The question of place

International Tax Large Corporate

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Key Points

What’s the issue?

A company is UK tax resident if it is incorporated in the UK, or if its central management and control actually abides in the UK. Several recent changes in the UK legal framework have made corporate residence a key feature of the tax landscape faced by multinationals doing business in the UK.

What can I take away?

The introduction of the multilateral instrument is likely to mean that more dual residence cases will be resolved (or attempted to be resolved) with the involvement of the competent authorities than was the case previously. Other tax treaties may resolve dual residence in other ways; for example, via the 'place of effective management' tiebreaker.

What does it mean to me?

There have been several recent changes to the UK corporate residence rules that multinationals should be aware of and review where appropriate. It is worth reflecting on whether residence will continue to be as important as it currently is in determining the scope of the UK's taxing rights over companies.

Several recent changes in the UK legal framework have made corporate residence a key feature of the tax landscape faced by multi nationals doing business in the UK. This article summarises some of those changes, and key practical areas to look out for.

The basic rules of UK corporate residence

It is worth starting with a recap on the basic rules of UK corporate residence. A company is UK tax resident if it is incorporated in the UK, or if its central management and control actually abides in the UK.

Residence then determines the extent of the UK's taxing rights over the company. UK tax resident companies are generally subject to UK corporation tax on their worldwide income and gains. In contrast, non-UK tax resident companies are generally subject to UK corporation tax on profits attributable to a UK permanent establishment, as well as UK income tax on certain UK-source income.

Case law update: Development Securities

The 'central management and control' test derives from the famous case of De Beers Consolidated Mines v Howe (Surveyor of Taxes) [1906] AC 455. A line of cases then developed from De Beers, the latest of which is the Upper Tribunal decision in Development Securities and others v HMRC [2019] UKUT 169.

The case concerned the incorporation of various Jersey subsidiaries of Development Securities plc, a property development and investment company, as part of a tax planning scheme dating back to 2004.

It was essential to the operation of the scheme that the subsidiaries were not only incorporated, but also tax resident in Jersey, and not the UK. The First-tier Tribunal found that the subsidiaries were UK tax resident, and the taxpayer appealed to the Upper Tribunal, where that decision was reversed.

A number of practical points can be drawn from the case. The first is to summarise the case law on central management and control:

- A ‘substance over form’ approach should be taken, which will cause the courts to see through ‘shams’.
- The question as to where central management and control abides is one of fact; i.e. where central management and control actually is and not where it ought to be.
- Central management and control abides where the company’s ‘paramount authority’ is exercised (which is normally exercised by the board).
- Influencing the board is different to controlling it.
- The courts must be alive to the board ‘rubber stamping’ decisions taken by others.
- It is possible for a company to be dual tax resident.

The case also indicates that incorporating a subsidiary for a specific purpose (i.e. to act as a ‘special purpose vehicle’) does not in itself determine where central management and control abides.

This is encapsulated in the following quote from the judgment (at para 17):
‘The mere fact that a 100% owned subsidiary carries out the purpose for which it was set up, in accordance with the intentions, desires and even instructions of its parent, does not mean that central management and control vests in the parent.’

Finally, the case also considered key indicators of the board ‘rubber stamping’ decisions taken by the company’s shareholders so that central management and control is really being exercised by the shareholders. In the Upper Tribunal’s view, these indicators are:

- where the board ignores its statutory duties when taking decisions; and
- knowingly acting without sufficient information.

This sets a high bar for 'rubber stamping'. While this may be good news for advisers wishing to incorporate overseas 'special purpose vehicles' for use in specific transactions, it may be prudent to treat the case with an element of caution – in particular, because there is speculation that the decision may be appealed in due course.

Gains arising from disposals of UK real estate from April 2019

As already mentioned, non-resident companies are generally subject only to UK corporation tax on profits attributable to a UK permanent establishment, as well as income tax on certain UK-source income. However, from April 2013 onwards non-UK tax resident companies that held certain high value UK residential real estate came within the scope of the then new annual tax on enveloped dwellings (ATED) on an ongoing basis, and of ATED-related CGT on exit.

The rules for disposals of UK property have continued to evolve since then, culminating in new rules that came into effect in April 2019. Now, chargeable gains arising to non-resident companies on the disposal of UK real estate (both residential and non-residential) are subject to UK corporati on tax at the prevailing rate.

While a detailed summary of these rules is beyond the scope of this article, it is fair to say that they are far reaching. This is illustrated by the way in which, broadly, gains arising on disposals of assets that derive at least 75% of their value from UK real estate are within the scope of charge. This could catch disposals of shares in 'property rich' overseas corporate vehicles, making it important to understand the composition of a corporate vehicle's balance sheet before advising on the tax impact of disposal of shares in it.

Anti-hybrids

The anti-hybrid rules were introduced in the UK with effect from 1 January 2017, replacing the previous anti-arbitrage provisions (TIOPA 2010 Part 6A, replacing Part 6). Catalysed by the OECD's base erosion and profit shift ing (BEPS) Acti on 2 proposals on this topic, the UK's anti-hybrid rules are far-reaching and complex, providing mechanical adjustments to 'deduction/non-inclusion' or 'double deduction' mismatches of tax treatment resulting from hybridity. Separate chapters address mismatches arising as a result of hybrid entities, hybrid instruments, and dual resident or multi national companies. A full summary of the rules is outside the

scope of this article.
However, in brief and in so far as they relate to dual tax resident companies, Chapter 10 of the anti-hybrid rules seeks to prohibit dual resident companies from obtaining tax advantages that are perceived to be unjustified economically. By virtue of its dual residence status, a dual tax resident company is taxable in two territories. Prima facie, such a company would have both income and expenses recognised in each of those territories (subject to differences in calculation of the tax base). Simply put, the anti-hybrid rules ensure that a company that is resident in both the UK and in a foreign jurisdiction cannot claim double deductions for its expenses, unless such expenses are offset by doubly taxed (or ‘dual inclusion’) income.

Historically, a dual tax resident company may have benefited from the ability to utilise a tax loss in two jurisdictions. The anti-hybrid rules effectively prohibit such action from 2017 onwards.

The Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS

Otherwise known as the ‘multilateral instrument’ (MLI), this was introduced to ensure that the treaty network of BEPS participants reflected certain minimum standards. The MLI took effect in relation to UK corporation tax on 1 April 2019, and the UK’s existing tax treaties will be altered once the counterparty jurisdiction has implemented the MLI and to the extent that the UK and that jurisdiction have each not made any reservations against the relevant articles.

Article 4 deals with dual resident entities. It provides a ‘treaty tiebreaker’ that will replace the existing tiebreakers in covered tax treaties where the counterparty jurisdiction has not made any reservations. Article 4(2) reads (with emphasis added) as follows:

‘Where by reason of the provisions of a Covered Tax Agreement a person other than an individual is a resident of more than one Contracting Jurisdiction, the competent authorities of the Contracting Jurisdictions shall endeavour to determine by mutual agreement the Contracting Jurisdiction of which such person shall be deemed to be a resident for the purposes of the Covered Tax Agreement, having regard to its place of effective management, the place where it is incorporated or otherwise constituted and any other relevant factors. In the absence of such agreement, such person shall not be entitled to any relief or exemption from tax provided by the Covered Tax Agreement except to the extent and in such manner as may be agreed upon by the competent authorities of the Contracting Jurisdictions.'

The main difference is that many treaties previously contained a 'place of effective management' tiebreaker, which has now been replaced with a mutual agreement procedure between competent authorities for covered treaties. While the place of effective management is still a relevant factor that should be taken into account, it is now just one factor of many. Moreover – and this is the key practical point – the test requires the active involvement of the competent authorities in determining the company's place of residence. Treaty benefits are also denied until such time as that process is completed (absent any specific agreement from the competent authorities). This is in marked contrast to the 'place of effective management test', which applied automatically and which companies could interpret without recourse to the competent authorities.

In practice, the competent authorities' involvement in resolving dual residence is likely to slow the process down. It is also not entirely clear whether the taxpayer has to take the initiative and commence the process with the respective competent authorities under the mutual agreement procedure. Literally construed, the competent authorities are responsible for taking the initiative without any commencement being required on the taxpayer's part. Clarification from HMRC on this point would be welcomed, given the likely increase in the volume of cases now needing competent authority input.

Resolving dual residence

The introduction of the multilateral instrument is likely to mean that more dual residence cases will be resolved (or attempted to be resolved) with the involvement of the competent authorities than was the case previously. Other tax treaties may resolve dual residence in other ways; for example, via the 'place of effective management' tiebreaker.

A dual resident company could, of course, shift its residence to a single jurisdiction by removing some of the levers that leads to the assertion of residence by a second jurisdiction.

As outlined above, a company is UK tax resident if its central management and control actually abides in the UK. A dual resident company with UK central management and control could take positive action to shift that central management and control from the UK to the second jurisdiction. Of course, the same could be said of a dual resident company incorporated in the UK but centrally managed and controlled overseas, by shifting management and control to the UK. It may also be possible in certain jurisdictions to shift the legal seat of a company, thereby moving residence on the basis of an incorporation based test. However, it is understood that a shift of legal seat is not possible in the UK.

It should be noted that any action taken unilaterally or via a treaty tiebreaker provision to move from being a dual tax resident (UK and overseas) company to solely resident overseas is treated as an emigration from the UK for UK tax purposes. The treatment of such an event would be broadly similar to a solely UK tax resident company shifting its residence overseas. Advance notice must be provided to HMRC, and HMRC's approval obtained for the company's arrangements to pay any outstanding tax liabilities. This can take time and should be factored into any emigration plan.

In addition, the company's assets are, broadly, deemed to have been disposed of and reacquired for market value on the day of exit, which may give rise to a so-called 'exit charge'. The policy intention behind this is to bring into charge any 'latent profits' represented in the company's assets. There are specific rules that apply to each category of asset from a tax perspective (chargeable gains assets, stock, capital allowance pools, etc.), which are similar but often subtly different to each other. In practice, it is advisable to review these rules carefully, as unexpected exit charges may derail an emigration.

Action taken unilaterally or via a treaty tiebreaker provision to move from a dual tax resident (UK and overseas) company to a solely UK tax resident company should involve a much simpler UK tax analysis. The company would retain its UK tax residence status with limited changes; namely, that the UK rules relating to dual residents (e.g. the anti-hybrid provisions discussed above) would no longer be relevant.

Conclusion

As can be seen, there have been several recent changes to the UK corporate residence rules that multinationals should be aware of and review where appropriate. As a concluding remark, it is worth reflecting on whether residence will continue to be as important as it currently is in determining the scope of the UK's taxing rights over companies. The UK is increasingly looking beyond residence in this regard, one example being the new regime for chargeable gains arising to non-resident companies mentioned above. This trend is set to continue with the proposed introduction of a new tax in April 2020, the digital services tax, as a new means of collecting tax from large multinationals based on revenues derived from UK customers as opposed to a profits-based test linked to tax residence.