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Excellence in Taxation

THE ADVANCED DIPLOMA IN INTERNATIONAL TAXATION

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Suggested Solutions

PART A

Question 1

Part 1

Notwithstanding Canadian Law, as a UK resident and incorporated company, Wheels, will not be subject to Canadian corporate income tax on its profit from carrying on a business in Canada if it does not have a PE in Canada as defined by Article 5 of the Double Tax Treaty (DTT). The following is an analysis of article 5 as it applies to the facts and circumstances of Wheels' activities in Canada. All reference to paragraphs, are to paragraphs in Article 5.

Paragraph 1 generally defines a PE as a fixed place of business in which the business of the enterprise is wholly or partly carried on.

Paragraph 2 notes that the term PE shall include especially (a) a place of management; (b) a branch; (c) an office; (d) a factory; (e) a workshop; (f) a mine, quarry or other place of extraction of natural resources; and (g) a building site or construction project or assembly project which exists for more than 12 months.

Paragraph 3 notes that the term PE shall not be deemed to include:

- Using facilities solely to store, display, or deliver goods or belonging to the enterprise;

- Maintaining a stock of goods or merchandise belonging to the enterprise solely for the purposes of storage, display or delivery;

- Maintaining a stock of goods or mechandise belonging to the enterprise solely for purposes of processing by another enterprise;

- The maintenance of a fixed place of business solely for the purpose of purchasing of goods or merchandise, or collection of information for the enterprise; and

- The maintenance of a fixed place of business solely for the purpose of advertising, for the supply of information, for scientific research or for similar activities which have a preparatory or auxiliary character for the enterprise.

Paragraph 4 states that a person, other an agent of an independent status to whom paragraph 5 applies, acting in a Contracting State on behalf of an enterprise of the other Contracting State shall be deemed to be a PE in the first mentioned State if he has, and habitually exercises in that first – mentioned State, an authority to conclude contracts in the name of the enterprise, unless his activities are limited to the purchase of goods or merchandise for the enterprise.

Per paragraph 5, an enterprise of a Contracting State shall not be deemed to have a PE in the other Contracting State merely because if carries on business in that other State through a broker, general commission agent or any other agent of an independent status, where such persons are acting in the ordinary course of their business. There is no mention of independent agents in the information provided and therefore no further consideration is given to this paragraph.

From the information provided, it does not appear that Wheels has premises in Canada. Wheels may however, be viewed as having a fixed place of business in Canada if it uses Spoke's facilities and premises to partly carry on its business including:

- the use of Spoke's warehouse facility for the storage of inventory; and

- the storage of cars prior to delivery to the distributor.

If Spoke's facilities are to be viewed as a fixed place of business in Canada for Wheels, then the potential exemption for preparatory or auxiliary activities needs to be considered.

It is unlikely that the finishing facility will fit the definition of a building site, construction or installation project and consequently paragraph 2 (g) should not apply. Paragraph 2 (f) should also not apply.

Wheels is using Spoke's warehouse facilities for storing and / or delivering goods belonging to it. These activities should meet the exemption in paragraph 3 if the facilities are used solely for these activities.

Spokes is acting as a sub-contractor to Wheels. Throughout the process, Wheels retains title to the goods. Revised proposals to the OECD Model Tax Convention 2013, included an example regarding premises being at the disposal of the foreign enterprise of contract manufacturer and whether it would create a PE for the foreign enterprise. Where the premises of the contract manufacturer were not used by the foreign enterprise itself and could not be viewed as being at the disposal of the foreign enterprise, it was held that these activities in and of themselves would not create a PE.

The Treaty does not clearly provide guidance regarding the use of the facilities for more than one of the activities listed in paragraph 3; the OECD Commentary does provide guidance where there are multiple uses and provides that "combinations of activities mentioned in sub-paragraphs (a) to (e) in the same fixed place of business shall be deemed not to be a permanent establishment, provided that the overall activity of the fixed place of business resulting from this combination is of a preparatory or auxiliary character. Accordingly a full review of the activities carried on at Spoke's premises need to be made.

In order for a PE in Canada to exist under the dependent agent rule, Wheels would need to have an employee or dependent agent (such as an employee of Spokes) who has, and habitually exercises, the authority to conclude contracts in Canada in the name of Wheels. This applies not only to the sale contract with the distributor, but also to purchase and service provider contracts. If employees of Wheels or of Spokes (including those seconded from Wheels) were to either enter into such contracts in the name of Wheels which such employees were in Canada, then the potential application of the preparatory or auxiliary exemption would have to be considered.

The final PE report of October 2015 (Preventing the Artificial Avoidance of PE Status) is the 3rd paper produced by the work on Action 7 under the OECD led BEPS project. Action 7 was directed at correcting specific abuses arising from the existing terms of the threshold PE rule. The paper summarises proposed changes relating to the PE rules in Article 5 as well as proposed updates to the related Commentary in the following areas:

1. Dependent Agents – the existing test focuses on the habitual contract conclusions by the agent concerned. The revised test is met where the agent "habitually concludes contracts or habitually plays the principal role leading to the conclusion of contracts that are routinely concluded without material modification" by the principal.

2. Independent Agents – the major change to the independent agent test is to prevent agents that act exclusively for "closely related" parties from being able to qualify as an "independent agent".

3. Preparatory or Auxiliary – The proposals would tighten the specific activity "exemptions from PE" for facilities used for purchasing, storage display or delivery of goods by ensuring that each specific test must satisfy the general conditions that the activity is preparatory or auxiliary in nature. The proposals also include an "anti-fragmentation" test to prevent the artificial split of activities across separate legal entities in order to qualify for that exemption.

For Wheels, the key area of concern is around the dependent agent definition and the preparatory or auxiliary rules.

Although not exhaustive, in order to minimise the risk of a PE in Canada, Wheels should not:

- have its own place of business in Canada where it has a formal legal right to the use of the space;

- exercise control over the premises in Canada; or

- have employees in Canada who have decision making authority and the ability to enter into and conclude contracts. These employees should not have business cards, advertisements and telephone listings that refer to a Canadian address as an address of Wheels.

If Wheels were to found to have a PE in Canada, then the following consequences would follow:

- The profit attributable to the PE would need to be determined (using transfer pricing principles); and
- Wheels would be subject to Canadian corporate income tax on such income.

Part 2

If an employee performs employment duties outside the UK, earnings are generally taxed on a "receipts" basis. Therefore if a UK resident and domiciled employees works abroad for a short period e.g. 4 months, the earnings paid in respect of those overseas duties will be fully taxable in the UK even if the earnings are paid abroad and kept in a foreign bank account. Double tax relief will apply if those same earnings are taxed in the overseas country as well as in the UK.

Longer assignments may result in the employee becoming non UK tax resident. Whether or not the employee is non-resident will be established from the statutory residence test.

There are special rules for overseas travel expenses. Costs of travelling to a "temporary workplace" i.e. costs of travelling to Canada, will not be taxable as employment income under ss 337 and 338 ITEPA 2003.

Additionally s341 ITEPA 2003 provides that the costs of travel at the start and end of an assignment where the employee works wholly abroad are fully deductible for the employee if they are met by the employee. This only applies where the duties of the employee on secondment are performed wholly outside of the UK and the employee is UK tax resident.

S376 ITEPA 2003 provides that accommodation and subsistence costs of the secondee will also not be taxable where the expenses are met directly by the employer.

The costs of interim visits by an employee's spouse and family are not taxable under S371 ITEPA 2003 where:

- The employee is tax resident in the UK;
- The costs of the interim travel are borne by the employer;
- The employee is absent from the UK for a continuous period of 60 days;
- The journey is from the UK to non-UK; and
- The employee's spouse, partner or minor child is either accompanying the employee at the beginning of the period, visiting the employee, or returning to the UK after accompanying or visiting;

Relief is restricted to the cost of a maximum of 2 outward / inward journeys in any tax year and only covers travel costs, not accommodation and subsistence.

<u>Question 2</u>

<u>Part 1</u>

Mediax is an Irish incorporated company. A foreign incorporated company is UK resident where it's central management and control is located in the UK. Central management and control is the top level strategic management of the company. Examples of decisions that may demonstrate central management and control include:

- Major finance decisions, e.g. the making of loans or entering into funding or loan arrangements;
- Decisions concerning the acquisition and disposal of significant assets;
- Decisions concerning the payment of dividends; and
- Decisions to acquire or dispose of businesses or subsidiaries.

Where key strategic decisions such as those outlined above are taken by the directors of the company at directors' meetings central management and control will reside at those meetings. Thus the company will be resident where those meetings are held. This old principle known as "the case law test of central management and control" which was first expounded in *De Beers Consolidated Mines Limited v Howe (Surveyor of Taxes)* (1906) 5 TC 198 was reconfirmed in the Court of Appeal in *Wood v Holden* heard in 2006.

The question confirms that the key decisions affecting the company's business are taken at the board meetings so that *prima facie* Mediax is resident where the board holds its meetings.

If Phelan and Dermott phone in to board meetings held in Dublin, from London there is a significant danger that control will be held to emanate from London, particularly since Phelan sees himself as exerting control over the company.

If directors meetings alternate between London and Dublin again there is a significant danger that Mediax will be held to be UK resident.

In order to reduce the risk of Mediax being held to be UK resident, it is recommended that Phelan resigns his role as chairman. In addition, Phelan and Dermott should physically attend board meetings in Dublin. Further, Phelan and Dermott must not carry out negotiation of key contracts in the UK. *Laerstate BV -v- HMRC*.

If the UK-Irish tax treaty is applied to determine corporate residence then the treaty tie-breaker will determine residence by reference to place of effective management however, the distinction between central management and control and place of effective management is a very fine distinction, and in practise the two often coincide.

As a practical matter HMRC may have limited incentive to argue Mediax is UK resident since Mediax has substantial substance in Ireland and in any event HMRC would have to provide relief for Irish tax paid against any UK liability.

<u>Part 2</u>

Mediax will be required to operate PAYE if it has a taxable presence in the UK. *(Oceanic 56 TC 183)*. As the clear intention is to create a London office it would be recommended that PAYE is operated from the outset.

Phelan and Dermott could apply to remain in their home jurisdictions national insurance regime. If they continue to pay into the Irish system then they would be able to obtain a certificate of coverage which would exempt them from National Insurance in the UK. In particular where the employee is from a country in the European Economic Area (EEA) they will require a Portable Document A1, E101 or E102. They will not have to pay UK national insurance for the first two years.

A resident individual will be subject to UK tax on the salary they receive. However, they may for the period of the first 3 years of residence be entitled to a relief (overseas workday relief) in respect of the duties performed abroad, so that they are not taxed on the foreign proportion of their salary provided that it is not remitted.

The conditions to qualify for OWR are that one:

- must be not domiciled in the UK throughout the year;

- must be taxed on the remittance basis; and

- must perform the duties of the employment wholly or partly outside the UK, and that year is either the first tax year immediately following three consecutive tax years for which they are not resident in the UK, or one of the next two tax years after such a year.

It should be noted that OWR does not require a 'dual contract' and applies where a remittance basis employee carries out both UK and non-UK duties under a single contract of employment. The total earnings from the employment will be apportioned on a just and reasonable basis which is likely to be by reference to a day count of days spent performing duties in each country. The earnings relating to the UK duties will be assessed on an arising basis. The earnings qualifying for the relief are treated to be 'foreign earnings' and are not taxable in the UK unless remitted to the UK.

<u>Part 3</u>

The secondment of the Dublin office employees for less than 60 days should not result in a UK tax liability, provided they remain on the Dublin payroll throughout their secondment. This is because employees resident in a Double Taxation Agreement country who remain on the foreign payroll may be treated as employed by a foreign employer where they are present in the UK for a period of less than 60 days.

<u>Part 4</u>

The Dublin office employees seconded to London will not be subject to UK taxation on the earnings arising during their secondment provided they satisfy the conditions set out in Article 15 of the UK-Irish tax treaty. In particular, Aricle 15(2) provides:

(2) Notwithstanding the provisions of paragraph (1) of this Article,

Remuneration derived by a resident of a Contracting State in respect of an employment exercised in the other Contracting State shall be taxable only in the first-mentioned State if:

(a) the recipient is present in the other State for a period or periods not exceeding in the aggregate 183 days in the fiscal year concerned; and
(b) the remuneration is paid by, or on behalf of, an employer who is not a resident of the other State; and
(c) the remuneration is not borne by a permanent establishment or a fixed base which the employer has in the other State.

Conditions a) and b) would be satisfied. However if the London office bore the salary costs of the seconded employees condition c) would not be satisfied and the earnings would be subject to UK income tax.

<u>Part 5</u>

Phelan's and Dermott's creation of the London office will create a UK permanent establishment. This includes establishing a UK sales force, acquiring offices and creating an administrative function in the UK.

'Permanent establishment' is defined at CTA 2010, Pt 24 Ch 2 (s 1141 et seq). The definition closely follows that in the OECD model Treaty, adopted in the UK-Irish treaty. A company has a 'permanent establishment' in a territory where:

- it has a 'fixed place of business' there through which its business is wholly or partly carried on; or

- it has an agent acting on its behalf there and this agent has and habitually exercises there authority to do business on its behalf.

A 'fixed place of business' includes a place of management; a branch; an office, factory or workshop, etc.

There are three specific exclusions, which include:

- where the business is carried on there through an agent of independent status acting in the ordinary course of his business; or

- where the activities being carried on through a fixed place of business or agent are only of a 'preparatory or auxiliary character'.

Part 6

When Phelan and Dermott move to London and acquire and staff the London office it is likely that this will constitute a UK permanent establishment of Mediax. This is because Mediax will have a 'fixed place of business' in the UK through which its business is wholly or partly carried on. A UK PE is liable to corporation tax on its UK profits. Mediax may either undertake its activities through a permanent establishment, or alternatively incorporate a UK company and carry on its UK activities through that company. The UK corporation tax rate is 20% i.e.' higher than the Irish rate of 12.5%. This will not affect the decision to incorporate since the 20% rate will apply to UK profits regardless of the decision whether to incorporate.

From a UK tax perspective the choice between carrying out the UK activities via a PE or UK incorporated company is fairly neutral, as the UK corporate tax regime applies to both. The determination of whether to carry on the UK business through a branch (PE) or company, ultimately may be driven by Irish tax considerations. For example if the Irish regime allows Mediax to access the early years branch losses, this may be a significant factor in determining whether to incorporate immediately or perhaps run the business initially as a branch.

PART B

Question 3

Section 371AA TIOPA 2010 defines a controlled foreign company ("CFC") as a company which:

(a) Is not resident in the UK; and
(b) Is controlled by a UK resident person or persons.

IT is clear from the group structure of Nevis plc and all the overseas subsidiaries are controlled from the UK. This includes Hope, which although not controlled by Nevis, is owned 10% by Nevis and 45% by another UK company. One of the definitions of control is that the UK persons are entitled to more than 50% of any income distributed by the overseas company or have more than 50% of the voting rights in the overseas company. Nevis and the other UK company between them have 55% of each and therefore Hope is a controlled foreign company.

The consequence of being a controlled foreign company is that unless one of the exemptions cannot be claimed or the profits of the CFC do not pass through the "gateway" tests, set out in the legislation, the chargeable profits of the CFC will be attributed to Nevis plc and taxed at the main rate of UK taxation. It should be noted that double tax relief is permitted.

The analysis below takes the circumstances of each company in turn to establish whether its circumstances mean that it falls within one of the exemption or whether its profits are caught by the gateway tests.

Loyal

S371JD(1) sets out the exempt period exemption. Nevis plc bought Loyal in July 2015, within the 12 month period that is set out as one of the conditions for the exempt period exemption to apply. Further Loyal was bought from a US group which had held the company for 5 years, meaning that Loyal could not have been a CFC within the last 3 years. We are told that Nevis views the acquisition of Loyal as a long term investment for the group. Therefore it is likely that there is no intention at the current time to sell Loyal to non-UK persons. We are not given sufficient information to confirm whether the subsequent period condition will apply but, so long as Loyal either meets one of the exemptions for the accounting period ending 31 March 2017 or it does not have any chargeable profits as a result of the pre gate way or gateway tests applying (chapters 3-8) then Loyal will meet all the conditions of the exempt period exemption and its profits for the accounting period ended 31 March 2016 will not be subject to UK taxation as the taxable profits of Nevis plc.

Consideration should also be given to the low profits exemption given that the profits before tax are just above the low profits threshold of £500k. It may be that taxable profits are below the £500k level.

We are not given enough information to confirm whether the low profit margin exemption could apply.

It is considered unlikely that the gateway tests will need to be considered for this entity.

Cobbler

We are told that Cobbler operates the call centre for the Nevis group. Section 371MB TIOPA 2010 provides and exemption for companies that generate low profit margins. The exemption applies if the CFC has profits of less than or equal to 10% of its operating expenditure in a territory where low cost call centres are reliable and plentiful. Although both of these conditions are met by Cobbler, it must also be demonstrated that the call centre was not just set up in that location to secure the CFC exemption. To avoid a successful challenge from HMRC, Nevis group must be able to demonstrate, if required, that Cobbler is in its location for good commercial reasons. IT if can do this, its profits will not be attributable to Nevis plc under the CFC legislation.

If Cobbler were to fail the low profits exemption it could consider the pre gateway tests at chapter 4. If it can show that if any of the conditions A to D are met then its profits would be outside the scope of the CFC charge.

Tinto

Tinto is described as the Group Finance Company. It is a CFC and its effective tax rate is less than 75% of the UK tax rate. It has high annual profits and it is unlikley that the excluded territories legislation would apply. Given its activities, the low profit margin would not apply.

The group would look to the finance company partial exemption which could exempt up to 75% of Tinto's profit if it is considered to have 'qualifying loan relationships'. Further work would need to be undertaken to assess whether this partial exemption could apply.

Any remaining profit would likely pass through the gateway and be subject to a CFC charge.

Keen

IT is noted that Keen is Spanish tax resident and this suggests that it could come under the excluded territories exemption s371KB TIOPA 2010. However, this exemption only applies where a company is liable to tax on its income (s371KC) As Keen has benefitted from a tax holiday for the past 3 years it is unlikely to be able to benefit from this exemption.

We do not have much further information about Keen and therefore it is difficult to establish whether it could meet the conditions of one of the five exemptions, however, it may be that its profits do not pass through the pre gateway or one of the "gateway tests" set out at section 371CA.
Keen is described as an established Spanish trading business. The gateway test that is most applicable here is the test to establish whether there are profits attributable to UK activities. It appears that Keen is fully managed and controlled from Spain and has a full management team there. It therefore may be possible for Nevis group to be able to successfully argue that no UK activities are carried out in Spain and therefore its income does not pass through the Gateway. Further detailed analysis is required, but if the conditions are met and the income does not pass through the gateway, then there will be no apportionment of the profits to Nevis plc.

Lomond

The low profits exemption is set out in s371LB TIOPA 2010. Low profits are defined as accounting profits or total taxable profits of not more than £500,000. This exemption does not apply where arrangements have been entered into where the main (or one of the main) purposes was to secure this exemption. It also does not apply where the CFC only acts as an intermediary between UK individuals. We do not have enough information to conclude that the low profits exemption does apply, but it should be explored further as the most obvious exemption.

Hope

It is noted that the overseas tax rate applied to the profits of Hope is 19%. Under s371 NB, where the effective tax rate is not less that 75% of the tax rate that would be applied under UK tax law, Hope would be exempt from an apportionment under CFC legislation. The fact that the rate of tax is NOT lower than 75% of the corresponding UK tax is an indication that the high tax exemption could apply but a calculation of the overseas tax versus the theoretical UK tax would need to be undertaken to confirm.

Question 4

Part 1

If Edward arrives in the UK on 1 March 2015, he will spend less than 46 days in the UK for 14/15 and will therefore be non-resident under the automatic overseas residence test.

Part 2

Edward will qualify for split year treatment case 5. HMRC's guidance contained in RD3 provides:

Starting full-time work in the UK

5.30 You may receive split year treatment for a tax year if you start to work full-time in the UK and you meet the third automatic UK test over a period of 365 days.

You must:

- be UK resident in the tax year;
- be non-UK resident for the previous tax year; and
- not meet the sufficient ties test for the part of the tax year before the point you first meet the third automatic UK test - when you are considering whether you have sufficient UK ties in this part of the year; you should reduce the day count limits in the sufficient UK ties tables as shown in Table F.

As Edward is coming to the UK to work fulltime and has not been previously UK resident and has not spent any time in the UK prior to coming to the UK to work, so that he does not meet the sufficient ties limb he qualifies for split year treatment.

Jane will qualify for split year treatment under case 8 HMRC's guidance contained in RD3.

Case 8: Starting to have a home in the UK

5.44 If you have no home in the UK but at some point during the tax year you start to have a home in the UK then you may meet the criteria for Case 8. You must:

- be resident in the tax year;
- be non-resident for the previous tax year;
- be UK resident for the following tax year (this must not be a split year);
- have no UK home at the beginning of the tax year but start to have a UK home at some point during the tax year and continue to have a UK home for the rest of the tax year and all of the following tax year; and
- not have sufficient UK ties to make you UK resident in the period from the 6 April to the point you start to have a UK home - when you are considering whether you have sufficient UK ties in this part of the year, you should reduce the day count limits in the sufficient UK ties tables by substituting the values from Table F.

Jane may qualify as she will satisfy the UK home requirement, having a UK home from the commencement of Edward's assignment. In addition she has not previously been UK resident so will not meet the sufficient ties limb.

If split year treatment applies Edward and Jane's foreign investment income generated by their respective international portfolios of equities and bonds would only be subject to UK income tax to the extent it arose on or after 1 October 2015. This treatment would also apply to, Jane's Australian property income. The amount arising prior to 1st October would be pure capital and could be remitted to the UK free of UK tax. However the split year treatment would not apply to UK dividend and interest income which would be assessable to UK tax on an arising basis from 6 April 2015.

Notwithstanding the above, Edward and Jane could elect for the remittance basis.

Part 3

Split year does not apply to Edward as he fails the sufficient ties limb spending 70 days in the UK. In this regard Edward will have two connecting factors i.e. the work tie and accommodation tie. Table F provides that in the case of an individual who has not been resident in any of the 3 previous years in these circumstances you may only spend 60 days in the UK before you fail this limb and consequently may not elect for split year treatment.

Split year treatment continues to apply to Jane as her fact pattern has not altered.

Part 4

As the assignment is temporary he may wish to continue to pay into the Australian social security system. If Edward continues to pay the equivalent of UK national insurance in Australia then he would be able to obtain a certificate of coverage which would exempt him from National Insurance in the UK. In particular where the employee is from a country in the European Economic Area (EEA) they will require a Portable Document A1, E101 or E102. They will not have to pay UK national insurance for the first two years.

Part 5

A resident individual will be subject to UK tax on the salary they receive. However, they may for the period of the first 3 years of residence be entitled to a relief (overseas workday relief) in respect of the duties performed abroad, so that they are not taxed on the foreign proportion of their salary provided that it is not remitted.

The conditions to qualify for OWR are that one:

- must be not domiciled in the UK throughout the year;
- must be taxed on the remittance basis; and
- must perform the duties of the employment wholly or partly outside the UK, and that year is either the first tax year immediately following three consecutive tax years for which they are not resident in the UK, or one of the next two tax years after such a year.

It should be noted that OWR does not require a ‘dual contract’ and applies where a remittance basis employee carries out both UK and non-UK duties under a single contract of employment. The total earnings from Ned’s employment will be apportioned on a just and reasonable basis which is likely to be by reference to a day count of days spent performing duties in each country. The earnings relating to the UK duties will be assessed on an arising basis. The earnings related to duties performed in Hamburg are treated to be ‘foreign earnings’ and are not taxable in the UK unless remitted to the UK.

PART C

Question 5

UK VAT rules for the supply of goods are based on the place of supply (section 7 VATA 1994). Detailed below is how these supply rules apply to:

- The export of goods to the USA;
- The import of goods from the USA;
- Acquisition of goods from other EU countries; and
- Dispatch of goods to other EU countries.

Export of Goods to the USA

If goods are exported outside of the UK by Peters Ltd, the place of supply is deemed to be the UK as the goods are leaving the UK. These exports will be zero rated, regardless of the types of goods being exported. In order to apply the zero rate, Peters Ltd is required to retain records of proof of export e.g. bill of lading. Consequently, Wendy, Inc. will not incur any UK VAT on the purchase of goods from Peters Ltd.

Import of goods from the USA

When Peters Ltd imports goods from Wendy, Inc., the place of supply is not in the UK as goods are *arriving* in the UK.

As long as Wendy, Inc. is not the importer of record of the goods, the company is not required to account for any UK VAT on the import at all and has no reporting obligations in the UK for VAT purposes.

However, import VAT is due on the goods under section 1 VATA 1994. Unless Wendy is registered and documented as the importer of record, then Peters Ltd will have to pay the import VAT. The rate of import VAT applied to the goods is the rate that would have been applied if the place of supply had been in the UK. The current standard rate of VAT in the UK is 20%. However there are reduced rate including a 0% rate for certain goods such as children's clothes and food.

As long as Peters Ltd is a VAT registered trader which is making "taxable supplies" – i.e. those which attract VAT (at any rate, even zero), Peters Ltd will be able to claim back this import VAT as "input VAT" when preparing its VAT returns, and therefore the import VAT should be fully recoverable.

Acquisitions from other countries in the EU

Goods purchased by Peters Ltd and delivered to the UK, from other EU countries are treated as "acquisitions" for the purposes of it VAT return. No import VAT is due because transfer of goods within the free trade area are not considered to be imports. However cross border VAT rules still apply.

As the supply is considered to be outside the UK, the EU supplier does not need to consider UK VAT. If Peters Ltd gives the EU supplier its UK VAT number, the supplier is required to include this on its invoice and is required then to "zero rate" the purchase i.e. charge a 0% rate of VAT on the purchase.

In its UK VAT return, Peters will then apply the appropriate rate of UK VAT to the supply which will be included as both input and output VAT in the return. As a result, the net position on the VAT return will be NIL.
Should Peters Ltd not provide its VAT number to a EU supplier, the EU supplier will be required to apply VAT to the invoice under its own country's VAT rules. Peters Ltd can recover this VAT but the process for doing so is lengthy and administratively onerous.

Dispatches by Peters Ltd to other EU countries

Goods sold by Peters Ltd and delivered to other EU countries are treated as "dispatches" for the purposes of its VAT return. Again, no import VAT applies on the cross border transaction. The place of supply is the UK because the goods are *leaving* the UK. Consequently UK VAT will apply to the transaction.

If the EU customer is VAT registered and provides their VAT number to Peters Ltd, Peters Ltd can apply a zero rate of VAT to the invoice. The “acquiring” EU company will then apply the acquisition VAT treatment to the invoice under its own country’s regulations. Peters Ltd will again be require to retain proof that the goods were sent outside of the UK.

<u>Summary of cost effect on Wendy, Inc. and Peters Ltd</u>

The above analysis demonstrates that there is no UK VAT cost to Wendy, Inc. from trading with Peters Ltd. Peters Ltd, as a fully taxable VAT registered business will be able to recover all it’s input VAT on purchases which it can offset against its output VAT which it collects from customers and therefore will bear no cost of VAT , other than the costs of administering the tax.

<u>Summary of cash flow effects on Wendy, Inc. and Peters Ltd</u>

As detailed above, Wendy has no liability or filing obligation under UK VAT rules. We are not given any information on whether Peters Ltd makes sales in the UK, but on the assumptions that it does not, it appears that the majority of Peters Ltd’s sales will be zero rated. Therefore the company will be in a constant recovery of input tax position. The input tax is only recoverable once the VAT return is filed. Peters Ltd could file return monthly and this would improve the cash position. Another method of improving the cash position would be to set up a deferment account for the import VAT. Rather than paying the import VAT as the goods enter the UK, under the deferment account, payment is made on the 15th of the month following the date on which the goods were imported, potentially providing up to 45 days credit.

Question 6

UK tax implications

The incorporation of an non-UK branch of a UK limited company will normally have the following tax consequences:

1. There may be cessation of a trade by the UK company if Gloriosa carried on a separate trade from Diamondia.

2. There will be a deemed disposal of any plant on which UK capital allowances were claimed and stock will be deemed to have been disposed of at open market value.

3. Any capital assets of the branch will be deemed to be disposed of and reacquired at open market value.

Application to Incorporation of Gloriosa

Disposal of stock and plant on which UK capital allowances have been claimed

From the information provided in the question there is no difference between the book value and the open market value of the stock of Gloriosa and therefore the incorporation will not result in any gain or loss arising on the stock balance.

It is assumed that UK capital allowances have been claimed on the moveable plant & machinery. We do not have the information on the tax written down value of these assets, but if that value is lower than there open market value of the assets there will be a balancing charge.

Disposal of Capital Assets

The gain on the capital assets of Gloriosa comprises the gain on the warehouse of £20m and the gain on the Goodwill of £100m. The Goodwill is a capital asset because it relates to a business carried on pre April 2002.

Under the provisions of section 140 TCGA 1992, this gain can be postponed under the following conditions:

1. A UK resident company has to have been carrying on a trade outside the UK through a permanent establishment.

2. The trade and assets (excluding cash) used in the trade are transferred to a company that is non UK resident.

3. The transfer is wholly or partly in exchange for securities (shares or shares and loan stock) issued by the transferee to the transferor.

4. Following the issue of shares, the transferor holder at least 25% of the ordinary share capital of the transferee.

The incorporation of Gloriosa meets each of these 4 requirements and therefore the gain of £120m can be postponed at least in part. The part of the gain that can be postponed is calculated as

$$\text{Net gain x} \quad \frac{\text{Market Value of securities at transfer}}{\text{Market Value of total consideration}}$$

The postponed gain for Diamondia is therefore 120x 180/200 = £108m.
The entire gain cannot be postponed because part of the consideration is in cash.

The gain will crystallise when:

- Diamondia sells some or all of the shares received on the incorporation of Gloriosa. The gain crystallised at that point will be:

Postponed gain x $\quad$ <u>Market Value of securities disposed of</u>
Market Value of total holding before disposal

- Within 6 years, Gloriosa sells any part of whole of the goodwill and the warehouse on which the postponed gain arose. The gain crystallising at that point will be:

Postponed gain x $\quad$ <u>Gain on assets sold at date of transfer</u>
Total gain at date of transfer

The time limit for making a claim under section 140 TCGA 1992 is 4 years from the end of the accounting period in which the original gain arose.

Improvements to the Structure

As noted above, only part of the gain can be postponed where Diamondia receives cash as well as shares on the incorporation of Gloriosa. It appears from the initial information provided that the return of cash to Diamondia is a key component of the proposed transaction. However, if this assumption is incorrect, consideration should be given to Gloriosa issuing a full £200m of shares so that the whole of the dividend can be postponed.

UK Reporting requirements

The incorporation of Gloriosa will trigger a reporting requirement under the International Movement of Capital Rules. Under schedule 17 of FA2009 / SI 2009/2192, Diamondia Limited will be required to notify HMRC of the issue of shares by Gloriosa to Diamondia because the value in in excess of £100m and the shares have been issued by a non-UK company.

Diamondia will be required to report the following:

- The name of the overseas subsidiary issuing the shares, i.e. Gloriosa;
- The territory in which Gloriosa is incorporated, i.e. Singapore;
- The date on which the issue of shares took place;
- The name of each party to the transaction;
- The commercial reasons for the transaction; and
- An estimate of the effect of the transaction on the Group’s UK taxation liability.

Question 7

Part 1

A legitimate child's domicile is acquired from their father. This is known as the child's 'domicile of origin'. An individual retains their domicile of origin unless they acquire a domicile of dependency or domicile of choice in a different jurisdiction. (Bell v Kennedy [1868] LR 1 Sc & Div 307)

A child's domicile under the age of 16 normally follows that of their father (Domicile of dependency). When an individual attains the age of 16, they retain their existing domicile unless they acquire a domicile of choice in a new jurisdiction. In order to acquire a domicile of choice they must reside in the new country with the intention of residing there permanently or indefinitely. "a new domicile is not acquired until there is not only a fixed intention of establishing a permanent residence in some other country, but until also this intention has been carried out by actual residence there" (Bell v Kennedy [1868] LR 1 Sc & Div 307)

Pierre was born in France and presumably has a French domicile of origin although this fact should be investigated.

Pierre was seconded to London in 1990 by his employer. He has remained in London and has lived there for more than 25 years.

The ownership of London property (Re Flynn (No 1) [1968] 1 WLR 103) and the fact that he feels settled in London are factors pointing to the acquisition of an English domicile. Nevertheless there are strong factors pointing to the fact that Pierre has retained his French domicile of origin. These include the fact that he and his wife and children only carry French passports. The fact that he appears to have married a French citizen (Douglas v Douglas [1871] LR 12 Eq 617) and that the whole family are fluent French speakers again suggests strong connections with France.

Reviewing the above it is clear that to determine Pierre's domicile much further work is needed. In particular his future intentions must be established for example does he wish to remain in the UK, or does he wish to leave England and move back to France? In this regard a vague intention to return to France is not sufficient. He would need to show that he intends to return to France on the occurrence of specific circumstances e.g. when his children have finished their education. (Re: Clore (No.2) [1984] STC 609) It will also be necessary to review all the salient facts to determine whether they support his contentions, e.g. has he retained or acquired French property, has he acquired a French burial plot etc.

Part 2

All income and gains will be assessed to UK tax on an arising basis unless the remittance basis is claimed. If the arising basis applies Pierre will get credit for French tax suffered.

If the remittance basis applies Pierre's foreign income will only be assessed to UK tax if remitted to the UK, this must be claimed on Pierre's annual tax return. Pierre will also need to nominate a source of foreign income or gain for the remittance basis election to be effective. If the remittance basis is claimed the remittance basis charge must also be paid. As Pierre has been UK resident for at least 17 out of 20 years the maximum remittance basis charge of £90,000 must be paid. (S809C ITA 2007) This higher charge applies for 15/16 onwards.

If a claim for the remittance basis is made Pierre will lose his personal income tax and capital gains tax allowances. 809G ITA 2007.

Part 3

Pierre has been UK resident for approximately 25 years and therefore is deemed domiciled for inheritance tax purposes. Pierre will be subject to inheritance tax on his worldwide assets.

Question 8

Miki will become UK resident under the SRT if he spends more than 183 days in the UK. In which case Miki will be resident for the entire tax year.

However the split year basis may be available. In which case he will be treated as non-resident until the date of his arrival into the UK i.e. 1 October.

There are 8 cases where split treatment may be available. As Miki will continue to have a home available in Japan after becoming UK resident then the only case that might apply to him is case 8.

HMRC's guidance RD3 provides as follows:

Case 8: Starting to have a home in the UK

5.44 If you have no home in the UK but at some point during the tax year you start to have a home in the UK then you may meet the criteria for Case 8. You must:

- be resident in the tax year;
- be non-resident for the previous tax year;
- be UK resident for the following tax year (this must not be a split year);
- have no UK home at the beginning of the tax year but start to have a UK home at some point during the tax year and continue to have a UK home for the rest of the tax year and all of the following tax year; and
- not have sufficient UK ties to make you UK resident in the period from the 6 April to the point you start to have a UK home - when you are considering whether you have sufficient UK ties in this part of the year, you should reduce the day count limits in the sufficient UK ties tables by substituting the values from Table F.

Applying these conditions to Miki, he satisfies the first two conditions, i.e. he is non-resident in the previous year but resident in the year to which the split year basis may apply.

He also satisfies the requirement not to have a UK home at the start of the year, and intends to satisfy the requirement to have a UK home at some point during the year as he wishes to acquire a furnished property to live in as his home after his arrival in October. Provided this is achieved and he continues to have a UK home for all of the following year the UK home condition will be satisfied.

The final condition relates to UK connecting factors. In this regard Miki has two connecting factors i.e. he satisfies the '90 day' tie and the 'available accommodation' tie. In determining the amount of days that would trigger failure of the condition, Miki falls into the category of an individual who has not been UK resident in any of the previous three years. This means Miki could stay in the UK at least 120 days (on the basis of applying the test for a full tax year). As Miki plans to come to the UK on 1st October the number of days is reduced by Table F to 60. Given that Miki only plans to be in the UK for two weeks in the period 6 April to 1 October he satisfies the final condition.

In summary Miki will become UK resident from 6 April in the year of arrival, but is likely to satisfy the requirements for split year treatment.

UK taxation

Miki will be taxed as a UK resident but non-domiciled taxpayer. He will therefore be assessed on an arising basis on all his UK income and capital gains, however he will only be assessed on his foreign income and gains to the extent these are remitted to the UK. In order to obtain this treatment he must elect for it by way of his annual self-assessment tax return. There is no charge for the remittance basis for the first 7 years of residence. After a non-domiciled taxpayer has been UK resident for at least 7 out of 9 years, a £30,000 charge applies. In addition, the taxpayer must nominate income or gains each year on their tax return. An increased charge (£60,000) applies where the individual has been resident for at least 12 out of 14 years. The charge is increased again to £90,000 where the taxpayer has been UK resident for at least 17 out of 20 years.

It is noted that Miki may take up a part time role with a former colleague. As the role is based in the UK, Miki will be subject to UK tax on the salary he receives. However, he may for the period of the first 3 years of residence be entitled to a relief (overseas workday relief) in respect of the duties performed abroad, so that he would not be taxed on this foreign proportion of his salary provided that it is not remitted.

The conditions to qualify for OWR are that:

- Miki must not be domiciled in the UK throughout the year;
- he must be taxed on the remittance basis; and
- he must perform the duties of the employment wholly or partly outside the UK, and that year is either the first tax year immediately following three consecutive tax years for which he is not resident in the UK, or one of the next two tax years after such a year.

It should be noted that OWR does not require a 'dual contract' and applies where a remittance basis employee carries out both UK and non-UK duties under a single contract of employment. The total earnings from Miki's employment will be apportioned on a just and reasonable basis which is likely to be by reference to a day count of days spent performing duties in each country. The earnings relating to the UK duties will be assessed on an arising basis. The earnings qualifying for the relief are treated to be 'foreign earnings' and are not taxable in the UK unless remitted to the UK.

In order to avoid remitting income or gains to the UK, Miki should open offshore bank accounts and ensure income and capital are strictly segregated. Thus remittances should only be made from the capital account. The capital account would contain any income or gains earned before Miki became UK resident. The income account would contain all income earned since Miki becomes a UK resident. It may be advisable to open up separate bank accounts for each source of offshore income or gains. E.g. accounts could be opened for pure capital, foreign dividend income, foreign rental income, capital gains etc. This would provide greater control in determining the composition of any future remittances.

<u>Question 9</u>

Gains arising on the disposal of residential properties are potentially taxable under ATED and NR CGT. As the properties are let to third party tenants relief from ATED should be claimed. However from 6 April 2015 any gain arising on the disposal of a UK residential property by a non-resident is taxable. A rebasing election to 5th April 2015 market value may be made so that only the gain arising on or after 6 April 2015 would be subject to tax.

It is important to note that NR CGT only applies where a non-resident individual or non-resident company disposes of the property directly. It does not apply where a non-resident individual disposes of shares in a non-resident company holding the properties. Thus Jasper may sell the SPVs holding the properties without incurring NR CGT. He will however be liable to NR CGT on the disposal of the two properties he holds directly.

Although it is most likely HMRC will assess any disposals applying the CGT rules, there is some risk that HMRC may investigate whether Jasper is carrying out a trade dealing in UK properties, rather than simply holding the properties as investments.

This question is subjective, and various indicators will be considered including:

- Motive for acquisition;
- Method of finance;
- Whether the property is income producing;
- Period of ownership;
- Reason for disposal;
- Expertise of owner; and
- Supplementary work on the property.

This determination will be carried out in respect of each individual property and it is possible that some of the properties were acquired as investments whereas others were acquired with a trading motive.

Jasper has held most of the properties for many years which is an indication that the properties are being held as investments. In this regard the fact that certain properties were sold shortly after acquisition although unhelpful does not of itself determine a trading motive if the properties were acquired with the intention of holding as long term investments and were sold simply because a very generous unsolicited offer was received. HMRC may wish to establish the UK property manager's role in obtaining offers for the properties. A thorough investigation of all the facts must be undertaken before a definitive view can be given.