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Corporate Residence update

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Agenda

1. Who are we?
2. Company Residence
3. Substance
4. Permanent Establishment
5. How we can help – Residence and Substance
6. UK's fight against tax evasion
7. Questions

Who are we?

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Company Residence

Company Residence – the basics

Why is company residence important?

- Residence determines taxing rights over companies
- Company resident in Territory A would usually be subject to corporate tax in Territory A
- Because residence relates to corporate tax rights, residence is very important to both tax authorities and companies
- Residence also important for other tax reasons, e.g. withholding tax
- Consequence of accidentally becoming tax resident in jurisdiction not intended can be significant, i.e. unintended taxes and potentially interest and penalties thereon

Company Residence – the basics

How is residence defined?

- A company is resident in the UK if:

  - it is incorporated in the UK, or

  - the central management and control ("CM&C") of its business is within the UK

- It is possible for a company not meeting the above criteria to be taxable in the UK, i.e. a non UK resident company trading in the UK through a Permanent Establishment (more on this concept later)

Company Residence – the basics

How is residence defined?

- Different jurisdictions have different definitions of residence
- Possible to be tax resident in more than one jurisdiction

Company Residence – the basics

Concept of CM&C

- Corporate residence is a complex area
- HMRC issued Statement of Practice on the subject to provide guidance
- Key to corporate residence is the concept of CM&C
- CM&C concept has been built up through case law

Company Residence – the basics

Concept of CM&C

- CM&C examined in case law going back over a century
- Key concepts
  - Highest level of decision making
  - Effective management
  - Directors or other
  - Usurping control (Group situations)
  - Question of fact
  - Interaction of the above

Company Residence – the basics

Indirect taxes

- In addition to corporate tax, residence can impact on indirect taxes, i.e. VAT (covered in more detail later)

Company Residence – danger areas

What danger areas might there be?

Anything that might indicate **strategic level decision-making** for company being made outside its territory of incorporation (or outside its territory of intended tax residence, if different)

What sort of things might give these indications?

- Articles of Association?
- Shareholder Agreements?

They might give decision-making rights/powers to shareholders, rather than to company's Board of Directors?

Company Residence – danger areas

Even if nothing special in Articles of Association/ Shareholder Agreements – any indications that shareholders (or other persons who are not directors of the company) undertake strategic level decision-making, even though have no legal or contractual right to do so?

Company Residence – danger areas

What about a case where all business decision-making rests with directors – properly, as it should – rather than with shareholders?

Could there still be a problem?

Yes!

What danger areas might there be in relation to the actions of the directors?

Company Residence – danger areas

- Directors convene Board Meetings outside the territory of incorporation/desired tax residence, possibly in “danger” territory (usually, the shareholder’s territory)?

- NB: More recent (2010) HMRC guidance, providing some relaxations around Board Meetings being convened in UK/directors participating in Board Meetings from UK, but fairly restricted relaxations

Company Residence – danger areas

- Directors lack relevant industry expertise? (Much less significant for investment-holding companies than for trading companies)

- Directors do not get paid much?

- Directors do not convene many Board Meetings?
- Directors personally resident outside territory of incorporation/territory of desired tax residence, and personally resident in "danger" territory (usually, the shareholder's territory)?

Company Residence – danger areas

- Minutes of Board Meetings do not reflect strategic-level decisions

- Minutes of Board Meetings do reflect all strategic-level decisions, but are so briefly covered could be read as indicating mere “rubber-stamping”

“Central management and control” relevant to certain trusts

CM&C is the test, evolved in case law, for the tax residence of **companies**

Certain trusts are, like companies, tax opaque rather than tax transparent

Generally, trusts have their own tax residence rules, which do *not* rest on the issue of CM&C

However, there are certain exceptions:

- **Unit trusts** (usually opaque for gains if not for income) – the chargeable gains of unit trusts are computed as if the unit trust were a company, and the unit-holders were shareholders (S. 99 TCGA 1992). Thus, the tax residence of unit trusts (for the purpose of taxing gains) is determined in same way as for companies. **So, CM&C is relevant for unit trusts – including Jersey and Guernsey Property Unit Trusts (‘JPUTs’ and ‘GPUTs’)**
- **Collective investment schemes (funds) which are trusts other than unit trusts (or any other legal form that is not a company, a unit trust or a partnership)** – the chargeable gains of such entities are computed as if the entity were a company, and the rights of the participants in the fund were shares in the company (S. 103A TCGA 1992). Thus, the tax residence of such entities (for the purpose of taxing gains) is determined in the same way as for companies. **So, CM&C is relevant for all such entities**

Substance

Substance

•"Not the same thing as CM&C (although word often used as if it were!)

•An additional concept, focusing on a presence and activity at a lower operational level than strategic-level

•Relevant where company seeking treaty benefits

•Per case law to date (essentially, *Indofoods*), substance NOT relevant to tax residence

•Thus, possible that an overseas-registered company will succeed in being non-UK tax resident; but, because of a lack of "substance", will fail to qualify for treaty benefits

•Where an overseas-registered is relying on treaty benefits (usually because it has some form of "passive" income passing through it), must test for *both* residence and substance.

Substance

•"Genuine economic/commercial reason for existence of company, i.e., it has some activity of its own

•Profit-earning capacity – i.e., must be a potential to make a profit (even if only a "turn" or a "spread")

•Physical presence/infrastructure in desired territory (usually, territory of incorporation)

Permanent Establishment

Permanent Establishment

•Separate from residence risk

•Risk that a person accepted as being tax resident outside the UK nonetheless trades in the UK through a permanent establishment ("PE") in the UK

•If it does, UK tax liability arises on relevant part of profits

•Note **"trades"** in the UK. If the non-resident person isn't trading at all (e.g., if it is merely investing), then it can't have any "trading through a UK PE" risk

•Where the non-UK entity is a trading fund, the Investment Manager Exemption is likely to be relevant (exempts UK-based investment manager from being treated as a UK "dependent agent" permanent establishment of the fund)

Permanent Establishment

•What is a PE?

•Either a "dependent agent" (often, but not necessarily, an employee) concluding profit-generating contracts on behalf of the non-UK trader; or a "fixed place of business" of the non-UK trader

• Offshore trading company wants to avoid having either of these in the UK (or in any other tax territory outside its territory of desired tax residence – **including the US, which is included among the territories which seek to tax the profits of non-residents arising from trading activity within their borders**)

•Risk very commonly arises where same individual works both in a UK business and an associated non-UK business. Has to be very careful that only does work of the UK business whilst in the UK

•Strong overlap with Transfer Pricing – because have to be very clear what functions/activities are part of the UK business and what functions/activities are part of the non-UK business

•Can be a tension between defending a "UK PE" challenge, and justifying the Transfer Pricing that has been adopted

"

What about VAT?

Place of supply of services

•Up to 31 December 2009, for VAT purposes, most services were deemed to be supplied **where the supplier "belongs"** – i.e., **at the relevant "fixed establishment" of the supplier.**

•**For 1 January 2010 onwards, this continues to apply for B2C supplies**

Place of supply of goods

•Both before and after January 2010, goods are deemed to be supplied **at the place they are despatched to the customer** (which may not be the same place as the customer takes delivery of them). This will again usually be where the supplier "belongs" – i.e., where the supplier has the relevant "fixed establishment"

• So, clients may set up companies in non-EU territories to avoid output VAT

What about VAT?

Does your group/company have its relevant “fixed establishment” where it ought to have it?

Or, is the “fixed establishment” in the “danger” territory (the UK, or other ‘home’ territory)?

What about VAT?

In a nutshell:

If a company incorporated in, say, the CI is making supplies from an establishment in the UK (or elsewhere in the EC), **then output VAT will be chargeable on these supplies**

What about VAT?

So, HMRC wants to show that a non-UK incorporated company is making supplies from through an establishment in the UK (i.e., that the supplier "belongs" in the UK – at least in relation to the making of these particular supplies)

How would HMRC go about that?

What about VAT?

“The new pocket version of the legislation is

HMRC will look for the “human and technical resource” that is needed to make the supply(ies) in question

Is that “human and technical resource” present in the territory of incorporation?

If it’s not …

What about VAT?

… HMRC will argue that the necessary "human and technical resource" – which would constitute the relevant "establishment" – must be located elsewhere; i.e., that the supplier "belongs" elsewhere

In the absence of any positive evidence to the contrary, HMRC will assume that 'elsewhere' is located where the owners of the company are located (i.e., the UK, or other 'home' territory)

What about VAT?

A similar issue will arise where a non-EU company has been set up for the specific purpose of commissioning services – i.e., has been set up to be **the customer** (rather than the supplier) of 'VAT-able' services

Why would you be concerned about saving **input** VAT?

What about VAT?

If an organisation’s business comprises the making of “supplies” that are VAT-exempt, it cannot recover the VAT charged by its suppliers on any goods/services it buys

Normally, not much such an organisation can do

What about VAT?

However, in the particular situation where a company is going to be to commissioning a large volume of services over a fixed period in time (a typical example would be accountancy/law/tax advice being commissioned in a M&A transaction), a company might consider it worthwhile moving its location to outside the EU – or, more commonly, setting up a SPV outside the EU to be the “customer” for that particular transaction

Remember, from 1 January 2010, the place of supply of services (where B2B) is where **the customer** “belongs”. (And, even before 1 January 2010, that was the special rule applying for place of supply of all “intellectual” services – both B2B and B2C)

What about VAT?

So, where an EC-based organisation in a VAT-exempt line of business is facing a large block of expenditure on “intellectual” services (e.g., in the course of an acquisition or disposal), it may well set up a non-EC company to commission these services

Often, this SPV will be incorporated in the CI

“

What about VAT?

Here, the "danger" is exactly the same as before – that the UK (or other) tax authority will seek to establish that the CI-incorporated SPV does not actually "belong" in the CI

Why should company directors regularly review corporate residence?

- Enhanced certainty about company's liabilities
- Awareness of any soft spots, and opportunity to rectify them before they do fatal damage
- Ammunition in managing unhelpful behaviours of shareholders, and/or of directors resident outside territory of incorporation
- Having the "case for the defence" ready and waiting, against any future challenge from any tax authority

What's in this for the ultimate owner (shareholders)?

- Safeguarding value of investment
- Safeguarding reputation/standing with tax authority in shareholder's home territory
- (Where applicable) company a more attractive target to prospective purchasers (company residence would certainly be a "due diligence" issue)
- Ammunition in managing unhelpful behaviours of company officers

Other possible reasons for reviewing residence/substance/PE

1) Desire (on part of senior management/offshore directors) to manage unhelpful behaviours of shareholders/investors
2) Desire (on part of shareholder/investor) to manage unhelpful behaviours of offshore directors
3) FIN 48 requirements
4) Senior Accounting Officer responsibilities
5) An impending exit (residence/substance of offshore entities likely to be a due diligence issue)
6) Difficult questions being raised by a tax authority

How we can help – Residence and Substance

What are we doing

In last twelve months, we have:

•Conducted several residence/substance reviews of Netherlands holding structures operated by a UK/US-based Private Equity house and delivered training

•Conducted several residence/substance reviews of the Luxembourg holding structures of a UK/US-based Real Estate house

•Conducted a residence/substance review of the Luxembourg holding structures of a Swedish-based Private Equity house

•Conducted a residence/PE/TP review of the Guernsey-based sub-investment manager of a UK-based Private Equity house

•Conducted a PE review of the Guernsey-based service provider to a UK-based hedge fund investment manager

•Conducted residence/PE reviews for a number of non-UK structures in a global hedge fund management business, as part of Purchaser Due Diligence

•Conducted a residence review of a Luxembourg incorporated UCITS fund vehicle (Singapore residence risk)

How we can help

- Company residence/substance/PE reviews
- Best Practice guidelines - on (i) residence (central management and control), and (ii) substance, and (iii) PE
- Reports distinguishing strategic-level categories of decision from non-strategic level categories of decision
- Review of director contracts of service (or, where applicable, inter-company agreements under which the services of an individual as (usually, part-time) director are provided to an overseas company)
- Staff training (how to write up Board Meeting minutes in a manner that will be helpful and effective from a corporate residence defence perspective; training on other topics, on request)
- Template communications between UK shareholder organisation and overseas company, and related Board Meeting Minutes, to guide client through the process of managing a significant transaction - typically, an acquisition or a disposal being made by the overseas company

UK's fight against tax evasion

UK's fight against tax evasion

HMRC identified Tax Gap of £35bn

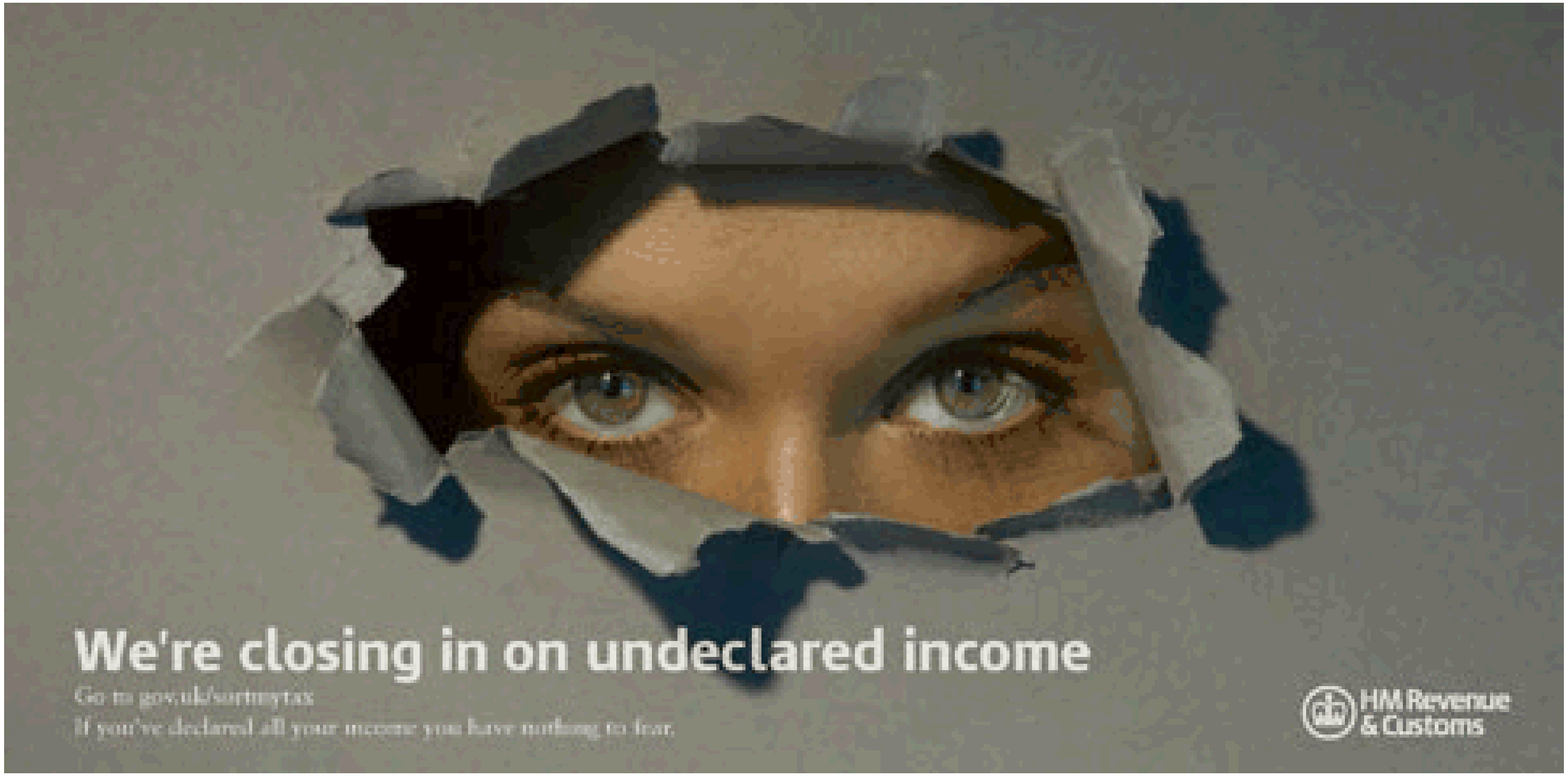
Determined to catch tax evaders

More serious consequences of tax evasion

- higher penalties
- more prosecutions
- 'naming and shaming'

Best ever opportunity to disclose

UK's fight against tax evasion



Recent developments

- UK/Swiss agreement
- HSBC Jersey whistleblower
- UBS – German tax authority raids

Liechtenstein Disclosure Facility

“The agreement allows investors in Liechtenstein who are liable to UK tax to legitimise their tax affairs for the past and ensure they are tax-compliant for the future.”

Liechtenstein Disclosure Facility

1. Tax disclosure of worldwide assets to HMRC
2. Unique guarantee of non prosecution
3. Cheapest way to disclose in most cases
4. HMRC go back to 06/04/99 only
5. Fixed 10% penalty (20% after 05/04/09)
6. Composite Rate Option
7. Clear disclosure process and no meeting with HMRC
8. No names approaches to HMRC to give certainty
9. Straightforward to establish relationship in Liechtenstein
10. Typical timescale from start to finish is 4 months

Liechtenstein Disclosure Facility

As at September 2012:

Registrations	Disclosures	Tax Paid
3,227	2,152	£465 million

Anticipated yield by 31 March 2016 - £3 billion

Any Questions?

Thank you