Guide to Corporate Residence

BUSINESS TAX GUIDE

October 2015

OVERVIEW

The tax residence of a company is of critical importance as this determines which country will have taxing rights, potentially, on its worldwide income. A company will generally be resident in the country in which it was incorporated. However, there are other factors which need to be considered, such as the place of central management, or the place of business of the company, which may be used to determine a company's tax residence status. If there is an intention for a company to be non-UK resident, strict guidelines need to be followed to ensure that the company does not inadvertently become UK tax resident.

How is Corporate Residence determined?

For tax purposes, a company is generally resident in the country in which it was incorporated. However, if the company's place of central management is in another country, or the company has a permanent establishment outside the country of incorporation, then these factors may affect where the company is treated as being tax resident.

Where is the 'Place of Central Management'?

There is no statutory definition of this term, and so its meaning is derived from case law. In essence, the term applies to where the highest level of control takes place (rather than the day to day management). The central management is determined by control at board level and not shareholder level. It is therefore necessary to look at where the board of directors conducts its business and where strategic decisions are taken.

What is a 'Permanent Establishment'?

A permanent establishment ('PE') is effectively a fixed place of business through which the company carries on its trading activities. In addition, a PE can include a place of management, or the place where an agent acting on behalf of the company has (and habitually exercises) authority to conclude business on behalf of the company.

Many double tax treaties specify that certain types of activity are either included or excluded from being treated as a PE for the purposes of that treaty.

What happens if a company is tax resident in more than one country?

If a company is treated as tax resident in more than one country it could potentially be taxable in each of those countries. This is clearly undesirable, so many countries (including the UK) have negotiated a network of double tax treaties with other countries. These seek to eliminate the risk of a company being subject to double taxation through the use of tie-breaker tests for residence.

If there is no relevant tax treaty, or the treaty does not include an appropriate tie-breaker clause, then HM Revenue & Customs ('HMRC') will consider various factors in determining whether a company is resident in the UK for corporation tax purposes.

What factors will HMRC look at?

HMRC has issued guidance on company residence which includes an explanation of the factors they use to determine whether an overseas company should be treated as resident for UK corporation tax purposes.

Based on established UK case law principles, it is accepted that an overseas company is resident where it actually carries on its business, and where its management and control actually takes place.

However, although the board meetings may take place in the same location as the place of business, HMRC do not assume that central management is necessarily located in the same place as the directors meet. In particular, HMRC will look at factors such as whether:

- The overseas company incorporated outside the UK is treated as tax resident in that territory by virtue of its incorporation;
- The overseas company is genuinely established in its home territory;
- The country of incorporation/ residence has a double tax treaty with the UK which includes a residence tie-breaker clause; and
- The board of directors actually exercise central management of the company at their meetings, or whether this is carried out elsewhere and simply 'rubber stamped' by the board of directors.

What are the tax implications of creating a UK PE?

If HMRC can successfully argue that a company has a PE in the UK as a result of its activities, then the profits attributable to those activities are taxable in the UK. This is broadly calculated on the presumption that the PE is a stand-alone entity bearing its share of the relevant costs and expenses on an arm's length basis, and receiving a market rate payment for its goods or services.

Practical application of the rules

It is vital that the board of an overseas company can demonstrate not only that all board meetings are held outside the UK, but also that these meetings do not merely rubber stamp decisions which have already been taken in the UK.

It will therefore be very important to carefully document all the decisions made and how they are arrived at, and also to be able to demonstrate that the actual decision making process takes place outside the UK.

Whilst the tax residence of individual directors is not the most determinative factor, it is recommended that the majority of directors should be non-UK tax resident if a company is to be treated as resident outside the UK for corporation tax purposes. In addition, UK resident directors should physically attend board meetings outside the UK. UK resident directors will also need to ensure that they do not inadvertently create a UK PE for the overseas company by exercising control in the UK or having authority to conclude business in the UK on behalf of the overseas company.

Finally, it will be important to ensure that any activities carried out by employees of UK subsidiaries for, or on behalf of, an overseas holding company, cannot be treated as creating a UK PE for that company, and thus will not create a liability to UK corporation tax on the profits attributable to those activities.

How can Rawlinson & Hunter help?

We have a great deal of experience in advising companies about their residence status and providing guidance about the actions required to ensure that a desired residence status is maintained.

If you are interested in further information in this regard, please contact the Rawlinson & Hunter partner who normally acts for you. Where you are not one of our regular clients, please contact Craig Davies or Andrew Shilling, who would be delighted to discuss this with you in more detail.

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October 2015

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