Corporate redomiciliation: Changing your company's corporate citizenship

International Tax Large Corporate

Image not found or type unknown

22 April 2022

The government's recent consultation on a proposed redomiciliation regime raises important questions about the scope and tax implications of changing a company's corporate citizenship.

Key Points

What is the issue?

Can a company redomicile from the UK to another jurisdiction?

What does it mean to me?

A UK resident company can cease being resident here and take up residence elsewhere but this is not without tax consequences.

What can I take away?

There is clearly a gap for a 'proper' outward redomiciliation regime. The government's consultation on a proposed redomiciliation regime for the UK places a larger emphasis on inward redomiciliation and even asks if an outward regime is desirable.

On several occasions recently, I have been asked the following question in some shape or form: 'Can a company redomicile from the UK to another jurisdiction?' Implicit in the question, but somewhat hidden, is the follow-on question of what are the tax implications, if any, of redomiciliation. Redomiciliation comes in different shapes and sizes and it all depends on what you mean by the word.

The question appears to have taken on greater significance with Brexit and the implications for UK groups with interests in different EU markets. But it is also of interest outside those parameters. For example, companies incorporated in low tax jurisdictions have to think about external pressures, such as OECD-driven rules requiring companies in those jurisdictions to have economic substance. If a company is in the 'wrong' jurisdiction, then redomiciliation to a better jurisdiction makes good fiscal and commercial sense.

In this article, I discuss the ways in which an English company can redomicile. With the recent close of the government's consultation on a proposed redomiciliation regime for the UK (see bit.ly/3ih66L6), I hope this article serves as a timely reminder of what is currently possible even without that regime.

Can an English company redomicile by changing its citizenship?

The most recent variant of this question came from a tax lawyer practising in an EU jurisdiction. He started talking about how in his own country it was possible for a company to change its place of incorporation and governing company law. He assumed that there was nothing objectionable about our mutual client, an English holding company of an international group, switching its corporate citizenship to that jurisdiction.

My colleague assumed that a company would be able to change its country of incorporation and remain in existence as the same legal entity – almost like an individual changing from a domicile of origin to a domicile of choice. But there is more to it than that. The change of 'corporate citizenship' involves the outgoing country agreeing that a company ceases to be incorporated there from a particular date and the incoming country agreeing that the company is treated as incorporated there from that date onwards.

The key to this route is that the legal personality of the company is recognised by both outgoing and incoming countries as remaining intact; i.e. it is the same company before and after the change.

This is possible in a number of jurisdictions, not just low-tax jurisdictions. However, it is not currently possible under English company law, both in terms of outward movement from, and inward movement to, the UK. Once a company is incorporated, it remains incorporated in the same place until it is liquidated. It cannot change its place of incorporation.

My EU tax colleague was incredulous when I gave him this news, as it is apparently quite straightforward in his country for a company to move its place of incorporation. The UK government's proposals aim to put this right but it is clear that currently an English incorporated company cannot redomicile by changing its corporate passport. So how can it redomicile, if at all?

Image

Image not found or type unknown

Redomiciliation by corporate inversion

Towards the end of the noughties, a number of public corporate movements of capital occurred involving companies supposedly leaving the UK. Some were quite high profile and were influenced by tax considerations where a group had built up substantial overseas operations.

The trend involved relocations to countries like Ireland, Switzerland and Bermuda with a view to the simplification of tax compliance matters, as well as substantive reductions in tax on non-UK profits. Some of this was driven by the then Labour government's aggressive approach to taxation of offshore royalties and more generally, the regime, as it was then, for controlled foreign companies.

The first company to 'go', in 2008, was Shire plc, the UK holding company of an international biopharmaceutical group. Over the years, the business of the group had shifted from UK-centric activities to offshore operations to such a degree that the vast majority of profits were generated overseas. In its press release on the move, the company said that its business and shareholders 'would be better served by having an international holding company with a group structure that is designed to protect the group's taxation position, and better facilitate the group's financial management'.

The group set up a new parent company which was incorporated in Jersey but tax resident in Ireland. The corporate mechanics involved an English company law scheme of arrangement. The shares in the existing English holding company (OldCo) were cancelled, and the cancellation reserve applied in issuing new ordinary shares to the new offshore holding company (NewCo). NewCo issued its ordinary shares to the former shareholders of OldCo. This is called a corporate inversion.

The next stage involves a reorganisation of group subsidiaries held by OldCo so as to put offshore controlled foreign companies directly under NewCo's ownership. Provided that NewCo is run as a true non-resident company, this eliminates the application of the controlled foreign companies rules to the group so as to maximise post-tax foreign profits.

Controlled foreign companies exposure is less of an issue since the revamp of the legislation in 2012. However, there are still good tax reasons, including the increasing burden of tax compliance for multinational groups, to reorganise group structures where the top company redomiciles as above. Of course, any reorganisation itself should be done in a tax-efficient manner. The substantial shareholdings exemption is a valuable tool to facilitate this.

The main tax reason for a Jersey incorporated company is to mitigate Irish stamp duty, which would otherwise apply on shares in an Irish-incorporated company. Of course, it needs to be non-UK incorporated anyway to avoid being UK resident under the place of incorporation test of residence.

Ireland was chosen by Shire as a place for central management partly because of its physical proximity to the UK, so as to facilitate the running of the company as a non-UK resident (and Irish resident), even if some UK resident individuals remained as directors. Also, its attractive tax regime for holding companies was a big factor in selection.

Other groups which relocated to Ireland included WPP (advertising), United Business Media (media) and Henderson (asset management). Famously, once the UK had introduced a more liberal controlled foreign companies regime, WPP returned to the UK after a four year Irish sojourn. The mode of return involved another corporate inversion where a UK resident holding company was put on top of the group.

This form of redomiciliation involves swapping one top holding company for another. There is no question of the same legal entity continuing as the head of the group. It may continue to exist, but only as a subsidiary of the new offshore holding company, and holding only UK resident subsidiaries.

An important point about this route is that it is tax neutral. No UK tax charges arise in relation to the scheme of arrangement itself, either for the holding companies or for the shareholders: UK resident shareholders will get rollover relief for giving up shares in OldCo and getting shares in NewCo under the Taxation of Chargeable Gains Act 1992 s 136. No stamp duty or stamp duty reserve tax charges arise on the cancellation scheme as no transfers are involved.

In a private company, a corporate inversion could be achieved without a scheme of arrangement. There would simply be a share-for-share exchange, whereby the new company acquired shares in the existing company in exchange for issuing its own shares to the shareholder(s). In transactions involving public companies, the scheme route is preferred to get 100% shareholder approval.

The corporate inversion route was, however, of not much use to the privately held group which my EU tax colleague and I were advising. Our clients still wanted the holding company to continue as the same legal entity for their own commercial reasons. So, is anything left in the UK which could get us there? The answer is found in our tax code, and involves a change of residence.

Redomiciliation by change of tax residence

A UK resident company can cease being resident here and take up residence elsewhere but this is not without tax consequences. If a company ceases to be UK tax resident, various tax charges can arise by way of ‘exit’ charges. For a UK incorporated company, it is quite difficult to cease to be tax resident because it will always be incorporated in the UK. That makes it tax resident under our domestic test of incorporation. If its central management and control moves abroad, it would technically become dual resident.

But in the EU matter, if the holding company moves its management and control to the EU country, it will be tax resident there under the local tax law. The country has a double tax treaty with the UK. The fact of dual residence triggers the residence ‘tiebreaker’ test under the treaty, which involves finding the place of effective management. This test of effective management points to the other country and not the UK, as essentially there will be no management in the UK, let alone effective management. The Corporation Tax Act 2009 s 18 then comes into play, which imports the treaty tiebreaker into our domestic law so that for all corporation tax purposes the company will be regarded as resident outside the UK and non-UK resident. That in turn means it has ceased to be UK tax resident, so the exit charges become relevant.

In case you are wondering about the amendment to the tiebreaker by virtue of the Multilateral Instrument, some EU countries have not as yet ratified it. Significant practical issues arise for a migration where the Multilateral Instrument has been adopted and the location of effective management depends on the agreement of the two tax authorities.

For the purposes of the exit charges, the company is treated as disposing of specified assets and reacquiring them at market value. Any profit or gain arising on the deemed disposal is taxable. The most relevant assets for a holding company are capital assets, loan relationships, derivative contracts and intangibles.

So, unlike the corporate inversion route, there could be a significant tax cost of migration. However, this can be significantly reduced in relation to a holding company’s principal assets, which are usually the shares in its subsidiaries. The deemed disposal of these shares on exit may qualify for the ‘substantial shareholdings exemption’ and if it does, then no tax would be payable in relation to gains arising on these assets. Where the substantial shareholdings exemption is relevant, it is critical to carry out a detailed study of the group to ensure it applies.

Apart from tax in relation to exit charges, the company also has to settle any ‘normal’ tax liabilities like income tax (PAYE) as part of the migration arrangements with HMRC. But because of the substantial shareholdings exemption, it is quite feasible for a holding company to redomicile by change of tax residence without incurring substantial exit charges.

If exit tax charges are payable, then the tax administration allows for arrangements to be entered into for settlement, including an instalment plan, if required. This has been amended to deal with Brexit and companies migrating to somewhere in the EU.

Change of tax residence is the only form of redomiciliation available to an English company if the idea is for it to remain in existence after the redomiciliation. This is not a true redomiciliation, particularly as the company will continue to have obligations under the Companies Acts by virtue of remaining incorporated here.

In conclusion

The reasons for redomiciliation continue to evolve, and are not simply tax driven, although tax can play a significant part. Even in cases where tax is not a main motivation, it is clearly important to ensure that the structuring is tax efficient. Equally importantly, the new structure should operate sensibly from the tax viewpoint; not only should there be good practice regarding governance at the outset, but it should be followed consistently on an ongoing basis.

The inversion route has a feel of being somewhat outdated and is quite complex. Change of tax residence only achieves a limited form of redomiciliation and now carries an additional layer of uncertainty where the Multilateral Instrument tiebreaker is relevant.

There is clearly a gap for a ‘proper’ outward redomiciliation regime. The consultation places a larger emphasis on inward redomiciliation and even asks if an outward regime is desirable. It will be interesting to see what the responses are, and the official decisions taken, but I would find it inconceivable for the UK to follow the limited number of jurisdictions which have introduced only inward redomiciliation. That hardly ties in with the following statement in paragraph 4.5 of the consultation:

‘The government is committed to maintaining the UK’s openness, flexibility and international competitiveness.’