Corporate Tax Residence in the UK and COVID-19

April 14, 2020

The unprecedented restrictions on travel caused by the COVID-19 crisis may have an impact for non-UK companies who are seeking to be, or not to be, UK tax resident. This note considers that impact, together with some of the steps companies might consider taking to mitigate it.

Background

As a general rule, where a company is incorporated in the UK, there is a presumption of UK tax residence. In addition it is possible for any non-UK incorporated company to become resident in the UK for tax purposes if 'central management and control' (**CMC**) of its affairs is exercised in the UK.

The CMC test is derived from case law and looks, broadly, at where the highest level of control of the company's business is carried on. Often CMC resides with the board of directors of a company (or the equivalent), but the test looks to the facts and circumstances in each case. Where, for example, a major shareholder or the board of a parent company assumes control of a company's affairs, CMC may reside elsewhere. It is also possible for CMC to be carried out in more than one place at a time.

Where the incorporation rule or CMC test would result in a company being resident in the UK, but not in it ceasing to be resident in another jurisdiction (for example, in the case of a non-UK incorporated company, its own jurisdiction of incorporation), double tax treaties may come into play. Where such a treaty is in force between the UK and that other jurisdiction, a treaty 'tie breaker' clause may be relevant in determining where residence will actually lie in practice. Failing this, a company may end up being dual-resident for tax purposes.

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Why is COVID-19 relevant?

Many organisations have non-UK companies in their corporate structures. There are some circumstances in which a non-UK company is intended to be resident in the UK for tax purposes. An example might be where UK tax residence is desirable but incorporation outside the UK offers corporate law advantages or allows for transactions in company shares without UK stamp taxes. This is usually achieved through a combination of steps aimed at ensuring CMC is exercised in the UK. These may include: appointing a board that comprises a majority of UK residents; providing that board meetings must be held physically in the UK; limiting the extent to which meetings can be attended remotely by those outside the UK; making sure any meetings that are attended remotely are initiated and chaired from inside the UK and can be quorate without any directors who are outside the UK at the time; and limiting the potential for decision-making powers — such as signing a written resolution, or voting on a measure — to be exercised outside the UK.

Where an organisation has a non-UK company in its corporate structure but does not intend it to be UK resident for tax purposes, the reverse is true. Similar steps are taken to ensure that CMC is exercised outside the UK, rather than within it. This close attention to residence is often relevant where a company already has some UK ties, such as UK board members, with the intention of ensuring that it does not become UK resident inadvertently.

Both scenarios will generally also involve making sure that the board has a real role in considering actions and transactions (including whether or not to enter into them at all). This is in order to ensure that CMC sits with the board of directors and not with some other person or body.

A key feature of the lockdown measures imposed over the past few weeks has been travel restrictions. Even where individuals are not themselves subject to shelter-in-place rules, the ability to travel freely has been diminished, through a combination of practical hurdles and legal measures. Travelling internationally to attend a board meeting or to sign a document has become difficult, if not impossible, in many cases.

In addition, the COVID-19 crisis and the resulting lockdown measures have already had a significant impact on businesses in many sectors. This has given rise to a perfect (and unprecedented) storm comprising business-critical decisions that must be made swiftly, but that can only be made wherever the decision-makers currently find themselves – whether that is within, or outside, the UK.

The net result is that many of the measures described above and used to control a company's place of residence cannot currently be carried out as normal. In addition to failing to maintain a desired ongoing residence position, the adverse consequences might include the potential for 'exit' corporation tax charges (based on deemed market value disposals of assets) if a UK resident company ceases to be so resident.

Has there been any confirmation of the position from the UK authorities?

The UK's tax authority, HM Revenue & Customs (**HMRC**), has published revised guidance on company residence against the backdrop of COVID-19. However, this guidance addresses only the position of non-UK companies seeking to avoid UK residence (not the position of non-UK companies seeking to secure UK tax residence), and it falls short of providing any safe harbours. Despite the sympathy expressed by HMRC, it therefore offers little to provide companies with confidence that their UK residence position will be unaffected by the operating procedures forced on them by the pandemic, in the absence of additional steps to manage the risk.

In essence, HMRC's guidance states that it considers the existing law and guidance on residence to be sufficiently flexible to deal with the current circumstances. It places an emphasis on the 'holistic' view that HMRC will take in assessing the location of CMC. Whilst it does state that 'a few board meetings' being held in the UK, or 'a few decisions' being taken in the UK 'over a short period of time' will not necessarily result in a non-UK company becoming UK tax resident, it also stops short of ruling this out in a circumstance where business practices have changed solely as a result of the COVID-19 pandemic. The message is very

much that each case will be assessed on its own particular facts and circumstances. This is unlikely to provide much practical reassurance if the duration of lockdown measures extends beyond the short term.

HMRC also notes that, even where CMC does take place in the UK, this will not necessarily result in a conclusion of UK residence, as there may still be treaty tie-breaker provisions to consider. Some tie-breaker clauses look to the 'place of effective management' (or POEM which, unlike CMC, can only be carried on in one place at a time), whereas others require a decision of the tax authorities in the two jurisdictions. As HMRC notes, this can allow for factors other than CMC to be taken into account, but it nonetheless remains difficult to predict with certainty the direction in which a tie-breaker decision would go, not least given the prevalence of tax authority decision tie-breakers following the UK's recent adoption of OECD-led treaty modifications.

What does this mean in practice?

Companies that are actively seeking to ensure that they are, or are not, UK tax resident should pay close attention to the location of directors and of any others who would ordinarily participate in the highest level of decision making. If any of those individuals are in the 'wrong' place (i.e., in the UK when the intention is for the company to be resident outside it, and vice versa), thought should be given to practical steps which could minimise the risk of an unintended shift in tax residence.

If the intention is to ensure that a company is not UK-resident, but directors and other decision-makers are currently present physically in the UK, those steps might include:-

— delaying meetings where business-critical decisions would otherwise be made (and ensuring that those business-critical decisions are not made, whether at or outside a meeting, by people who are currently in the UK);

— where meetings must take place, ensuring that they take place outside the UK and restricting the ability of individuals who are UK-based to participate in those meetings;

— if UK based individuals do participate (e.g., by electronic means), ensuring that the call or video conference is initiated and chaired from outside the UK, that the meeting is quorate without participants who are physically in the UK and that such participants are not able to vote on matters discussed; and

— if the above is not possible, adding to or amending the board to create a more robust non-UK based presence (although not with individuals who merely follow instructions given to them by people based in the UK).

Where a company is intended to be UK tax-resident but directors are currently present physically outside the UK, the converse of these practical steps might be considered.

In all cases, the impact of the practical steps should be examined carefully by a company with its professional advisors, to ensure that the steps taken to solve for potential tax residence issues are possible and do not create issues in other areas.

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