Tax structuring for UK subsidiaries

Companies that are subsidiaries of an overseas parent company face several unique tax issues. Below is a summary of cross-border tax issues that can arise.

Funding

Interest on debt finance

- Interest paid to overseas lenders attracts withholding tax, usually at 20%
- You can get tax clearance from HMRC for a lower rate (either under a tax treaty or EU Directive)
- Overseas corporate lenders may wish to register under the Double Tax Treaty Passport Scheme
- Tax relief on interest is subject to anti-avoidance provisions, including Thin Capitalisation and Debt Cap rules.

Foreign exchange on debt finance between the UK and overseas group companies

- May be a revolving credit facility or injection of loan capital
- UK tax treatment follows the accounting treatment, with gains/losses subject to UK corp tax on an accrued rather than realised basis. This can create significant tax liabilities in the UK sub.

Loans between group and the UK subsidiary

- Should be formally documented – esp regarding character and terms of the funding
- If challenged by HMRC this provides clear support for the accounting/tax treatment used.

Equity funding of UK subsidiaries

- Simpler UK accounting and tax position but may increase the tax rate for the group
- Debt was traditionally preferred due to flexible repayment, but is now less advantageous because of the simplified capital reduction process available under Companies Act 2006.

Capital contributions from overseas parent

- This is not recognised under English law and is usually seen as a non-taxable gift or a loan
- In certain circumstances, capital contributions to UK sub can be taxable, so careful review is needed before funding.

Trading

Permanent Establishment

- The relationship between parent and UK subsidiary must be clearly

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defined or you could create a permanent establishment in the UK. This will be the case the parent company engages with customers in the UK and leads are generated by a UK sales team.

Intellectual Property

- Define the nature and ownership of any group IP. If UK company pays royalties, they could incur withholding tax and be challenged under transfer pricing rules Relationships should be documented and supportable.

Global mobility of employees and executives

- Relocating staff brings issues about where the costs are borne and where their income should be taxed.

Inter-company transactions

- If a transfer pricing (TP) report has been prepared and imposed on the UK sub, it should be reviewed to ensure it is appropriate from a UK perspective.
- Size of the worldwide group will affect UK transfer pricing requirements (SMEs are exempt).

Customs duty is charged on goods imported from outside the EU

- Charged as a percentage of the total value of goods and must be aligned with the inter-company transfer pricing policy being adopted.
- Rates are selected from 14,000 commodity codes (av is 5% to 9%, but can be as high as 85%) so it worth reviewing the classification
- Reliefs from export duties are also available in certain circumstances.

Structuring

Group company structure

- Coordinate to optimise cross-border tax. Low UK corp tax rates make it the best place to make a profit.
- UK tax rate can be further reduced where qualifying R&D activity is carried out by the UK company, or if profits can fall within the patent box regime.

Share option schemes for key staff in UK company

- Including UK employees in an overseas share scheme is unlikely to be tax efficient
- UK subsidiary should set up a UK-approved scheme (such as EMI), with options over shares in parent company.

Sub-holding company - the UK is an ideal base for investment into other territories.

- UK has the widest tax treaty network in the world
- UK tax regime was specifically designed for holding companies – benefits include dividend exemption regime, capital gains exemption regime, business-friendly controlled foreign company regime and no withholding tax on outbound dividends.

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Reorganising UK trading or shareholding arrangements

- Changing ownership of assets or shares in a UK subsidiary could create a immediate tax charge or loss of benefits
- Various reliefs and exemptions can apply depending on the exact form of reconstruction.

Tax residence – the management and decision making of the UK subsidiary can affect the company's tax residency position.

- Most UK double tax treaties assume company and management are resident in same place.
- Documentation should support the residency position of the company, especially if it could be exposed to higher taxes in an overseas territory.
- Constitution of the board of UK sub should be carefully considered as statutory directorship fees are normally taxed under PAYE, unless no duties are performed in the UK.

Further information

Please contact Nick Farmer (nfarmer@menzies.co.uk)

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