THE ADVANCED DIPLOMA IN INTERNATIONAL TAXATION

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PAPER 2.09 – UNITED KINGDOM OPTION

SUGGESTED SOLUTIONS

PART A

Question 1

Part 1

The UK anti-hybrids legislation can be found in Part 6A TIOPA 2010, which was introduced by Finance Act 2016 and takes effect from 1 January 2017.

The rules replaced the previous anti-arbitrage rules in Tax Arbitrage rules in Part 6 TIOPA 2010, and are much wider in scope.

The legislation addresses arrangements using hybrid arrangements that give rise to a tax mismatch, and is based on the OECD's recommendations in relation to BEPS Action 2.

There are two types of tax mismatches:

- Double deductions for the same expense: for example in a branch / hybrid subsidiary and its parent.
- Deduction / non-inclusion cases: where a deduction is given for an expense and the corresponding income isn't fully taxed.

Hybrid arrangements can include:

- Hybrid financial instruments: e.g. where one party sees them as equity, and the other as debt.
- Hybrid entities: i.e. entities which are treated as transparent in one country but opaque in another.
- Certain arrangements involving permanent establishments (PEs) and dual resident companies.
- Hybrid transfers: mismatches arising from different approaches to arrangements such as stock loans and repos.

The various combinations of mismatches and hybrid arrangements are set out in Chapters 3 to 10.

The legislation aims to neutralise the tax mismatch created by altering the tax treatment of the deduction or receipt:

- For deduction / non-inclusion cases the primary response is to deny a deduction to the payer. If this doesn't occur (e.g. because the payer is in a territory without anti-hybrid rules) then the secondary response is to tax the receipt in the recipient.
- In double deduction cases, the primary response is to deny a deduction for the parent / investor. If this does not occur, then the secondary response is to deny a deduction to the PE or hybrid entity.

The legislation also includes rules to target attempts to circumvent the main anti-hybrid rules by routing a mismatch outcome through a third county, so that the UK is not directly involved in the mismatch. These are known as 'imported mismatches'.

There is also an anti-avoidance provision which allows for a just and reasonable counteraction if, as a result of avoidance arrangements, a person avoids the application of the anti-hybrid rules.

Part 2

Looking at the transactions you are concerned about:

Chloe Ltd

The interest paid by Chloe Ltd is likely to fall within Chapter 3 ‘’Hybrid and other mismatches from financial instruments’

Per s.259CA, for that Chapter to apply conditions A to D must be met:

- Condition A: the payments of interest are made under, or in connection with, a financial instrument. This condition will be met as the loan is a financial instrument.
- Condition B: either the payer or the payee are within the charge to corporation tax. This conditions will be met: the payer (Chloe Ltd) is within the charge to corporation tax.
- Condition C: it is reasonable to suppose that there would be a hybrid or otherwise impermissible deduction / non-inclusion mismatch in relation to the payments. This condition will be met: Chloe Ltd will deduct 100% of the interest expense but the recipient will only be taxed on 10% of the amount received.
- Condition D: the two companies are related, or the loan is a structured arrangement. This condition will be met as the two companies are in the same group.

It therefore appears likely that Chapter 3 will apply.

Under s.259CD Chloe Ltd’s allowable deduction in relation to the interest will be reduced by the amount of the mismatch. As the lender is only taxed on 10% of the income it receives, Chloe Ltd will only be allowed a deduction for 10% of its interest expense, with the remaining 90% disallowed.

Sita Ltd

The interest paid by Sita Ltd is likely to fall within Chapter 5 ‘Hybrid payer deduction/non-inclusion mismatches’.

Per s.259EA, for that Chapter to apply conditions A to E have to be met:

- Condition A: The payments are made under, or in connection with, an arrangement: This condition will be met as the loan from Radcliffe Inc will be an ‘arrangement’.
- Condition B: The payer is a hybrid entity. This condition will be met: Sita Ltd is an opaque company in the UK, but a transparent branch in the US.
- Condition C: The payer or payee is within the charge to corporation tax. This condition will be met: Sita Ltd is within the charge to corporation tax.
- Condition D: It is reasonable to suppose that there would be a hybrid payer deduction /non-inclusion mismatch in relation to the payment. This condition will be met: it is assumed that Sita Ltd will claim a UK tax deduction for the interest it pays to Radcliffe Inc. As Radcliffe Inc sees Sita Ltd as a branch, it is also assumed that it will not tax the interest income as it sees the payments as taking place within the same company.
- Condition E: The payer and payee are in the same control group, or there is a structured arrangement. This condition will be met: Radcliffe Inc and Sita Ltd are in the same group.

It therefore appears likely that Chapter 5 will apply.

Per s.259EC, Sita Ltd will not be entitled to a deduction for the interest expense which is not included as income of Radcliffe Inc.

Swinton Ltd

The anti-hybrid rules will not apply to these payments. This is because, although the royalty income is only taxed at a very low rate, the income is brought into account in full.

There is therefore no double deduction or deduction / non-inclusion outcome.

The Diverted Profits Tax (DPT) may however apply to the payments to Ruritania if there is little substance in that country. This would impose a tax charge of 25% on any profits deemed to be diverted out of the UK.

The UK may also be liable to withhold taxes on the royalty payments, depending on the treaty position with Ruritania.

Depending on which group companies hold the Ruritanian company, there may also be a CFC apportionment in respect of its profits.

UK PE

The interest paid by the UK branch is likely to fall within Chapter 10 'Dual territory double deduction cases'.

Per s.259JA, for that Chapter to apply conditions A and B have to be met:

- Condition A: A company is a dual resident company, or relevant multinational company. Radcliffe Inc will be a relevant multinational company, as defined at s259JA(4) as it is not resident in the UK, but is within the charge to UK tax because it carries on business here via a PE.
- Condition B: There is an amount which it is reasonable to suppose could be deducted by the company both in the UK and another territory. This condition will be met if the interest is deducted by Radcliffe Inc for US tax purposes and by the branch for UK corporation tax purposes.

It therefore appears likely that Chapter 10 will apply.

Per s.259JD, if a deduction has not been counteracted by similar anti-hybrid rules in the US, the deduction in the branch will be restricted to any amounts not deducted in the US.
If Radcliffe Inc has deducted the full amount of interest in the US the UK branch will not be entitled to any deduction.

Question 2

Telesis (BVI) Ltd

Telesis (BVI) Ltd is the top holding company of the group. It is acknowledged that the group is effectively run out of Hamburg (via Telesis GmbH) where the key personnel reside. In order to determine the corporate residence implications to Telesis (BVI) Ltd of JS moving to the UK, it would be necessary to identify the key decisions being considered by that company. It may be that the only decisions being made by the top hold co are to retain its investment in the underlying group, determine dividend payments and perhaps enter into banking commitments.

If JS moves to the UK and instructs Telesis (BVI) Ltd board from London regarding e.g. the acceptance or rejection of a bid made by a potential purchaser, payment of dividends or the entering into of financial commitments then given that the other board members are nominee directors it is likely HMRC may argue that the company is being managed and controlled from the UK.

If however the nominee directors were replaced by more robust directors with knowledge of the company's business e.g. directors of operating subsidiaries and JS did not instruct but merely offer advice it would be less likely that HMRC would be able to successfully argue that the company was managed and controlled in the UK. It would be necessary that these directors met at least quarterly and as and when required and made decisions rather than merely rubber stamping decisions made by JS in London.

De Beers Consolidated Mines Ltd v Howe (Surveyor of Taxes) 5 TC 198 is often quoted as authority for the rule that a company is resident where its board of directors meet, provided that the real business of the company is carried on at those meetings. This rule has been affirmed in subsequence cases including *Wood v Holden*, [2006] STC 433, CA the last corporate residence case to reach the Court of Appeal.

The importance of holding substantive board meetings was also underscored in the *Laerstate* case. Indeed, *Laerstate* BV [2009] UKFTT 209 (TC) exhibits a catalogue of fundamental flaws which undermined the assertion that the real business of that company was being conducted at directors' meetings. For example for a substantial period, no board meetings were held, even though significant management activities were being undertaken in the UK by the UK-based director.

The following recommendations are made to ensure that central management and control is being exercised at board meetings held outside the UK, in the case of Telesis (BVI) Ltd and the intermediary holding companies.

- The companies should acquire substance in their respective countries of incorporation e.g. staff and offices.
- Key personnel should be appointed to the respective boards;
- Meetings should be held quarterly and as and when required
- Neither JS or any other director should participate in board meetings from the UK
- Actual decisions should be taken at the board meetings. i.e. the meetings should not merely rubber stamp decisions made elsewhere.
- JS should not negotiate key contracts in the UK.

Ideally the meetings would take place in the BVI but subject to local BVI advice for logistical reasons they may wish to consider moving the location to a more accessible jurisdiction. E.g. a channel island.
It would be advisable for JS to attend board meetings in person and also that other directors also physically attended.

The intermediary holding companies

Similar comments apply to those made in respect of Telesis (BVI) Ltd. In addition, certain cases have considered the application of the case law test in the context of subsidiaries.

Untelrab Ltd v McGregor; *Unigate Guernsey Ltd v McGregor* [1996] STC (SCD) 1, was a case in which subsidiaries of a UK-resident parent were held to be resident where their boards met (in Bermuda) and their business was transacted. This was even though it was found that the boards functioned to give effect to the parent's wishes and were 'complaisant' to do the parent company's will. Nevertheless, the directors demonstrated that they were exercing decision making since if the parent had made an improper or unreasonable request the board of the subsidiary would have refused to comply.

Wood v Holden mentioned above also acknowledged that in the case of Special Purpose Vehicles these companies do not engage in much positive outward activity, so that these companies do not need frequent and lengthy board meetings.

HMRC in SP1/90 acknowledge that "*It is particularly difficult to apply the 'central management and control' test in the situation where a subsidiary company and its parent operate in different territories"*

The fact that certain of these companies are located in treaty jurisdictions with a standard residency tie-breaker clause means that for UK purposes their residence will be determined by where their place of effective management is located if they are deemed to be resident in the UK by virtue of central management and control and resident in their country of incorporation e.g. by virtue of being incorporated there. Given that it is noted that these companies have little presence in their countries of incorporation it is unlikely that the place of effective management criteria will lead to a different determination than that obtained by applying the case law test of central management and control.

As the tax residency of the intermediary holding companies may be significant to the international tax structuring of the group it would be necessary to take advice in each of the countries affected by the residency status of an intermediary holding company as each country may apply different criteria in determining corporate residency.

Telesis GmbH

Telesis GmbH has been described as a company of considerable substance based in Hamburg with a strong board of directors. It is unlikely that JS' move to the UK would result in that company becoming UK resident. This is provided that the local board meets regularly and decisions are taken at those board meetings relating to the key strategic decisions of that company.

Even if central management and control was demonstrated to be exercised in the UK, the German-UK tax treaty would apply the treaty tie-breaker test so that residence would be determined by reference to Telesis GmbH's place of effective management.

It is very unlikely in practise that HMRC would challenge the residence status of an operating company such as Telesis GmbH with substantial presence located in a high tax country, as the UK would be required to give credit for the foreign tax suffered on its profits. Prima facie no benefit to the UK exchequer would arise even in the unlikely event HMRC were successful.

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 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.
- Where an individual elects for the remittance basis they lose their personal income and capital gains tax allowance.

- Subject to certain conditions a non-domiciled taxpayer may benefit from overseas workdays relief (OWR) for the first 3 years of their UK tax residency.
- If OWR applies then the non-domiciled employee is not subject to tax on their employment income to the extent it relates to foreign workdays and provided the relevant income is not remitted to the UK.
- A non-domiciled taxpayer is subject to UK inheritance tax on their UK assets only.

PART B

Question 3

Part 1

From a UK perspective if Bob works full time (FTWA) in Canada he will be non-UK resident under the automatic overseas residence test. FTWA broadly equates to the standard UK concept, i.e. 35 hour week. Normal holiday leave is allowed. Bob must not work more than 30 days in the UK to qualify. Work in the context of the 30 day test means working for more than 3 hours. Any UK duties may be subject to UK tax as this represents UK source income received from a UK company. However, he will have no UK liability on his earnings if he does not perform duties in the UK.

Bob would pay no UK income tax on his Canadian earnings and under the Canada-UK NI agreement could remain within the UK NI system.

Part 2

Regarding the UK employer's liability to operate PAYE an exemption may be available. Unsurprisingly the rules are fairly complicated but I have summarised them below:

To be protected by the agreement to not operate PAYE, the employees must be:

- resident in a country with which the UK has a double taxation agreement under which the 'dependent personal services – income from employment' article is applicable;
- coming to work for a UK company or the UK branch of an overseas company, or are legally employed by a UK-resident employer, but economically employed by a separate non-resident entity; and
- expected to stay in the UK for 183 days or fewer in any 12-month period.

I believe Bob meets the above requirements.

Part 3

As Bob will be non-resident for 2016/17 his liability will be restricted to liability in respect of UK source income. He will therefore not be liable to UK income tax in respect of his employment income to the extent it arises from duties performed outside the UK. This is the position even though Bob is to be paid by a UK company. Bob's relocation package should therefore not be subject to tax.

Part 4

As there is a bilateral social security agreement in place between the UK and Canada, Bob may remain within the UK NI regime.

Part 5

The fact that the Canadian company will employ Bob directly does not affect the determination of Bob's residence status. Bob's liability to income tax remains the same as that applying in the scenario where he is employed by the UK company. As Bob will be non-resident his liability will be restricted to liability in respect of UK source income. He will therefore not be liable to UK income tax in respect of his employment income to the extent it arises from duties performed outside the UK. This is the position regardless of whether Bob is to be paid by the Canadian or the UK company.

Part 6

Bob does not qualify to remain in the UK NI regime under the bilateral UK-Canada social contribution agreement. Bob will therefore be subject to Canadian social security.

Part 7

Bob may wish to make voluntary contributions to preserve certain UK social security benefits.

Part 8

Part of the agreement with HMRC is an obligation to file annual reports providing details of the number of STBVs arriving in the UK each tax year. It is therefore necessary to have a system in place that records employees' movements, such as travel records, expense claims and office visitor records. HMRC requires an internal reporting system to be in place.

Reports are due to HMRC by 31 May after the end of the tax year. The requirements vary depending on the amount of time spent in the UK:

1–30 days: no reporting requirements.

31–59 days: if there is no formal contract of employment with the UK employer and the 59 days do not form part of a more substantial period (together with earlier or subsequent trips) only a list of names of such employees is required.

1–59 days not falling within the scope of the above category, and other visitors for 60–90 days: the employer must provide the following information for each relevant employee:

- full name;
- last known UK and overseas addresses;
- nature of duties undertaken;
- date work started and ended;
- to which country a tax return covering worldwide income is submitted; and
- employer statement confirming that the UK company does not ultimately bear the cost of the employee's remuneration or function as the employee's economic employer during the visit.

91–150 days: all of the above, plus a certificate of residence from the home country's tax authorities.

Question 4

Part 1

A 'branch exemption' election under s18A CTA 2009 excludes profits attributable to a foreign permanent establishment (PE) of a UK company from the charge to corporation tax. Similarly, any losses attributable to a PE cannot be relieved.

Currently, as Sebastian plc has not made an election under s18A, it will include the profits and losses of its PEs in its results for corporation tax purposes, and claim double tax relief by way of a credit where possible. Looking at each of the branches in turn:

- UK corporation tax will be payable on the profits of the French branch. However, as the tax rate in France is so high these are most likely to be covered in full by double tax relief.
- Sebastian plc will be able to take into account the losses in the US branch, setting these against its own profits for corporation tax purposes.
- UK corporation tax will be payable on the profits of the Hungarian branch. Double tax relief will be available for the tax paid in Hungary, but as the rate is only 9% it is likely will still be UK corporation tax to pay.

An election under s18A CTA 2009 is permanent and affects all a company's PEs. It is not possible to 'cherry pick' and apply the exemption to some branches but not others.

As a result, if Sebastian plc were to make an election:

- The position would be broadly similar for the French PE: there would be no UK corporation tax to pay as the profits would be exempt.
- The position would be worse in the short term for the US branch, as Sebastian plc would not be able to claim relief for the branch losses.
- The position would be better for the Hungarian branch, as there would be no UK corporation tax at all to pay on its profits since these would be exempt.

Whether an election would be beneficial for Sebastian plc will therefore depend on the amount of corporation tax saved on the Hungarian branch profits versus the extra corporation tax payable from forfeiting the losses of the US branch:

- If the tax saved on the Hungarian branch exceeds the extra cost of losing the tax relief from the US branch losses, then an election may be beneficial.
- If instead the value of the forfeited US losses is higher than the tax saving on the Hungarian PE then it is unlikely to be beneficial, at least in the short term.

Part 2

When a company makes an election under s18A CTA 2009 this becomes effective from the start of the next accounting period. The exception to this is where its foreign permanent establishments are in a net loss position at the start of that period.

Where this is the case, the transitional provisions in s18J – s18O provide for a clawback of the previous relief which the company will have had for those branch losses. It does so by deferring the start of the exemption until the losses in the 6 years before the election have been matched by profits after the election.

The rules operate by looking back to see what total losses have arisen in all foreign PEs of the company in the 6 years prior to the first accounting period for which the election is made. Where there are net losses that have not been matched by subsequent profits during those 6 years there will be a loss carry forward known as the opening negative amount.

This opening negative amount has to be matched by profits post-election before the exemption can take effect.

Looking at the profits and losses of Sebastian plc's branches over time the opening negative amount will be £70,000:

Profits / (losses) attributable to:

Year ended	French branch	USA branch	Hungarian branch	Total profit / (loss)	Loss carried forward
31 December 2012	100,000	(50,000)	10,000	60,000	0
31 December 2013	90,000	(120,000)	13,000	(17,000)	17,000
31 December 2014	110,000	(20,000)	12,000	102,000	0
31 December 2015	85,000	(80,000)	15,000	20,000	0
31 December 2016	75,000	(25,000)	5,000	55,000	0
31 December 2017 (projected)	100,000	(20,000)	10,000	30,000	0

Taking all the branches together there is no opening negative amount.

Although the branches overall made a loss in 2013, this has subsequently been matched by profits in later years.

If there were an opening negative amount then this would have to be matched by total profits from the PEs in periods from 31 December 2018 onwards.

Whilst this matching took place the profits of the PEs would continue to be subject to corporation tax, with double tax relief available in the usual way for any foreign tax paid.

Depending on the future profits and losses of the PEs this could delay exemption for some time. It may be possible to reduce this delay by making an election to 'stream' the profits and losses of the US branch. This would mean they are looked at in isolation for the purposes of the transitional rules rather than being aggregated with the results of the other two PEs.

This would mean there is no delay in exemption for the Hungarian and French branches.

The US branch losses would be looked at in isolation, and could only be matched with future profits from that branch. This is likely to mean a longer period of time before profits of that branch are exempt, though double tax relief would be available for any US tax paid.

However a streaming election is not beneficial here, as overall there is no opening negative amount.

Part 3

Generally, an election under s18A applies to chargeable gains and losses in the same way as other profits and losses attributable to permanent establishments.

Per s18B(1) chargeable gains and losses are left out of account for UK corporation tax purposes to the extent that they are attributable to the PE under the relevant treaty.

The capital gains article of most double tax treaties based on the OECD Model include provision for gains on immoveable property (such as buildings) to be taxed by the State in which they are located.
Even if a treaty does not have this provision, s18B(2) ensures that profits attributable to a PE includes any gains or losses in respect of immoveable property used for the business of the PE in that territory.

Therefore, provided that the French branch continues to use the property in France for its business any gain or loss should be left out of account for UK corporation tax once the election under s18A takes effect.

If the building is not used solely by the PE then it may be necessary to make a just and reasonable apportionment of the gain.

Part 4

The branch exemption legislation contains anti-diversion rules which are based on the rules for controlled foreign companies (CFCs).

s18G states that the anti-diversion rules will apply where a UK company has:

- An adjusted relevant profits amount (i.e. PE profits that would otherwise be exempt)
- That amount includes ‘diverted profits’, and
- None of the exemptions set out in s18I apply.

Diverted profits are defined in s18H as any profits of the UK company which pass through the ‘diverted profits gateway’. The diverted profits gateway applies the CFC gateway rules with some modifications.

Effectively, this requires you to assume that the UK company is a CFC and apply the Gateway rules in Chapters 3,4, 5,6, 7 and 9 of TIOPA 2010. If none of the company’s profits would pass through the Gateway then there are no diverted profits and the anti-diversion rules won’t apply. If there are any diverted profits these will not be included in the branch exemption

s18I applies the entity exemptions in Chapters 11 to 14 of the CFC rules (TIOPA 2010 Part 9A) in the context of foreign PEs. These are:

- The excluded territories exemption
- The low profits exemption (applied to taxable profits alone and not accounting profits)
- The low profits margin exemption
- The tax exemption.

In applying these rules you have to assume that the PE is a separate company that is a CFC resident in its territory of operation.

Looking at the Hungarian PE of Sebastian plc the anti-diversion rules are unlikely to apply as it should currently qualify for the low profits exemption.

If the Hungarian PE’s taxable profits were to increase above the low profits threshold of £500,000 then it would be necessary to look at whether any of the profits of the PE were ‘diverted profits’ applying the Chapter 3 and Chapter 4 gateways.

Part C

Question 5

Part 1

For UK tax purposes, overseas entities can be classed as either ‘opaque’ or ‘transparent’.

How to determine whether an entity is opaque or transparent is not set out in legislation, and instead we have to look to the relevant case law and HMRC guidance for assistance.

A good starting point is HMRC’s guidance. This contains a list at INTM 180030 of those entities where HMRC have been asked their view on the question of transparency / opacity. As we are not told what country the LLP has been incorporated in it is not possible to confirm whether it is on this list.

Even if a specific entity is of a type listed in HMRC’s guidance this does not necessarily mean that it is certainly opaque or transparent. This is especially the case if there can be variations in the legal agreements for that type of entity.

This was highlighted in the case of *Anson v HMRC* where the UK Supreme Court ruled that a Delaware LLC should be treated as transparent for UK tax purposes, going against HMRC’s guidance and long standing practice that such LLCs were opaque.

A key case in entity classification is *Memec plc v* CIR, which identified a series of factors to be considered. These factors are also set out in HMRC’s guidance.

Applying them in turn to the LLP*:*

1) Does the foreign entity have a legal existence separate from that of the persons who have an interest in it?

   Yes: the ability to trade, take out loans in its own name etc. indicates that the LLP is opaque

2) Does the entity issue share capital or something else, which serves the same function as share capital?

   The ‘partner shares’ sound similar to share capital, in that there is a register, they have a fixed value, certificates are issued and there are restrictions on transfer. This suggests the LLP is opaque.

3) Is the business carried on by the entity itself or jointly by the persons who have an interest in it that is separate and distinct from the entity?

   The LLP carries on business in its own name, which suggests it is opaque.

4) Are the persons who have an interest in the entity entitled to a share in its profits as they arise, or does the amount of profits to which they are entitled depend on a decision of the entity or its members after the period in which the profits have arisen, to make a distribution of profits?

   The agreement states that the partners are entitled to profits as they accrue, which would suggest transparency. However, the fact that these are only paid over once a year following finalisation of the accounts may point more towards being opaque, particularly if a decision or vote of the partners is required first.

5) Who is responsible for debts incurred as a result of the carrying on of the business: the entity or the persons who have an interest in it?

The partners are jointly and severally liable which suggests transparency.

6) Do the assets used for carrying on the business belong beneficially to the entity or to the persons who have an interest in it?

   The LLP owns its own assets which would suggest it is opaque.

To decide on the status of the LLP each of the above factors need to be weighed up. HMRC always pay particular attention to 3) and 4).

On balance these seem to indicate that the LLP is likely to be opaque, though further information should be sought on the exact mechanics by which profits are allocated and distributed. This was a key point in *Anson.*

<u>Part 2</u>

Classification as transparent or opaque will dictate how and when Mr Dawson is taxed on the profits of the LLP:

- If the LLP is opaque Mr Dawson will not be taxed on its profits until they are distributed to him.
- If the LLP is transparent, any profits and gains will be taxed on Mr Dawson as they arise. This is likely to result in him paying tax earlier than if the entity is opaque.
- Double tax relief is likely to be available to Mr Dawson if the entity is transparent, meaning he can set any foreign tax paid by the LLP against his UK tax liability. No double tax relief is likely to be available if the entity is opaque.

Question 6

Part 1

A controlled foreign company (CFC) is defined in s.371AA TIOPA 2010 as a company which:

- Is not resident in the UK, and
- Is controlled by a UK resident person or persons.

The finance company will be a CFC as:

- It is assumed it will be Irish tax resident.
- It is controlled by HWC plc – a UK resident company.

As a result, unless the finance company can claim an exemption, or its profits do not pass through any of the CFC gateways in the legislation, its profits will be apportioned to HWC plc and subject to UK corporation tax.

It is unlikely that any of the CFC exemptions will apply to the finance company.

- Ireland is not an 'excluded territory' for the purposes of the excluded territory exemption in s.371KA.
- If the finance company has an effective tax rate similar to the headline tax rates in Ireland and the UK, the company will not qualify for the tax exemption in s.371NA as the Irish rate is less than 75% of the UK rate.

The finance company may qualify for the low profits exemption in s.371LA if its accounting or taxable profits for the period are no more than £50,000. This may be the case when it is first set up and has not made many loans. We are not given enough information to confirm this.

If the finance company does not qualify for the low profits exemption it will be necessary to look to the CFC gateways. As the finance company will only have non-trading finance profits, it will be the Chapter 5 gateway which is relevant.

Profits of the finance company will pass through this gateway if they derive from any of the following:

- Assets and risks in relation to which the Significant People Functions (SPFs) are carried out in the UK.
- Capital investment from the UK.
- Loans made in lieu of paying dividends.
- UK finance leases.

As the loans made by the finance company will be funded by equity contributions from HWC plc the second of these will apply. As the finance company will be controlled by a UK company and have UK based directors it is also possible that it will have UK SPFs.

The profits of the finance company are therefore likely to pass through the Chapter 5 gateway.

Where a CFC has non-trading loan relationship profits which pass through the Chapter 5 Gateway it can claim for them to be dealt with under Chapter 9 (exemptions for profits from qualifying loan relationships instead) instead if:

- The profits arise from 'qualifying loan relationships'
- It meets the 'business premises' condition.

The business premises condition will be met if, at all times during the accounting period, the finance company has premises in Ireland from which its activities are wholly or mainly carried on, and it does so (or intends to) with a reasonable degree of permanency. As the group has offices in Ireland this condition should be met provided the directors and employee of the finance company have access to those offices and carry out the company's business there.

If Chapter 9 applies then 75% of the finance company's profits from its 'qualifying loan relationships' will be exempt. Any profits not from qualifying loan relationships will continue to fall within the Chapter 5 Gateway and be fully apportioned back to Sebastian plc.

A qualifying loan relationship is defined at s371IG as a creditor relationship:

- Where the ultimate debtor is a qualifying company.
- Which is not excluded by s371IH.

A qualifying company is a company which is:

- Connected with the CFC, and
- Controlled by the same UK resident which controls the CFC.

Loans from the finance company to fellow group companies should therefore be qualifying loan relationships provided they do not fall within any of the excluded categories in s371IH. The exclusions which may be relevant here are:

- A loan used for the purposes of a UK PE or UK property business.
- A loan where the ultimate debtor is a UK company (unless the loan is attributed to an exempt overseas PE)
- A loan to another CFC where the debits result in no, or a reduced, CFC charge under the low profits exemption or gateway chapters.

Applying these rules to the finance company:

- Loans to overseas group companies should be qualifying loan relationships provided they are not allocated to a UK PE and don't result in a reduced CFC charge for the borrower. As a result, 75% of the profits on these loan relationships will be exempt from a CFC apportionment and will not be taxed in the UK.
- Loans to UK group companies will not be qualifying loan relationships. As a result, 100% of the profits on these loan relationships will be apportioned to HWC plc and taxed in the UK.

S.371IB does provide a further exemption for up to 100% of non-trading finance profits if loans are funded out of 'qualifying resources'. This exemption is very narrow in focus, and generally only applies where a loan is funded from profits generated in the borrower's territory. It is therefore unlikely to be available to the finance company.

<u>Part 2</u>

Depending on their local domestic laws the other group companies may be required to withhold tax on the interest payments they make to the finance company. For example, the UK companies would be required under domestic UK law to withhold tax at 20%.

It may be possible to reduce this withholding tax as far as 0% under the relevant double tax treaty with Ireland or the EU Interest and Royalties Directive.

Under the EU Interest and Royalties Directive, payments between 'associated' companies within the EU are exempt from withholding tax. To be associated:

- One company must hold at least 25% of the share capital or voting rights of the other, or
- A third company must directly hold at least 25% of the share capital or voting rights of both companies.

Question 7

Part 1

As Mrs Wortley is not UK resident she will not generally be subject to UK capital gains tax (CGT). The exception to this is that, from 5 April 2015, non-residents are subject to CGT on the disposal of UK residential property.

The rules on this non-resident CGT charge (NRCGT) are included in s.14B – s.14H and Sch 4ZZB TCGA 1992.

These state that NRCGT applies to non-resident individuals disposing of UK residential property.

'UK residential property' is defined in Sch B1 as being land which includes a 'dwelling'. There are exceptions for certain types of buildings, including prisons, hospitals and hotels.

Of the three properties:

- The houses in Reading and London will be 'dwellings' and therefore fall within the NRCGT charge.
- The hotel in Brighton will not be classed as a 'dwelling' and its sale will therefore not be within the scope of the NRCGT. Any gain on the sale of the hotel should not be taxed in the UK, though may be taxed in Spain.

The NRCGT charge only applies to gains accruing after the rules were introduced on 5 April 2015:

- As the house in Reading will only be acquired after this date the entire gain will be taxed.
- For the house in London, only that part of the gain arising after 5 April 2015 will be subject to CGT. The gain accruing before that time will be exempt. Mrs Wortley can choose to either time apportion the entire gain over her period of ownership, or rebase the property to its market value on 6 April 2015.

Mrs Wortley will have to file a NRCGT return and pay the tax due within 30 days of completing the sale of either house.

If the disposal would also be taxable in Spain she may be able to claim relief under the UK – Spain tax treaty.

Part 2

SDLT will be payable on both properties as they are situated in the UK.

The hotel will be subject to SDLT at the non-residential rates.

The house in Reading will be subject to SDLT at residential rates. As Mrs Wortley already owns a property in the UK (the house in London), and is not replacing a main residence, she will be subject to an extra SDLT charge of 3% above the normal SDLT rates.

Part 3

The rental income received from the houses will be subject to UK income tax even though Mrs Wortley is not UK resident.

The rental income is likely to be subject to withholding tax under the non-resident landlords scheme.

S.971 ITA 2007 provides that the basic rate of income tax (i.e. 20%) must be withheld from any UK rental income paid to a person whose 'usual place of abode' is outside the UK.

This tax must be withheld by the letting agent and paid over quarterly to HMRC. A deduction can be claimed for any allowable expenses paid by the letting agent.

Mrs Wortley can apply to HMRC to receive her rental income gross if her UK tax affairs are up to date. She will still be subject to income tax on the rental income, and will have to file a self-assessment return.

Question 8

Giuseppina's domicile

At birth Giuseppina would have acquired her father's domicile as her domicile of origin. (Bell v Kennedy [1868] LR 1 Sc & Div 307) It is not clear whether at the time of her birth her father's domicile remained Italian or whether he had acquired a domicile of choice in Ireland.

In any event until Giuseppina attained the age of 16 her domicile would have followed that of her father so that if he had an Italian domicile at the date of her birth, but prior to her attaining the age of 16 had acquired a domicile of choice in Ireland, by physically residing there with the intention of remaining there permanently or indefinitely, she would have acquired a domicile of dependency in Ireland (Bell v Kennedy [1868] LR 1 Sc & Div 307).

It is therefore likely that at the point she left Dublin Giuseppina had an Irish domicile either through domicile of origin or domicile of dependency/choice.
Giuseppina's Irish domicile would remain unless she resided in London with the intention of residing there permanently or indefinitely.

Giuseppina feels settled in London and has remained there for almost 25 years apart from her two year secondment to Prague. She owns London Property (Re Flynn (No 1) [1968] 1 WLR 103) where her husband Pedro and her teenage children reside with her. Against this she carries an Irish Passport and stays connected to her Irish friends and family. In addition she also expects to acquire Irish property.

Giuseppina's domicile status is unclear and further investigatory work is required. Determination of domicile is a complex matter involving the consideration of all the facts and circumstances pertaining to that individual. For example it is necessary to establish whether she has plans to return to live in Ireland perhaps on her retirement? Does she intend to reside personally in the Irish property she contemplates she will acquire? or has she in fact formed at intention to remain permanently or indefinitely in London?

Discretionary Trust

Inheritance Tax

- As Giuseppina has been UK resident since August 1990, i.e. 1990/91 apart from a couple of years when she was seconded to Prague, clearly she has been UK resident for not less than 17 out of 20 years of assessment and is therefore deemed domiciled for the purposes of UK inheritance tax.
- As Giuseppina is deemed UK domiciled for inheritance tax purposes she is not entitled to the excluded property regime.
- A transfer of her offshore portfolio into an offshore discretionary trust to the extent it exceeds her available nil rate threshold will therefore be a chargeable transfer which will be liable to inheritance tax at 20%.
- If Giuseppina dies within 7 years of making a transfer into the trust her estate will have to pay Inheritance Tax at the full amount of 40%.
- The offshore trust will be subject to the relevant property regime, i.e. the 10 year anniversary charge and exit charges will apply.

Income tax and capital gains tax

- Giuseppina is not deemed UK domiciled for income tax or capital gains tax purposes. Note however a HMRC enquiry into Giuseppina's domicile status is on-going.
- As Giuseppina is taxable on the remittance basis, any chargeable gains arising on the disposal of her foreign investment portfolio to the offshore trust will not be immediately chargeable to capital gains tax as the disposal will not give rise to any remittable proceeds. However if distributions received from the offshore trust are subsequently remitted into the UK any gains arising on the original transfer into trust may become liable to capital gains tax at that point.

- As Giuseppina is entitled to the remittance basis Giuseppina is not liable to income tax or capital gains tax on foreign income or foreign gains arising in the trust.
- However, if Giuseppina remits distributions she receives from the trust into the UK, these distributions may become liable to tax at that point.

Question 9

Dear Roberto

Many thanks for your email.

I note your intention to move back to Italy. I also note you already have a home in Roma, and that your wife, three daughters and two grandchildren all live there. Your residence will be determined by the statutory residence test. Within this test there are various 'tests' which may apply. The tests are hierarchical The highest level tests are the automatic UK residence tests and the automatic overseas residence tests. The automatic overseas tests have primacy and if you satisfy any of the automatic overseas tests then you are not UK resident. The first automatic overseas residence test which I will consider is the full time working abroad test. This may apply where you are leaving the UK for full time employment abroad. Unfortunately on the facts this seems unlikely to be satisfied, since I note your employment in Italy will be non-paid. The SRT specifically provides that voluntary work does not count in determining whether the FTWA test is met. Further you intend to continue working for the London university albeit on a limited basis.

You are also unlikely to satisfy the other 'automatic' non residence test which is you spend less than 16 nights in the UK in any tax year, particularly given your continuing commitment to the university.

I assume you will retain your London home for the foreseeable future?

This leaves the ties test to determine your residence. You will be a leaver under these provisions so the following five ties are relevant.

1. Accommodation

   You will have accommodation in the UK which you will retain. This counts as one tie.

2. Family

   As your wife and three daughters are non-resident you will not have a tie under this condition.

3. 90 day tie

   As you will have spent more than 90 days in the UK in one of the two previous tax years you will have a tie under this test.

4. Work tie

   This condition is triggered by reference to a 40-day threshold. For these purposes, a person works in the UK if he does more than three hours' work in the UK. My guess is you may have a tie under this condition.

5. Country tie

   I expect you will spend more days in Italy rather than the UK so that you will not have a tie under this criteria.

   I estimate you are likely to have three ties. Your position will be determined by reference to the leaver provisions, i.e. those taxpayers who have been UK resident in at least one of the last three tax years This will mean you would only be able to remain in the UK 45 days.

   If you do not have the work tie you would be able to remain up to 90 days. However, in my view the longer an individual such as yourself remains in the UK the more likely it is that they will breach the work tie. Bearing this in mind, thinking pragmatically provided you do not exceed the 40 work days tie you might spend say 60-75 days in the UK and not be UK resident.

Turning to the specific queries you have raised, I believe I have explained the framework of the SRT and the days you may spend in the UK without becoming UK resident above. With regard to the work tie, which looks at work related activities rather than personal activities e.g. managing your own investment portfolio. Writing a report in the UK, preparing work related emails, etc. would certainly seem to constitute work activities, as would lecturing or indeed preparing the material to be used in a lecture.

After you have become non-resident for three complete tax years you will be treated as an arriver under the connecting ties test. This means you will be able to spend more time in the UK and still qualify to be treated as non-resident. However the interaction between the conditions is complicated since if you spend more than 90 days in the UK in any year, for the subsequent two years this will count as a tie and will reduce the number of days you can spend in the UK for those two subsequent years.

Finally I have not mentioned the tie-breaker provisions of the UK-Italy treaty at this point.

Split-year

Turning to your second question the scenario where you would leave the UK in August 2017 to go and live in Italy. Under the SRT if you are resident for any part of the tax year you are treated as resident for the full tax year.

However subject to meeting qualifying conditions the tax year may be split between a UK part and overseas part. This normally will mean that an individual is not chargeable to income tax or capital gains tax in respect of any chargeable non-UK income or capital gains accruing to him in the overseas part of the year.

However on your facts you do not appear to qualify for split year treatment as you do not fall within any of the prescribed cases. In this regard there are only three cases in which an individual who leaves the UK part way through the tax year is entitled to split year treatment.

Case 1

Starting FTWA

As explained above you do not qualify under this criteria.

Case 2

The partner of someone starting FTWA.

Case 3

Ceasing to have a home in the UK.

As you have explained to me that you wish to retain your UK home you will not qualify under this case.

In summary you will not qualify for split year treatment so would be treated as UK resident for the full 2017/18 tax year if you left the UK in August 2017.

Best regards