

If the employees are resident under both UK and Canadian law, the tie-breaker test in the double tax treaty will determine their residence. The tie-breaker in the OECD treaty will deem them resident as whichever country is the location of their permanent home, which in this case is likely to be the UK.

Split year treatment may be avaliable under Case 1 (going to work full time overseas) if they become non-UK resident in the year following departure.

Assuming that the employees are non-UK resident, due to working full-time abroad, their employment income will only be taxed in the UK to the extent which it relates to UK employment.

Expenses:

The treatment of expenses while working in Canada will depend both on the length of time they are seconded to Canada and also who incurs the expenditure.

If the secondment is temporary, as it appears it would be, then travel to and from the UK at the beginning and end of the secondment, as well as accommodation provided during the stay in Canada will not be subject to UK taxation.

In addition, if Wheels provides free travel for the employees' spouse or minor children, then that will also not constitute a taxable benefit.

Question 2

1): Risk of MediaX becoming UK resident:

Definition of UK resident:

Under UK law, a company is UK resident either if it is incorporated in the UK, or if its "central management and control" (CMC) is in the UK. Central management and control is not specifically defined in the legislation, but refers to the strategic decision making of the company.

If a company is resident in the UK and another country, then if there is a double tax treaty between those two countries with a residency tie-breaker clause, then that will determine the company's residence for all UK tax purposes.

As MediaX is incorporated in Ireland, it can only become UK resident under the central management and control test.

Central management and control:

HMRC have stated that in determining the central management and control, they will first look at where the board meets and if the board exercises the central management and control.

Although the location of board meetings is important, as demonstrated by the Untelrab case, it is not the only factor and it is important that the board can demonstrate that it does not merely 'rubber stamp' the decisions of another person.

As Phelan is the majority shareholder and also the chair of the board, it would appear that he has a great deal of influence over the strategic direction of the company.
As the chair of the board, he will likely have a casting vote on board resolutions which have resulted in a tie. As there are six members of the board, the casting vote could be significant.

However, as only Phelan and Dermott are relocating to the UK, it is important that the remaining board members are all non-UK resident and ideally resident in Ireland. This would provide evidence that the central management and control is still in Ireland.

In order to maintain its Irish residency, the board must ensure that it does not 'rubber stamp' Phelan's wishes.

It is not clear yet how HMRC will treat the location of board meetings where individuals either phone in or video conference. It is possible that HMRC would argue that Phelan phoning from London and chairing the board meeting would result in the meeting occurring in London.

Therefore, Phelan should not chair the board meetings from London and they should not be held in London if UK residency is to be avoided.

Double tax treaty:

If Irish law is similar to the UK and considers Irish incorporated companies to be Irish resident and HMRC deems MediaX to be UK resident, then MediaX's residency will be determined by the tie-breaker test in the UK-Irish double tax treaty.

Assuming this follows the OECD model treaty, MediaX will be resident where its 'place of effective management' is. This is a different concept to central management and control and generally refers to a lower level of management, typically the location of the head office.

Therefore, MediaX should maintain its head office in Ireland so that it would be deemed Irish resident under the tie-breaker clause.

Actions to take to prevent MediaX becoming UK resident:

- maintain a majority of the board Irish resident
- never hold board meetings outside of Ireland
- consider removing Phelan and or Dermott from the board

2): PAYE, National Insurance and overseas workday relief:

PAYE must be operated by all UK companies paying UK staff.

Assuming that Phelan and Dermott have been Irish resident all their lives and are not UK domiciled, then they will both be eligible to be taxed on the remittance basis.

Non-UK domiciled, UK resident individuals who have been non-UK resident for a period of three years are eligible for overseas workday relief for the following three years.

Therefore, Phelan and Dermott will be eligible for it for their first three years of UK residence. Overseas workday relief allows them to be taxed only on their UK portion of employment income, if they claim the remittance basis.

The UK portion of their income will be based on the number of workdays in the UK as a proportion of total workdays in the year.

National Insurance:

National Insurance is payable by anyone who is ordinarily resident in the UK. This is a different concept to residence as determined by the statutory residence test.

It is likely that Dermott and Phelan will be required to pay National Insurance unless they are able to enter into an agreement with HMRC to continue to pay Irish social security contributions.

3): PAYE issues around short term secondment of Dublin employees:

While the general rule is that PAYE must be operated in relation to all UK employees, a dispensation is available for overseas employees working in the UK for less than 60 days. This allows the company to pay over the amount due at the end of the year, rather than each payment period as normal.

Therefore, provided that agreement is obtained from HMRC, it should be possible to avoid having to operate a PAYE scheme for the short term secondees.

4): UK income tax implications of secondments of more than 60 days up to 120 days:

The employees would be subject to income tax if the secondments were extended up to 120 days due to being more than the 91 day limit.

Assuming they employees were non-UK domiciled, they would likely be eligible for overseas workday relief, as explained above.

5): Likelihood of creating a UK permanent establishment:

A UK permanent establishment (PE) is created if the company has a "fixed place of business through which the business of an enterprise is carried on." A PE is also created when there is an agent who has, and habitually exercises the authority to conclude contracts in the company's name.

There are two exceptions to the above rules, which are:
- if the activities carried on are of an auxiliary or preparatory nature
- if the agent is independent and acting in the normal course of its business.

Preparatory or auxiliary activities are activities which do not form an integral part of the trade carried on by the enterprise.

A fixed place of business includes a place of management, a branch, an office, a factory and a workshop.

Acquisition of office:

Although they plan on acquiring an office, which is explicitly listed under UK law as a fixed place of business, the initial plan for secretarial and administrative support would appear to be of a preparatory or auxiliary nature.

Therefore it would appear that a PE would not be created at that point, but further details would be required to ensure that the functions carried on were of a preparatory or auxiliary nature.

Sales team:

Once a sales team were added to the office, it is unlikely that they would be deemed to be of an auxiliary and preparatory nature and therefore at that point a PE would likely be created.

Activities of Dermott and Phelan:

Dermott and Phelan plan to visit existing and potential customers and it would appear that the office would be at their disposal, so similarly to above, details would be required as to the activites that Dermott and Phelan will carry out to determine whether or not they are of a preparatory or auxiliary nature.

Dermott and Phelan would not be independent agents due to being employees of MediaX, but as neither of them will be concluding contracts with customers, it appears unlikely that they would fall within the PE category of being dependent agents.

6): Implications of carrying on UK business through a company:

From a UK tax perspective, the treatment of PEs and companies is similar: both are subject to UK corporation tax on their profits, subject to transfer pricing adjustments for transactions with connected entities.

However, the establishment of a UK subsidiary of MediaX could provide legal protection in the event of a legal dispute involving the UK operations.

In addition, the UK does not impose any withholding tax on dividends paid by UK companies to foreign companies, so there would not be any disadvantage to incorporation from a profit extraction point of view.

It may be beneficial to operate as a PE initially, until the operation becomes profitable, at which point it could be incorporated, with any gains on assets deferred.

It would appear to be beneficial to carry on the UK business through a UK company due to the lack of disadvantages and the benefit of legal protection for MediaX.

Question 3

Controlled foreign company analysis for Nevis group:

The controlled foreign company (CFC) rules consist of three parts. The exemptions, the pregateway tests and the gateway tests.

If any of the exemptions are satisfied, then they apply to all profits of that company and the gateway tests need not be considered.

The CFC rules apply to a non-UK resident company which is controlled from the UK. Controlled means that either a UK person controls the company, or a UK person, together with another person controls it. Broadly speaking, control means greater than 50% of the voting rights (or more than 50% of income, or assets on a winding up).

As Nevis holds more than 50% of the shares in all the non-resident subsidiaries, they are all CFCs. As Hope is controlled by Nevis, together with a UK investor, it is also considered a CFC.

Exemptions:

There are five exemptions:
- exempt period (applies for the first 12 months where a CFC is acquired by a company and rearranges the CFC's structure so that it no longer falls within the CFC rules)
- excluded territories exemption (if the CFC is resident in an excluded territory, its profits are exempt)
- low profits exemption (if its profits are less than £50,000, or its profits are less than £500,000 with less than £50,000 of non-trading finance profits)
- low profit margin exemption (if its operating profit is less than 10% of its expenditure)
- tax exemption (if the tax payable in its territory of residence is at least 75% of the tax that would have been payable if the tax had been computed using UK rules and the UK rate)

Considering the CFCs and the exemptions:

Loyal was acquired within the previous 12 months from US conglomerate, so would appear to satisfy the exempt period exemption. However, as a long investment, Loyal will fall within the CFC rules after the exempt period of 12 months, so it should be restructured so that it does not constitute a CFC.

Cobbler had profits of £250,000 on expenditure of £3 million, which is a profit margin of less than 10%, so the low profit margin exemption applies to Cobbler.

Tinto is the group finance company and does not appear to satisfy any of the exemptions.

Keen is a Spanish resident company and Spain is on the list of excluded territories, so Keen is exempt.

Lomond has profits of less than £50,000 and so satisfies the low profits exemption.

Hope suffers a tax rate of 19%, which is more than 75% of the UK tax rate and so would appear likely to satisfy the tax exemption, but this must be verified by computing the tax under UK rules.

Therefore, it appears that only Tinto does not satisfy one of the exemptions.

Having considered the exemptions, the gateway tests must be considered.

Gateway tests:

There are five gateways:
- profits attributable to UK activities
- non-trading finance profits
- trading finance profits
- captive insurance business
- solo consolidation

As Tinto is not a bank or insurance company, the captive insurance and solo consolidation gateways do not apply.

Assuming that the loans that Tinto provides are managed in its location of residence, then the profits attributable to UK activities will not apply.

There is an election where trading finance profits can be treated as non-trading finance profits, so therefore only the trading finance profits gateway need be considered.

The profits which pass through the gateway are attributed to UK companies based on their ownership, so Nevis will have 80% of Tinto's profits which pass through the gateway attributed to it. Those profits will be subject to UK corporation tax at 20%.

The profits which do not pass through the non-trading finance gateway are the profits from qualifying resources. As Nevis injected £300 million of capital, the profits from that £300 million will not be from qualifying resources.

Only 75% of non-trading finance profits are deemed to pass through the gateway.

Assuming that the entire £5m of profits arises from the £300 million injection of capital, then 75% of £5 million (= £3.75m) of profits will pass through the gateway and be subject to UK corporation tax.

Question 7

From: Tax Manager

To: Pierre

Subject: Answers to your questions relating to your personal tax situation

1): Pierre's domicile status:

Under UK law, each person has a domicile and only one domicile (as decided by Udny v Udny case). Domicile is a common law concept and there is not a statutory test in the same way as there is for residence.

Also, as decided by the Udny case, a person first acquires the domicile of their father at birth (known as domicile of origin). Therefore, Pierre will have first had a domicile of origin of France.

An individual's domicile follows that of their father (domicile of dependency) until they reach the age of 16, at which point it remains the same, unless they acquire a domicile of choice.

Therefore, Pierre will have a French domicile, unless it has been displaced by an English domicile.

To replace a domicile requires a settled intention to permanently, or indefinitely reside in a particular country. It requires the individual to demonstrate both that they have created new ties with the new country of domicile and have severed ties with the previous country of domicile.

Pierre has several ties to England (for example learning English as per the Irvin v Irvin case), but as he still retains a French passport, it is questionable whether he has severed ties sufficiently with France.

The fact that he has remained in London, despite moving jobs several times, suggests that he has a settled intention to remain in England.

Much depends on his future intentions - if he intends on returning to France, for example to retire, then he likely still has a French domicile. Whereas if he intends on remaining in the UK permanently, it is likely there is sufficient evidence to have acquired an English domicile of choice.

Under UK law, for inheritance tax purposes only, an individual has a deemed UK domicile if they have been resident in the UK for 17 out of the previous 20 years. Therefore, next year, Pierre will likely be deemed to be UK domiciled for inheritance tax purposes.

In addition, next year, the UK government plans on introducing further rules regarding domicile for long term UK residents. These rules would likely make Pierre English domiciled for all purposes.

Overall, it would appear that if Pierre intends on returning to France, he could probably argue that he has retained his French domicile, but if he intends on remaining in England permanently, then he likely has acquired an English domicile of choice.

2): Taxation of income and gains:

Pierre is UK resident and the general rule is that UK residents are subject to income tax and capital gains tax on their worldwide income and gains.

However, if Pierre does not have a UK-domicile, then he is able to claim the remittance basis.

By claiming the remittance basis, he will only be subject to UK income tax and capital gains tax on UK source income and gains on UK situs assets.

Claiming the remittance basis results in the loss of an individual's personal allowance and annual exemption for capital gains tax. Also, for Pierre, as he has been a long term UK resident, (for at least 17 of the last 20 years), if he claims the remittance basis he will be required to pay the remittance basis charge of £90,000.

The remittance basis is claimed on an individual's self-assessment form and is claimed (or not) each year and can be changed from one year to the next.

Income or gains are remitted to the UK if the funds are transferred to the UK, or otherwise 'enjoyed' in the UK, for example if foreign funds are used to pay off a UK credit card.

Situs of inherited assets:

Real estate has a situs where the asset is located. Therefore income or gains on the French real estate will only be subject to tax if Pierre does not claim the remittance basis or if it is remitted to the UK.

The works of art have a situs of where they are located, so if the art is maintained outside the UK, then any gain on it will only be subject to UK tax if Pierre either does not claim the remittance basis or remits it to the UK.

If the artwork has a value below £6,000 it will count as a chattel and be exempt from UK capital gains tax.

The situs of bank accounts is deemed to be the location of the bank branch of the account. Therefore, if the bank accounts are at a French bank, they will have a non-UK situs

The situs of a share portfolio is wherever the share register is maintained, which in the case of listed companies will be whichever stock exchange they are listed on.

3): UK inheritance tax implications for Pierre's estate:

For UK domiciled individuals, UK inheritance tax is charged on their worldwide assets at 40%.

For non-UK domiciled individuals, UK inheritance tax is only charged on their UK situs assets at a rate of 40%.

As Pierre appears to be non-UK domiciled currently, only his UK situs assets would be subject to UK inheritance tax.

However, as mentioned above, it would appear that he will become UK domiciled next year under the deemed domicile rules.

Therefore, it may be beneficial for Pierre to set up an offshore trust, which acquires the domicile of the settlor at the time of creation and does not subsequently change.

An offshore trust, with a non-UK domicile would be outside of his estate for inheritance tax purposes.

Question 8

From: Tax Manager

To: Miki

Subject: Statutory residence test application to your circumstances

The UK determines an individual's residence on the basis of the statutory residence test. It consists of three parts - the automatic overseas tests, the automatic residence tests and the sufficient ties test.

If an individual satisfies one of the automatic overseas tests, then they are non-UK resident and the remaining tests need not be considered. If none of the automatic overseas tests are satisfied, then if any of the automatic resident tests are satisfied, then the individual is UK resident and the sufficient ties need not be considered.

A day is counted as being in the UK if you are present in the UK at midnight on that day.

Automatic overseas tests:

These are:

1. You were resident in the UK for at least one of the three preceding tax years and spend less than 16 days in the UK in the tax year.

2. You were resident in the UK for none of the three preceding tax years and spend less than 46 days in the UK in the tax year.

These first two tests are not satisfied as you will spend more than 46 days in the UK in the year of arrival.

3. You work full time overseas in the tax year and spend fewer than 91 days in the UK.

This test is not satisfied due to spending more than 91 days in the UK.

Therefore, the automatic resident tests must be considered.

Automatic resident tests:

1. You spend more than 183 days in the UK in the tax year.

It would appear that you will satisfy this test due to 1 October 2016 - 5 April 2017 being more than 6 months.

No further tests need be considered as you have satisfied this test.

The general rule is that an individual who is UK resident is UK resident for the whole of the tax year (from 6 April - 5 April the following year). However, in some cases 'split year' treatment is available. This treats part of the year as non-UK resident and the remainder as UK resident.

Split year treatment:

Cases 1 to 3 apply to individuals leaving the UK, so do not apply in this situation.

Case 4 applies when an individual becomes UK resident and starts to have a home only in the UK. This does not apply due to Miki's intention to retain his Japanese home.

Case 5 applies to starting full-time work in the UK. Again this does not apply, due to Miki not working full-time in the UK.

Case 6 applies when ceasing full-time work overseas. This does not apply to Miki as he has not been UK resident before.

Case 7 does not apply.

Case 8 applies to someone starting to have a home in the UK. It would appear that this applies to Miki due to not having a home in the UK at the start of the year, but having one for the rest of the year and the following year.

This would result in the year being split on 1 October. So the non-resident period would be the period from 6 April 2016 to 30 September and the UK resident period would be from 1 October 2016 to 5 April 2017.

Non-domiciled taxpayer:

As Miki is UK resident, the general rule is that UK residents are subject to income tax and capital gains tax on their worldwide income and gains.

However, as Miki does not have a UK-domicile, then he is able to claim the remittance basis.

By claiming the remittance basis, he will only be subject to UK income tax and capital gains tax on UK source income and gains on UK situs assets.

Claiming the remittance basis results in the loss of an individual's personal allowance and annual exemption for capital gains tax. Also, for long term UK residents, if they claim the remittance basis they will be required to pay the remittance basis charge, which depends on how long they have been UK resident for.

Miki will not need to pay this initially, as it first applies to individuals who have been UK resident for seven of the previous 9 years, to which a charge of £30,000 applies, if the remittance basis is claimed.

The remittance basis is claimed on an individual's self-assessment form and is claimed (or not) each year and can be changed from one year to the next.

Income or gains are remitted to the UK if the funds are transferred to the UK, or otherwise 'enjoyed' in the UK, for example if foreign funds are used to pay off a UK credit card.

Therefore, it is important to maintain separate foreign bank accounts for foreign income and foreign gains, so as to avoid a 'mixed fund'.

In a mixed fund, untaxed foreign income is deemed to be remitted first, which is disadvantageous to the tax payer.

Any capital which has been accumulated prior to the individual becoming UK resident is 'clean' and can therefore be remitted to the UK without giving rise to a UK tax charge.

Similarly, for his employment income in Belgium, that should be paid into a separate overseas account so that it is not remitted to the UK.

Income that is remitted to the UK is taxed as non-savings income, even if it arose from dividends