

Analysis Inward Migration

With all the press surrounding the steady flow of UK headed groups out of the UK over the past few years (including WPP and Regus), it would seem inconceivable to contemplate the idea of migrating a foreign group company to the UK.

However, there are certain circumstances where the current economic conditions could make it attractive for a group with significant UK operations to migrate offshore companies into the UK including:

- where the foreign company holds assets which, upon disposal, could give rise to a capital loss but where the benefit of such capital loss will be unavailable in the foreign territory (for instance, due to a capital gains tax exemption) and unavailable in the UK to use against gains made on the disposal of assets by UK companies in the group. Migration could assist to improve the overall tax position of the group;
- where groups incur significant compliance costs to maintain the foreign tax residence of the company and such costs and tax exposures are disproportionate to the potential benefit; and
- where dealing with the controlled foreign companies' compliance requirements in the UK headquarters outweighs the benefits of having offshore subsidiaries.

This article considers some of the key issues relevant to groups looking to migrate foreign companies into the UK particularly where they have underperforming assets held in offshore structures which, if realised, would not result in any benefit to the wider group or where (increasingly) the costs of maintaining such structures is greater than any likely benefits.

What is inward migration?

In this article, reference to migration involves the maintenance of the registered office of the migrating company in its territory of incorporation but with central management and control (and effective place of management) of the company moving into the UK. In this way, this inward migration can be distinguished from the situation referred to in the CJEC decision of *Cartesio Oktato es Szolgaltato* (Case C-210/06) where there was an intended migration of the company's seat and registered office of the Hungarian limited partnership to Italy.

Possible exit taxes

The first issue to be considered is whether the termination of the tax residence of the company in its territory of incorporation would give rise to a deemed disposal of the company's assets (or a deemed liquidation of the assets) for tax purposes. Each country will have its own rules regarding exit taxes arising from a transfer of the tax residence of the company to the UK.

However, the offshore holding jurisdiction may not impose any capital gains taxes on asset

SPEED READ Recent economic conditions have led to a decline in the value of group-held assets, together with the dreaded anticipation of substantial losses on disposal of such assets. Typical assets currently standing at a loss in many groups include foreign property investments or trades. These investments held may have been structured to provide for maximum tax efficiencies on sale with the inherent assumption that the relevant asset would be sold on at a profit. Unfortunately, not enough thought may have been given by some groups to the reality that such investments might prove loss-making (at least in the short or medium term) or that any anticipated tax benefits could be outweighed by high compliance costs in maintaining an offshore structure. Groups with significant UK operations may now find that their foreign subsidiaries holding such loss-making foreign investments are unable to fully benefit from losses in these foreign jurisdictions. Rather unusually, these groups may find themselves considering whether migrating a foreign subsidiary to the UK could potentially improve the group's overall tax loss utilisation and costs position.



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disposals, in which case a deemed disposal of the company's assets or a deemed liquidation for tax purposes would not trigger any exit charges in the relevant jurisdiction of incorporation. In the case of underperforming assets, an exit charge may not arise where a deemed disposal of assets would not result in a gain. In addition, within the EU, it could be argued that such exit taxes are discriminatory in any event, in light of the decisions in *De Lasteyrie du Saillant* (Case C-9/02), and *N v Inspecteur van de Belasting-dienst* (Case C-470/04).

Residence in the UK

It may seem obvious, but in order to migrate the company, it should be clear that the company has indeed become UK tax resident. The company's central management and control must be in the UK as established by the decision in *De Beers Consolidated Mines Ltd v Howe* (1906) 5 TC 19. Where there are significant UK interests in the wider group, this requirement should not be difficult to meet. Nevertheless, practical guidelines should be followed, including board meetings conducted in the UK to establish the date of migration and to ensure that such UK tax residence is maintained.

HMRC will query the residence status of a

company where it suspects that the residence status of a company is part of an arrangement to obtain substantial UK tax advantages not countered by anti-avoidance legislation and, in particular, where it appears that the purpose is to obtain group relief for losses. In such circumstances, HMRC may seek to argue that the company is not UK resident or has also maintained a dual residence in its place of incorporation. A dual resident company may be unable to obtain certain reliefs including transfers of assets intra-group on a no gain/no loss basis and group relief for losses.

Whilst CTA 2009 s 18 provides that where a company is treated as resident outside the UK under a double tax treaty, it will be treated as resident in that territory for all UK tax purposes, this rule does not expressly apply to situations where the company is resident in the UK. Ideally, and to reduce the risk of any HMRC argument of dual residency, an applicable treaty should include a 'tie-breaker' clause to prevent the company being treated as resident in its country of incorporation where it is effectively managed in the UK. Where there is no available treaty or tie-breaker clause, there would be a greater risk of dual residence arising upon the migration of a company into the UK.

In addition, care should be taken to ensure that the migrating company does not then inadvertently cease to be UK resident (which could result in the imposition of an exit charge under TCGA 1992 s 185).

Ability to benefit from trading losses

As the company will become resident in the UK for tax purposes by reason of a movement of the central management and control to the UK, it will become subject to UK corporation tax on its worldwide income from the time of migration.

An accounting period will commence when the company becomes UK resident and no UK relief is available for losses incurred by the company before it comes within the charge to UK corporation tax. Any foreign trading losses generated whilst the company is non-UK resident would only be available for use in accordance with the tax treatment in the foreign territory and (subject to the limited ability to use losses in the UK in accordance with the ECJ decision in *Marks & Spencer v Halsey* (Case C446/03)), could not be used to offset against profits in the UK.

However, from the time that the company becomes resident in the UK, current year losses incurred by the company should be available for surrender to other UK group companies for overlapping accounting periods but subject to the restrictions set out in ICTA 1988 Part X Chapter IV (including restrictions applicable to overseas property businesses).

Companies looking to migrate should consider the potential impact of a migration on the availability of existing trading losses. Upon a migration, carry-forward losses are likely to be lost unless the company continues to conduct a trade

through a permanent establishment in that territory. There could be an argument that the inability to use carry-forward losses would be discriminatory where the company was originally resident in within the EU (as compared with a situation where the EU was a single taxing territory or where the company was UK resident). Nevertheless, the practical consequence is that, even if the losses were technically available for carry forward in the foreign territory, there may not be any profits arising within the foreign territory against which any such trading losses could be utilised.

If, after migration, the assets do generate foreign income subject to local taxes or there is a foreign permanent establishment, foreign tax should be creditable against the UK corporation tax (up to the amount of UK corporation tax applicable to the same taxable profits net of relevant expenses). HMRC is currently sounding out the possibility of introducing a UK exemption from the taxation of profits derived from foreign permanent establishments. However, the downside is that such exemption would also prevent UK companies from benefiting from losses arising to a foreign permanent establishment.

Ability to benefit from capital losses

There is no general deemed acquisition of capital assets by the company at market value on a migration of the company to the UK (save in the case of plant and machinery used in a trade). Rather the company will retain its historic base cost in respect of the acquired capital assets upon it becoming UK tax resident and any inherent capital gain would be recognised in the UK by the migrated company upon the subsequent disposal of the asset.

It would, therefore, follow that a reduction in the value of the assets whilst the company was outside the UK should also be recognised on a future disposal of assets by the company. However, the current legislation provides that a company should not benefit from losses which are unrealised but which have accrued to the company prior to its UK migration. In a welcome development, a recent consultation paper regarding the simplification of the capital gains rules for groups of companies issued on 22 February 2010 indicates that the Government is moving towards an acceptance that losses realised after a company joins a group should not be restricted (unless there is a tax motivated arrangement in place). The draft legislation proposed should ensure the consistent treatment of a migrating company into the UK irrespective of whether it holds assets standing at an inherent gain or loss.

Current rules regarding allowable loss accrued on pre-entry assets

The latest Government proposals are still being discussed, with comments invited by 17 May 2010. So what about the current rules regarding unrealised losses inherent in capital assets at the time the company migrates to the UK? The pre-entry loss rules are contained in TCGA 1992 Sch 7A. Provisions were also enacted in 2006 in ss 184A

to 184I which take precedence over Sch 7A but which should not apply in a migration context where there is no change of ownership of the migrating company and there is no tax avoidance scheme.

The Sch 7A rules apply automatically, do not require a tax avoidance motive and apply to losses on 'pre-entry assets' which include assets held at the time immediately before migration even if the migrating company had acquired the assets after the company became a member of the worldwide group.

The current rules essentially restrict the ability of the company to use the 'pre-entry proportion' of any allowable capital loss actually arising to the company when it ultimately disposes of assets which it held at the time of migration. The pre-entry proportion of a loss is calculated by reference to a time apportionment formula or, if a lower restricted loss would arise, by reference to the market value to the asset immediately before migration. For the market value rule to apply, an election must be made within two years of the end of the accounting period in which the loss accrues. It is, therefore, sensible for any migrating company to value its assets prior to migration where it expects that the assets are standing at an inherent loss so that it can assess whether a market value election should be made on a future sale of the assets.

Unfortunately, the current provisions dealing with the way the restricted loss on disposals of assets after a migration could be applied against capital gains arising to the wider UK group companies are unclear. It is noted that losses made by UK resident companies within a group can generally be set off against capital gains made by other UK group companies under the notional disposal rules contained in TCGA 1992 s 171A. Schedule 7A para 7 enables restricted losses arising prior to the entry of a company into a group to only be used against 'pre-entry gains' (ie, gains on assets held by the loss company or gains on assets held by an associated company of the loss company immediately before 'entry' into the relevant group). 'Associated companies' for this purpose are companies 'joining' the relevant group at the same time as the loss company and which were members of another group immediately before that time.

The difference with a migration situation is that, in consequence of the definition of a 'group' extending to non-UK resident members, a migrating company does not 'enter' or 'join' a group. It is already a member of the worldwide 'group'. Does this mean that all assets held by the wider group (including any UK members) could all be viewed as pre-entry assets for this purpose (and, therefore, any gains on disposal of those assets being capable of offset against a restricted pre-entry loss using the notional disposal mechanism of s 171A)?

Whilst there is no express reference to migration of the company into the UK being treated as constituting the 'joining' or 'entry' into a group, HMRC appears to interpret the wording in para 7 in this way in their Capital Gains Manual (para 47005), where it is stated that the rules are designed to 'prevent loss importation by an existing group member becoming resident in the UK and utilising the loss latent in an asset at the time of becoming

resident to cover gains on assets held elsewhere in the group'.

But what about companies which migrate together into the UK? The pre-entry loss rules are designed to enable companies joining a group together to offset their pre-entry losses against pre-entry gains of other such companies. In a migration context, it is not clear whether companies which migrate together can benefit from this treatment and nor is there any clear reason for any restriction.

Given the consensus that the Sch 7A rules are complex, overlap with the provisions in ss 184A to 184I and, in the migration context, are unclear in their application, it is welcome that the Government's latest consultation document on the issue has essentially proposed the abolition of these Sch 7A rules in the context of migration.

If enacted, these proposals could encourage groups with significant UK interests to migrate offshore entities back to the UK in order to reduce their compliance costs, particularly where these costs are not justified by the underperforming nature of the assets held by the offshore entity. It would also have the benefit of reducing the tax exposures to the group where assets are held by offshore holding companies in territories where there is limited activity undertaken in that territory.

Other relevant issues

There are other issues which should also be considered on a migration, including (but not limited to):

- Dividends paid by the company should no longer be subject to any foreign dividend withholding taxes.
- Financing provided to the company should now fall within the loan relationship rules with relief for loan relationship debits dependent on the application of UK anti-avoidance legislation. Where the migrating company is a lender, CTA 2009 s 327 prevents a migrating company from obtaining tax relief in respect of losses arising on loan relationships prior to migration.
- Interest payable by the migrating company could become subject to UK withholding taxes under ITA 2007 Part 15 Chapter 11 if the interest payments made by the company are now treated as UK sourced.
- Whether the migrating company should register for VAT in the UK.

Conclusion

Where a group with substantial UK interests has underperforming assets held in foreign jurisdictions, the group should assess whether a migration of the foreign company to the UK would improve the overall tax effectiveness of the group. Moreover, the reduction in the compliance costs and tax risks could also justify a migration to the UK. Whilst the full value of inherent capital or trading losses may not be available to the group, the migration may provide sufficient benefits to make such a step attractive in the current economic climate. ■

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