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BRIGHTER THINKING

INTERNATIONAL UPDATE

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Managing the tax residency of non-UK companies

The ownership of non-UK companies by UK-based shareholders can create tax problems – a main one being keeping the company's tax residency outside the UK. Failure to do so will leave it subject to UK corporation tax on worldwide profits.

Under UK tax rules, a company can be considered to be UK tax resident:
- If it is incorporated in the UK
- If it is incorporated outside the UK but central management and control is deemed to be in the UK

Central management and control refers to the highest level of power and influence in a company – typically decisions taken at board level. Examples would be decisions on employing executives, expansion or contraction of business activities, borrowing, material contracts and transactions.

Although central management and control may be distinguished from control of day-to-day operations, both types are often exercised from a single location. Therefore, the location and conduct of an offshore group's board meetings plays a large part in determining where central management and control is seen to reside.

If management and control is in a different jurisdiction from where the company is incorporated, it may be considered to be dual resident. In such instances a tie-breaker test may be applied to determine the country of residency, but this is only possible if there is a relevant tax treaty between the two countries. Where there is no treaty, which is often the case with low-tax jurisdictions, the UK rules will increase the level of taxation suffered by the company.

Essentially, the management-and-control test is based on the facts of each case. The table below lists some of the dos and don'ts which help to mitigate the risk that a company is deemed by the UK tax authorities to be managed and controlled in the UK.

These are only general guidelines and the facts of each case will need to be considered carefully.

Guidelines

Issue	Actions
Directors	The majority of the board should be non-UK resident.
	Directors should have relevant expertise, qualifications and sector experience, and this should not be concentrated in the UK directors. Otherwise HMRC may argue that non-UK directors are just 'men of straw' and acquiesce to the UK directors, and just approve the UK directors decisions.
	Ideally a non-UK director should chair the meetings and have the casting vote on decisions.
	UK-resident directors should not behave in a way that leads others to believe they are authorised to bind the company to strategic decisions without board approval.
	UK-resident directors should not be able to form a quorum at meetings or pass resolutions on their own.

Board Meetings	All meetings of the board must be held outside the UK. From a UK perspective they do not have to be held in the jurisdiction of intended residency, however, there may be wider international tax implications.
	Directors should never join a meeting remotely from the UK. UK directors should retain travel records to evidence attendance.
	The board should make all fundamental policy decisions, such as those concerning • major company contracts • approval of financial statements • approval of budgets, forecasts, cash flow and other projections. If, for timing reasons, certain actions have to be taken between meetings, for example the decision on a major contract, the decision should be made with the authority of a non-UK resident director.
	Meetings should be held regularly and at least every quarter, to demonstrate the working authority of the board.
	All board meetings should be clearly minuted and state who was present. These should demonstrate the decision making process and that genuine consideration has been given to each decision. The board meeting should not be a rubber-stamping exercise.
Actions of company personnel	Where actions are to be carried out between board meetings, the board should delegate appropriate powers with the appropriate person providing a progress report at the subsequent meeting.
Shareholders	Any shareholder requests should be expressed as such, rather than as instructions. The board can listen to opinions but has the ultimate decision.

Other international tax considerations

Establishing and maintaining clear management and control procedures is crucial if a foreign incorporated company is to be kept outside the UK tax net. However, this is only part of the story, and a number of other tax issues will be relevant when structuring international activities. These include:

- Controlled foreign company rules – which can act to bring profits incurred in overseas subsidiaries into UK companies in certain circumstances where it is deemed that profits have been artificially diverted from the UK.
- Creation of permanent establishments – where companies can create a taxable presence in another jurisdiction through either a fixed establishment or the activities of an agent.
- Transfer pricing rules – which aim to ensure that all related party transactions are carried out on an arms-length basis. In addition, the government is proposing a diverted-profits tax where large groups are deemed to be artificially moving profits out of the UK.
- Transfer of Assets Abroad rules – which apply to UK resident individuals that transfer assets to non-UK entities. This would include transferring cash when subscribing for share capital in a non-UK company. If one of the purposes of such a transaction is avoiding a liability to UK taxation, the income generated by the entity can be attributed to and taxed on the UK resident individual.

Central management and control is key to determining the tax residency of non-UK companies, and it is important that the right procedures are followed in this respect. It is best to assume that every document, from board minutes to internal memos, may be read by HMRC at some point. An email can be a powerful contemporary record of what people are thinking and why they are doing things. It is therefore vital not only to have strong procedures in place, but also to ensure that they are followed in practice.

Further information

Please contact your usual Menzies tax team representative or e-mail taxconnect@menzies.co.uk