
# UK tax regime: holding companies

## Introduction

The UK tax regime "checks all the boxes" for a holding company location as a result of recent improvements to the UK corporate tax regime. Indeed, because of generous tax reliefs available under the UK tax regime, it is competitive with many traditional holding company locations.

The relatively benign tax regime, coupled with the practical advantages of language, culture and the stable economic and regulatory environment, make the UK an attractive option for the location of holding companies.

In overview, the UK tax regime:

- has a competitive tax rate;
- does not have a withholding tax on dividends;
- provides many exceptions from its interest withholding tax rules;
- operates only a few restrictions on tax deductibility for finance costs;
- offers an attractive low tax regime in respect of patent income;
- provides a participation exemption for most capital gains;
- exempts most inbound dividends (rather than operating a credit system);
- has significantly relaxed its controlled foreign company regime (compared with the sub-Part F regime); and
- offers large companies unparalleled access to HMRC specialist tax officials ("the Large Business Service") in order to resolve uncertainty over the expected tax treatment.

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> Berwin Leighton Paisner"

## Summary

Since 1 April 2015, the UK corporation tax rate is 20%.[1] The rate of tax is reduced to an effective rate of 10% on profits falling within the patent box regime[2], described in more detail below.

In principle, UK corporation tax is charged on the worldwide profits of a company resident for tax purposes in the UK.[3] In certain circumstances, however, a UK resident company can elect for the branch profits exemption which, in broad terms, removes a liability for corporation tax on profits which may also be liable to tax in overseas locations.[4, 5]

A company is resident for tax purposes if it is incorporated in the United Kingdom.[6] A company

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1 Section 6 FA 2013.

2 Schedule 2 FA 2012.

3 Section 5(1) CTA 2009.

4 Where a UK resident company has a permanent establishment in another territory and is therefore liable for US tax, because the company has not made a branch profits exemption, in principle credit for the overseas tax is given against UK tax otherwise payable on branch profits.

5 Section 18A CTA 2009.

6 Section 14(1) CTA 2009.

incorporated in another jurisdiction is resident for tax purposes in the UK if it is centrally managed and controlled in the UK.

A company which is not resident for tax purposes in the UK is liable to UK corporation tax only to the extent that it carries on a trade through a UK permanent establishment ("PE").[7] While in principle it might be subject to UK income tax, in practice a non-resident company is liable to income tax only to the extent that tax is collected by withholding at source on yearly interest, rent, certain royalties and "annual payments".

## Dividend Payments

The UK tax system does not impose any withholding tax on the payment of dividends.

As far as incoming dividends are concerned, a UK holding company can be an attractive location for two reasons.

First, to the extent that it holds qualifying interests in companies in other EU member states, it can rely on the Parent: Subsidiary Directive[8] which prevents withholding tax being imposed in a member state on dividends flowing to another member state.[9]

Also, the UK benefits from many double tax treaties that remove or reduce withholding tax on dividends paid by non-EU companies.

Secondly, since 2009, the UK in most circumstances dividends received from overseas are exempt from tax, as is the position for dividends received from other UK companies.[10]

There are certain circumstances in which the liability to tax on dividends is preserved in circumstances where HMRC perceive avoidance taking place.

## Interest Withholding

Where a UK's resident company makes a payment of yearly interest to a non-resident the company is required to withhold income tax at the rate of 20%.[11]

It should be noted, however, that the UK does not impose withholding tax on premiums or discount arising on debt instruments nor does it impose withholding on "short interest" ie interest where the underlying liability is not expected to exceed 365 days.[12]

7 Section 6(2) CTA 2009.

8 Council Directive 90/435/EEC.

9 Except in avoidance circumstances.

10 Sections 931A – 931W CTA 2009.

11 Section 874 ITA 2007.

12 There must be no arrangements for the short term debt to be repaid and immediately "rolled-over".

In addition the UK treaty network provides that in many, but not all, cases yearly interest may be paid without withholding provided that the payer has received prior consent from HMRC to pay without withholding.

It is important to note, however, that payments to certain jurisdictions may be subject to a reduced rate of withholding which may be relevant where a UK company is part of a larger international group structure.

Another significant exception from withholding tax is the "Quoted Eurobond" exemption. A quoted Eurobond is an Interest-bearing security issued by a company which is listed on a recognized stock exchange.[13]

## Tax Deductibility

A UK company is ordinarily able to deduct interest and other financing costs and expenses (but not generally dividends) calculated in accordance with usual accounting principles (ie on an accruing, rather than on a paid, basis) except where a particular restriction or anti-avoidance provisions apply.

Where the company is carrying on a trade, ordinarily the costs will reduce profits liable to tax:[14] if the expense is not incurred in connection with trade, then ordinarily net interest accruals and deductions are taxed or relieved.[15, 16]

Where funds are lent by related parties, there can be restrictions on the amount that can be deducted by reference to arm's length principles. This applies both to direct lending and where unrelated parties make funds available on terms that they would not have done but for the provision of a guarantee by a related party.[17]

A further restriction on relief for finance costs is the "worldwide debt cap", which very broadly seeks to restrict tax deductibility on related party debt to the extent that net finance costs of the worldwide group are lower than the finance costs being borne by the UK sub-group.[18]

In specific circumstances, deductions can be restricted to the extent that an equity-like return is provided to the lender eg where more than a reasonable commercial return is given for the use of the amount lent.[19]

13 Section 874 ITA 2007.

14 Section 297 CTA 2009

15 See section 299-301 CTA 2009.

16 The difference in the way finance costs are relieved becomes more significant if a company's profits are insufficient to absorb the finance costs fully in the period in which they accrue.

17 Part 4 ITTOPA 2010: in particular sections 152-154 and sections 191-194.

18 See Part 7 TIOPA 2010 for more detail.

19 See Part 23 CTA 2010 for more detail.

Finally, relief can be restricted to the extent that a loan relationship of the borrower has "an unallowable purpose".[20]

### Patent Box

The Patent Box enables a company to elect that relevant IP profits are chargeable at an effective rate of 10% corporation tax. To obtain relief the company needs to hold qualifying IP rights or hold an exclusive license or to have done so and satisfy certain "active ownership" conditions. These conditions, very broadly, involve the company having created, or significantly contributed to, the creation of the invention or to the development, rather than merely passively holding the IP, either by itself or in certain circumstances where the IP has been developed by other group companies.

The income that can benefit from the reduced rate is that derived from, or generated in connection with, a patent granted under the UK or certain other countries' patent legislation, including the European Patents Convention.

The profits can include those directly derived from relevant IP and also a proportion of income derived from products incorporating or otherwise benefitting from the IP. In certain circumstances a proportion of income derived from services or processes that would have had to be paid away by way of a notional royalty to a person permitting IP to be used in the provision of those services can benefit from this relief.

### Participation Exemption

A UK resident company is in principle liable to corporation tax on disposals of chargeable assets at a gain. Likewise a non-resident company carrying on a trade through a UK PE is liable to tax on disposals of assets held or used in or for the PE.

However, a company which satisfies certain conditions both as regards itself and as regards the company in which it is invested and has held a "substantial shareholding" for the relevant qualifying period, broadly a year, is not liable to tax on the sales of those shares.

In summary, and the test is operated on a worldwide basis, the UK resident company must be a member of a trading group and, following the disposal, except for certain pre-liquidation planning, continue to be a member of a trading group.

Correspondingly, the company being disposed of must have been a member of a trading group and either be a trading company in its own right or become a member of another trading group immediately following sale.

This is rather similar to the participation exemption operated in most European jurisdictions which require a certain holding period and varying percentages of shareholding in the company being disposed of.

However it does differ insofar as gains on sales of shares in companies that are not carrying on a trading business will remain potentially liable to UK corporation tax on chargeable gains.

### CFC Regime

As a result of the recent changes to this regime UK companies that control overseas subsidiaries or in which they have at least a 40% direct or indirect interest as part of a joint venture can readily ascertain whether they are outside or within the CFC regime. The UK CFC regime attributes to UK resident companies that, alone or together with connected companies, have at least a 25% interest in the controlled companies the appropriate share of chargeable profits of the CFC as if carried by the UK resident companies.

The CFC regime has been designed principally to operate as an anti-diversion regime, particularly with regard to profits relating to intellectual property developed at an early stage within the UK. In addition, very targeted rules apply to different kinds of companies – whether they are companies carrying on finance trades, companies carrying on non-trading finance activities, or other activities – unlike the previous rules which, because of their relatively general application, did not regularly accommodate the way in which multinational groups organized their arrangements. Further, the legislation contains rules which, in effect, give a reduced rate of 5% corporation tax to profits earned off-shore by finance companies which satisfy certain conditions.[21]

In more detail, a UK company with the requisite interest in an overseas company needs to operate the UK CFC regime only if overseas profits pass through the relevant Gateway.[22] The Gateway concept is designed to have regard to the activities of particular types of companies.[23] Even so particular kind of company which satisfied certain conditions – for example, a "group treasury company" will not be subject to tax.[24] A particular focus of one of the Gateways is the extent to which profits attributable to activities carried on or liabilities and risks borne outside the UK could be earned were activities in connection with those assets and liabilities to stop being supported by UK activities.[25]

Even if profits of overseas companies do pass through the Gateways, there are mechanical exemptions based on whether the country concerned is "an excluded

20 See sections 441 and 442 CTA 2009.

21 See, in particular, sections 371A-371IJ TIOPA 2010.

22 See section 371BB TIOPA 2010.

23 Section 371CA – 371 CG TIOPA 2010.

24 See section 371CE(2), (4) TIOPA 2010.

25 See section 371CA TIOPA 2010.

territory";[26] companies with low profits; companies with low profit margins (therefore the amount of profits in the CFCs that should be attributable to the UK are not worth bothering with); and the relative rate of tax in the local jurisdiction compared with the UK rate.[27]

## UK Administration

HMRC has decided to allocate resources to businesses that, in global terms, have a business turnover in excess of £200 million via Customer Relationship Managers ("CRMs"). For businesses with a global turnover of between £30 million - £200 million, or more than 250 employees worldwide, Customer Coordinators ("CCs") will be allocated.

The principal aim of CRMs and CCs are to provide access to a specialist within HMRC in order that points of uncertainty and complexity can be resolved to provide, to the extent possible, certainty for business. CRMs, in particular, are meant to understand and evaluate the risk profile of businesses to which they are allocated to ensure that HMRC do not make inappropriate requests for information, duplicate enquiries and otherwise seek to minimise compliance costs for the taxpayer.

The specialist teams will include those dealing with international issues, research and development, transfer pricing and the Tax Avoidance unit.

One significant difference between the US and the UK is that binding rulings are, generally, not available from HMRC. To some extent, companies within the CRM/CC regimes qualify for favourable treatment, as access to HMRC specialists can enable businesses to obtain certainty. The overall approach of HMRC is that, with limited exceptions, businesses-self assess their tax exposures and HMRC will review computations and estimated liabilities of tax after the end of the relevant tax year and raise enquiries or change self-assessments within the relevant periods.

## Contact details

If you would like any further information on the issues covered in this article, please get in touch.


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26 Which to some extent depends on the amount of particular types of income are earned in the CFC and the territory is "an excluded territory" – which covers most, but not all overseas jurisdictions.

27 Sections 371KA-371NE TIOPA 2010.