Tax on Inbound Investment 2020

Contributing editors
Peter Maher and Lew Steinberg

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Getting The Deal Through

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Tax on Inbound Investment

2020

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Peter Maher and Lew Steinberg

A&L Goodbody

Lexology Getting The Deal Through is delighted to publish the fourteenth edition of *Tax on Inbound Investment*, which is available in print and online at www.lexology.com/gtdt.

Lexology Getting The Deal Through provides international expert analysis in key areas of law, practice and regulation for corporate counsel, cross-border legal practitioners, and company directors and officers.

Throughout this edition, and following the unique Lexology Getting The Deal Through format, the same key questions are answered by leading practitioners in each of the jurisdictions featured. Our coverage this year includes new chapters on France and Romania.

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Every effort has been made to cover all matters of concern to readers. However, specific legal advice should always be sought from experienced local advisers.

Lexology Getting The Deal Through gratefully acknowledges the efforts of all the contributors to this volume, who were chosen for their recognised expertise. We also extend special thanks to the contributing editors, Peter Maher of A&L Goodbody and Lew Steinberg of Merrill Lynch, for their continued assistance with this volume.

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Publisher
Tom Barnes
tom.barnes@lbresearch.com

Subscriptions
Claire Bagnall
claire.bagnall@lbresearch.com

Senior business development managers
Adam Sargent
adam.sargent@gettingthedealthrough.com

Dan White
dan.white@gettingthedealthrough.com

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United Kingdom

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ACQUISITIONS (FROM THE BUYER'S PERSPECTIVE)

Tax treatment of different acquisitions

1 What are the differences in tax treatment between an acquisition of stock in a company and the acquisition of business assets and liabilities?

Whether, from a tax perspective, a share or a business acquisition is more attractive to a potential purchaser will depend on the facts, taking into account the nature of the relevant assets and liabilities of the business and what the purchaser intends to do with the business following its acquisition (eg, whether or not it intends to seek to sell the assets or shares to a third party shortly after the acquisition).

Tax liabilities of a target company carrying on the business will remain with the target company following an acquisition of shares in that company and, as a consequence, a purchaser will seek protection from the seller for pre-completion tax liabilities of the target company, both known and unknown (see question 9). Other tax attributes of the target company also remain; in particular, any tax losses continue to be available to set off against future profits (subject to various restrictions and anti-avoidance rules; see question 7).

The target company's historic base cost in its assets is generally unaffected by the transfer of ownership of its shares and is likely to be lower than the base cost the purchaser would have acquired if it had instead purchased the assets from the target company. So, if the purchaser intends to strip out and sell the assets, it would be preferable for the purchaser to purchase the assets themselves rather than shares in the target company. From the purchaser's perspective, another key advantage of an asset sale is the ability to claim capital allowances in respect of expenditure incurred on plant and machinery (and certain other assets) and to obtain tax relief for expenditure on intangible assets (but see question 2), rather than being confined to the target company's tax position.

Step-up in basis

2 In what circumstances does a purchaser get a step-up in basis in the business assets of the target company? Can goodwill and other intangibles be depreciated for tax purposes in the event of the purchase of those assets, and the purchase of stock in a company owning those assets?

Where a purchaser acquires business assets, the amount paid for such assets (plus the incidental costs of acquisition) will generally constitute the purchaser's new base cost in such assets for the purpose of calculating its chargeable gain on any future disposal. This is subject to a market value override that applies to transactions between connected parties.

The purchaser is able to claim tax relief for expenditure on acquiring intellectual property and certain other intangible assets in line with the purchaser's accounting treatment. In respect of goodwill and intangible assets such as customer lists, a writing-down allowance at a fixed rate of 6.5 per cent may be available, if the goodwill or assets are acquired after 1 April 2019 as part of the acquisition of a business that also involved the acquisition of intellectual property to use in the business going forward.

Where a purchaser acquires shares in a target company, there is generally no step-up in basis in respect of the target company's assets. However, a step-up can occur if a degrouping charge is triggered: if another company in the seller's group had transferred capital assets or certain intangible fixed assets to the target company within the six years before the purchaser acquires the target company, the target company will be deemed to have disposed of, and immediately re-acquired, the relevant assets at market value at the time of the degrouping. If the substantial shareholding exemption (SSE) (see question 15) is available to the seller, the capital assets degrouping charge would, however, be covered by the SSE and the intangible fixed assets degrouping charge (and the concomitant uplift in the target company's base cost) switched off. In that case, the capital asset would still get a step-up in basis, but the intangible fixed asset would not.

A step-up in basis in capital assets or certain intangible fixed assets may also occur if those assets are held by a non-UK resident company and, on or after 1 January 2020, those assets start to be held for a UK permanent establishment or that company migrates to the UK, triggering a tax exit charge in another EU member state.

Domicile of acquisition company

3 Is it preferable for an acquisition to be executed by an acquisition company established in or out of your jurisdiction?

The UK has generally been regarded as a favourable holding company jurisdiction (for non-banking groups) for the following reasons:

- with a corporation tax rate of 19 per cent, expected to decrease to 17 per cent by 2020, it has one of the lowest corporate tax rates in the G20;
- the UK has an extensive tax treaty network and does not generally impose a withholding tax on dividends (see question 13);
- the UK acquisition company should generally benefit from a tax exemption for dividends received from the target company, irrespective of whether its shareholder is resident in the UK or elsewhere;
- a UK acquisition company should generally be able to benefit from deductions for the finance costs of acquiring the target company (subject to the restrictions explained in question 8); and
- the SSE would enable a UK acquisition company to dispose of the target company without triggering a chargeable gain if the conditions are satisfied (see question 15).

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A key issue for business is whether the UK's exit from the EU is likely to have any adverse impact on the attractiveness of the UK as a location for a holding company, or an intermediate holding company, from a tax perspective. While there may be some changes relevant in certain fact patterns, in the majority of cases, the attractiveness of the UK's tax regime is likely to be unaffected and may even be improved as the UK seeks to retain the inward investment it already has and aims to encourage further investment. It is worth noting that if, as is likely, UK resident companies lose the benefit of the Parent–Subsidiary Directive and the Interest and Royalties Directive, the UK's extensive tax treaty network will protect a UK holding company from withholding tax on dividends, interest and royalties received from most European jurisdictions. There is potential for some tax leakage where the UK's treaties do not reduce withholding taxes to zero, but it is expected that groups should be able to restructure appropriately ahead of the UK's ultimate exit, which may be delayed further beyond the currently envisaged departure date of 31 October 2019.

Company mergers and share exchanges

4 | Are company mergers or share exchanges common forms of acquisition?

Since the EC Mergers Directive was implemented in the UK in December 2007, it has been possible to effect a 'true' merger in which all the assets and liabilities of a transferor company are transferred to a transferee company and the transferor company ceases to exist without needing to be put into liquidation.

The UK implementing regulations require at least two companies from different EU member states to be merged, and allow for three types of cross-border mergers: merger by absorption, merger by absorption of a wholly owned subsidiary or merger by formation of a new company. The procedure is lengthy and involves a number of court hearings. It is not commonly used and there are no other means of achieving a 'true' merger in the UK. Whether these rules are amended so as to apply post-Brexit depends on the deal negotiated with the EU. It is expected that, in a no-deal scenario, they would no longer apply.

Share exchanges are common forms of acquisition and can enable the seller to roll over any chargeable gain into shares or loan notes issued by the purchaser (other than qualifying corporate bonds (QCBs), being, broadly, securities expressed and redeemable in sterling) (see question 17).

Tax benefits in issuing stock

5 | Is there a tax benefit to the acquirer in issuing stock as consideration rather than cash?

The purchaser does not obtain a tax benefit from the issuing of shares as consideration.

Transaction taxes

6 | Are documentary taxes payable on the acquisition of stock or business assets and, if so, what are the rates and who is accountable? Are any other transaction taxes payable?

Share acquisition

Normally, the acquisition of shares in a UK private company would involve the execution of a share purchase agreement, setting out the commercial terms, and a separate instrument transferring the title to those shares, a stock transfer form (STF). Stamp duty is payable on the STF and stamp duty reserve tax (SDRT) on the share purchase agreement, in each case, at a rate of 0.5 per cent of the consideration (subject to a market value rule that deems the transfer of listed securities between connected companies to be made for consideration equal to the market value of those shares). However, the SDRT charge is not normally paid. This is because, if stamp duty is paid on the STF within six years of the date on which the SDRT charge on the share purchase agreement arose, the SDRT charge is cancelled (or, if the SDRT charge was already paid, it would refunded).

Prior to March 2015, takeovers of UK public companies in particular were frequently implemented by way of a cancellation scheme, meaning that the target company's shares were cancelled, the purchaser issued shares to the target company's shareholders and the target company issued new shares to the purchaser. This enabled a transfer of ownership without the need to pay stamp duty: as there was no instrument of transfer, no stamp duty was payable on a cancellation of shares. It is now no longer possible to use a cancellation scheme to effect a takeover. Acquirers must instead use a transfer scheme of arrangement or a contractual offer (on which stamp duty or SDRT is payable).

The acquisition of shares is not a supply for value added tax (VAT) purposes.

Acquisition of business assets

Which transfer taxes apply on the acquisition of business assets depends on the nature of the assets and on whether or not they are transferred as part of the transfer of a business as a going concern.

If the business assets include land in England or Northern Ireland, stamp duty land tax (SDLT) will be payable. The top rate of SDLT on transactions in non-residential property is 5 per cent. It applies where the consideration exceeds £250,000. On the transfer of land in Scotland, Scottish land and buildings transaction tax (LBTT) will be payable and, in respect of the transfer of land in Wales, Welsh land transaction tax (LTT).

If the business assets include an interest in a partnership that holds stock or marketable securities, stamp duty at 0.5 per cent will apply to the transfer of the partnership interest.

Unless the transfer of the business assets meets the conditions for being a transfer of a business as a going concern, VAT may be chargeable at a rate of up to 20 per cent, depending on the nature of the assets. For instance, most supplies of land are exempt from VAT, unless the seller has opted to tax the land.

Net operating losses, other tax attributes and insolvency proceedings

7 | Are net operating losses, tax credits or other types of deferred tax asset subject to any limitations after a change of control of the target or in any other circumstances? If not, are there techniques for preserving them? Are acquisitions or reorganisations of bankrupt or insolvent companies subject to any special rules or tax regimes?

There are restrictions on how carried-forward losses can be used, which apply irrespective of a change of ownership. There are also anti-avoidance rules that can deprive a company of, or restrict its use of, carried-forward losses after a change of control of that company.

Carry-forward of income losses – general rules

The way in which carry-forward income losses can be used depends on whether the relevant losses were originally incurred before 1 April 2017 or on or after 1 April 2017. But under both the old and new rules, no time limits apply to the carry-forward of losses and, if a company transfers its trade to another member of its group, the transferee will, subject to anti-avoidance rules, inherit the tax losses of the transferor, unless the transferor is in liquidation.

Post-April 2017 carry-forward losses can be used more flexibly than pre-April 2017 carry-forward losses. Pre-April 2017 carry-forward

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losses have to be streamed. This means that carry-forward trading losses may only be set against profits of the same trade in subsequent accounting periods and cannot be used by other companies within the same group. In contrast, post-April 2017 carry-forward trading losses can be set off against profits from other income streams and against profits of other companies within the same group. There are special rules in relation to the use of post-April 2017 carry-forward losses against the profits of other companies within the same group following a change in ownership.

Pursuant to the corporate loss restriction, the amount of taxable profit that can be offset by carried-forward income losses (whenever incurred) is restricted to 50 per cent (although this only applies to taxable profits in excess of £5 million calculated on a group basis). The UK government has published draft legislation for inclusion in the next Finance Bill that would extend the corporate loss restriction to carried-forward capital losses from 1 April 2020.

Overall, the 2017 reforms have created a very complex dual regime that requires companies to consider carefully the way they use their losses. It is particularly harsh that pre-April 2017 carry-forward losses do not benefit from the increased flexibility but, if set off against post-April 2017 profits, will be subject to the corporate loss restriction in the same way as post-April 2017 carry-forward losses.

Carry-forward of income losses – banks and building societies

Banks and building societies have been subject to the bank loss restriction since 1 April 2015. The bank loss restriction applies in respect of the carry-forward of trading losses, non-trading loan relationship deficits and management expenses originally incurred before 1 April 2015. Initially, 50 per cent of banks' and building societies' taxable profits in any accounting period could be offset by these carried-forward amounts (subject to a £25 million allowance for groups headed by building societies or savings banks). This was cut to 25 per cent from 1 April 2016 and, from 1 April 2017, banks have also been required to operate the corporate loss restriction to losses that fall outside the scope of the existing bank loss restriction.

Change of control

There are various anti-avoidance rules aimed at preventing loss buying and loss refreshing.

The carry-forward of trading losses may be denied if there is a major change in the nature or conduct of a trade carried on by the loss-making company within three years before, or up to five years after, the change in ownership (or, if either change occurred before 1 April 2017, within three years before, or up to three years after, the change in ownership), or if there is a change in ownership of a company at any time after the scale of its trading activities has become small or negligible, but before any considerable revival of the trade. The insertion of a new holding company at the top of a group of companies does not of itself constitute a change in ownership for these purposes.

Similarly, there are restrictions on the carry-forward of non-trading losses following a change of ownership if there is a major change in the nature or conduct of the trade or business of the loss-making company within three years before, or up to five years after, the change in ownership (or, if either change occurred before 1 April 2017, within three years before, or up to three years after, the change in ownership), or if there is a significant increase in the capital of the business or a significant revival of a trade or business that has become small or negligible.

To the extent that post-April 2017 carry-forward losses are not already dealt with by the loss-buying rules explained above, such losses cannot be used against profits that arise within five years of the change of ownership and that can be attributed to a major change in the nature or conduct of the company's trade or business or of a co-transferred company's trade or business within three years before, or up to five years after, the change in ownership (but this restriction does not apply if either change occurred before 1 April 2017). A co-transferred company is any company that was related to the transferred company both immediately before and immediately after the change in ownership.

While post-April 2017 carry-forward losses may generally be used against the profits of other companies within the same group, this ability is restricted following a change in ownership. Members of the new group cannot use the acquired company's pre-acquisition post-April 2017 carry-forward losses in the first five years following the change in ownership.

Capital losses

There are also a range of restrictions on the use of capital losses, and the UK government has published draft legislation for inclusion in the next Finance Bill that would extend the corporate loss restriction to carried-forward capital losses from 1 April 2020.

Interest relief

8 Does an acquisition company get interest relief for borrowings to acquire the target? Are there restrictions on deductibility generally or where the lender is foreign, a related party, or both? In particular, are there capitalisation rules that prevent the pushdown of excessive debt?

In principle, a UK resident acquisition company benefits from relief from UK corporation tax for borrowings incurred to acquire the target company, but this is an area that is subject to continually increasing restrictions:

- the UK has a thin capitalisation regime that applies to domestic as well as cross-border transactions. If the lender is a related party or the borrowing is guaranteed by a related party, these rules will be applied to determine the amount that the borrower could have borrowed from an independent lender, and this can result in part of the borrowing costs being non-deductible;
- there is an earnings before interest, tax, depreciation and amortisation (EBITDA)-based cap on net interest expense. The restrictions, which apply only where a group has over £2 million in UK net interest expense, include:
  - a fixed ratio rule that limits corporation tax deductions for net interest expense to 30 per cent of a group's UK EBITDA. Alternatively, a group can elect into a group ratio rule that limits corporation tax deductions for net interest expense based on the net interest-to-EBITDA ratio for the worldwide group; and
  - a modified debt cap, which provides that a group's net UK interest deductions cannot exceed the global net third-party interest expense of the group;
- corporation tax deductions for interest may be reduced or denied under the UK's transfer pricing rules;
- interest will not be deductible if it is treated as a distribution. This will include situations where the interest exceeds a reasonable commercial return, the rate depends upon the performance of the borrower, or the loan is convertible into shares;
- corporation tax deductions for interest may be denied under the UK's anti-hybrid rules, for example, if the interest is paid on an instrument that is regarded as debt in the UK, but as equity in the payee jurisdiction such that the payee is not subject to tax on receipt of the payment;
- interest relief may also be restricted where the loan has an unallowable purpose; namely, if a main purpose of being party to the loan in the relevant accounting period is to obtain a tax advantage; and
- interest relief may be denied or reduced by a targeted anti-avoidance rule where:

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- a loan-related tax advantage arises from arrangements;
- the obtaining of the tax advantage was a main purpose of the arrangements; and
- the tax advantage cannot reasonably be regarded as consistent with the policies and principles of the legislation.

The UK imposes a withholding tax on interest (at 20 per cent), which may be reduced or eliminated under a relevant double tax treaty, or benefit from one of the various domestic exceptions (see question 13). In any event, there is no requirement to withhold tax from interest payable on borrowings where the loan is only capable of being outstanding for less than one year.

Protections for acquisitions

9 What forms of protection are generally sought for stock and business asset acquisitions? How are they documented? How are any payments made following a claim under a warranty or indemnity treated from a tax perspective? Are they subject to withholding taxes or taxable in the hands of the recipient? Is tax indemnity insurance common in your jurisdiction?

On an acquisition of shares, a purchaser would generally expect to receive the benefit of both tax warranties and a tax covenant.

The tax warranties will seek to elicit information about the target company. If they prove to be incorrect, they may also form the basis of a claim for breach of contract, subject to the purchaser being able to evidence causation and loss.

The tax covenant is, in effect, a tax indemnity and sometimes referred to as such. It will give pound-for-pound protection in respect of historic tax liabilities of the target company (ie, the purchaser will not have to show loss to bring a claim). This protection may be sought up to the last accounts date, a specified 'locked box' date or the date of completion, depending on the commercial agreement between the parties as to the basis on which the purchase price has been calculated and the allocation of risk. The tax covenant is often contained in a separate document that is executed as a deed, but it can also be included in the share purchase agreement.

Payments in respect of a tax covenant claim or tax warranty claim should always be made between the seller and the purchaser as an adjustment to the purchase price (rather than being made directly to the target company). In that case, the purchaser should not be subject to UK tax on receipt (nor should there be any requirement to withhold tax from the payment). To the extent that the aggregate of the payments made by the seller exceed the purchase price (which is most likely to occur following the sale of a distressed company), these payments (to the extent of the excess) are likely to constitute taxable receipts for the purchaser. In this situation, the purchaser should seek to negotiate a gross-up obligation in the sale documentation.

On an acquisition of business assets, typically no tax covenant is given and there would be fewer tax warranties because, in general, the tax liabilities do not attach to the business assets and would, therefore, not transfer to the purchaser, but remain with the company.

Recently, indemnity insurance has become more common on an acquisition of shares, although insurers are typically reluctant to cover certain risks such as challenges to the target company's transfer pricing. If indemnity insurance is used, it is typically in the form of a buy-side policy. As there is a risk that the purchaser may be subject to tax on receipt of payments from the insurers, the purchaser may wish to seek to negotiate a gross-up obligation in the insurance documentation.

POST-ACQUISITION PLANNING

Restructuring

10 What post-acquisition restructuring, if any, is typically carried out and why?

The nature of any post-acquisition restructuring will be specific to each transaction, but the objectives will often be similar. These include the desire to ensure that the newly acquired assets are fitted into the purchaser's group in the most efficient manner, as influenced by tax and financing considerations, and that interest relief obtained in respect of any debt funding incurred to finance the acquisition can be set off against taxable profits generated by the business.

Restructurings will often involve steps such as hiving down the target company or its business into existing subsidiaries, sale and leaseback arrangements with property investment subsidiaries, the sale and licensing of intellectual property or the insertion of new holding companies.

Spin-offs

11 Can tax-neutral spin-offs of businesses be executed and, if so, can the net operating losses of the spun-off business be preserved? Is it possible to achieve a spin-off without triggering transfer taxes?

Effecting a tax-efficient spin-off involves ensuring that shareholders neither receive taxable income nor realise a chargeable gain, that the demerging company does not realise a chargeable gain and that transfer taxes are minimised.

Various corporate actions – which, depending on the particular circumstances, will achieve these objectives to varying degrees – are available to effect a spin-off. The choice will depend on commercial factors, the distributable reserves position, whether shares or business assets are to be spun out, the residence of the companies involved and the residence and other characteristics of the shareholders of the demerging company. The available structures include direct-dividend demergers, indirect (or three-cornered) demergers, capital-reduction demergers or liquidation schemes.

To achieve a tax-efficient spin-off from a UK shareholder perspective, the structures would rely on different reliefs and exemptions. For instance, direct-dividend demergers will often seek to fall within the exempt distribution legislation, whereas capital-reduction demergers will seek to ensure shareholders benefit from reorganisation treatment. Reorganisation treatment achieves, in effect, a rollover of any chargeable gain as the shareholders do not receive any additional basis in their shares in the spun-off company. Instead, the shareholders' basis in the rump company shares is split between those shares and their shares in the spun-off company.

Following a spin-off, trading losses may be capable of being preserved, but the plethora of anti-avoidance rules (see question 7) will need careful consideration in this context.

While stamp duty or SDRT would be payable if the spin-off involves the transfer of shares in a UK company, in practice, it is often possible to ensure that no stamp duty or SDRT charges arise. This may be because it is possible to rely on available reliefs, notably acquisition relief. Alternatively, it may be possible to ensure that there is no transfer for consideration by implementing a cancellation scheme rather than a transfer scheme or by relying on a distribution being for no consideration. It should, however, be noted that the latter is no longer possible to the extent that the transaction involves the transfer of listed securities between connected companies owing to the market value rule referred to in question 6.

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Where a spin-off involves transactions in UK land, it is likely that SDLT, LBTT or LTT (as applicable; for further information, see question 6) would need to be paid in respect of such transactions.

Migration of residence

12 Is it possible to migrate the residence of the acquisition company or target company from your jurisdiction without tax consequences?

A UK-incorporated company will be resident in the UK for tax purposes regardless of whether or not its central management and control is located in the UK. The only way to migrate a UK-incorporated company so that it is no longer treated as UK-resident is to ensure that its place of effective management and control is in a jurisdiction with a suitable double tax treaty. Such a treaty would need either to contain a residence tiebreaker clause (providing that the company is treated as resident solely in its place of effective management and control) or provide for a mutual agreement procedure to determine residence (which may resolve the question in favour of the place of effective management and control, but carries with it the risk of uncertainty of outcome).

A non-UK-incorporated company will only be tax-resident in the UK if it is centrally managed and controlled in the UK. Such a company can lose its UK tax residence by becoming centrally managed and controlled in another jurisdiction.

The UK imposes an exit charge on UK-resident companies (whether UK- or non-UK-incorporated) that cease to be UK tax-resident: the company is deemed to have disposed of and immediately reacquired all of its capital assets at their market value when it leaves the UK, thus creating a charge to corporation tax on any latent capital gains (unless a relief such as the SSE (see question 15) applies). Companies migrating to an EU or European Economic Area (EEA) country can seek to agree an exit charge payment plan with Her Majesty's Revenue and Customs (HMRC), which allows the resulting corporation tax to be paid in instalments or deferred for a period of up to 10 years until the relevant asset has been sold. The migrating company must notify HMRC of its proposed migration. In order to ensure that the exit charge regime is compliant with the EU Anti-Tax Avoidance Directive, a series of changes will take effect from 1 January 2020. These include the removal of the choice to pay upon realisation, so that the exit charge will need to be paid in six equal annual instalments.

Interest and dividend payments

13 Are interest and dividend payments made out of your jurisdiction subject to withholding taxes and, if so, at what rates? Are there domestic exemptions from these withholdings or are they treaty-dependent?

Interest

The UK imposes withholding tax at the rate of 20 per cent on yearly interest; namely, interest paid on loans capable of being outstanding for one year or more. Currently, the withholding tax can be eliminated if the Interest and Royalties Directive applies. Following Brexit, this may no longer be possible, and companies may instead have to rely on an applicable double tax treaty that may reduce or eliminate the withholding tax.

In addition, there are various domestic exceptions that may be available. There is no obligation to withhold if:

- the interest is paid by a bank in the ordinary course of its business;
- the person beneficially entitled to the interest is a UK-resident company, or is non-UK resident but carries on a trade in the UK through a permanent establishment and is subject to UK tax on the interest;
- the interest is paid on a quoted Eurobond; namely, an interest-bearing security issued by a company listed on a recognised stock exchange;
- the interest is paid on debt traded on a multilateral trading facility operated by a recognised stock exchange in an EEA territory; or
- the interest is paid on qualifying private placements.

There is no obligation to withhold tax on short interest (broadly, where the loan is only capable of being outstanding for less than one year) or on returns that constitute a discount (rather than interest).

Dividends

The UK does not generally impose a withholding tax on dividends. However, property income dividends paid by UK real-estate investment trusts are subject to withholding tax at a rate of 20 per cent if paid to non-resident shareholders (or to certain categories of UK-resident shareholders), although this may be reduced by an applicable double tax treaty.

Royalties

The UK imposes withholding tax (at 20 per cent) on any royalty paid in respect of intangible assets. Currently, the withholding tax can be eliminated if the Interest and Royalties Directive applies. Following Brexit, this may no longer be possible, and companies may instead have to rely on an applicable double tax treaty which may reduce or eliminate the withholding tax. A treaty override will, however, apply, if a royalty payment is made to a connected person as part of arrangements, a main purpose of which is to obtain a tax advantage by virtue of a double tax treaty, so that the withholding tax will be required irrespective of whether the treaty would otherwise restrict the UK's taxing rights. For the purposes of the UK's royalties withholding tax, royalties connected with a UK permanent establishment (PE) of a non-UK resident will be treated as having a UK source.

In the autumn 2017 Budget, the UK government launched a consultation regarding the possibility of extending withholding tax on royalties to cover non-UK entities that make sales to UK customers. Instead, an income tax charge on certain non-UK residents in respect of income from intangible property that is referable to sales of goods or services in the UK has been introduced with effect from 6 April 2019.

Tax-efficient extraction of profits

14 What other tax-efficient means are adopted for extracting profits from your jurisdiction?

Profits may be extracted from a UK company either by way of declaring dividends or by interest payments on loans made to the company by its shareholders. While dividends are not deductible for corporation tax purposes, interest payments are deductible for the borrower (even if loans are advanced by a shareholder), subject to the restrictions outlined in question 8. Interest payments may, however, be subject to withholding tax, whereas the UK does not generally impose a withholding tax on dividends (see question 13).

DISPOSALS (FROM THE SELLER'S PERSPECTIVE)

Disposals

15 How are disposals most commonly carried out – a disposal of the business assets, the stock in the local company or stock in the foreign holding company?

If the disposal is expected to result in a gain, UK corporate sellers typically prefer to sell shares in the target company. This is because, if the SSE applies, it exempts from corporation tax any chargeable gain on the disposal of the shares. There are three exemptions within the SSE, the main one applying if:

- the seller holds a substantial shareholding in the target company (broadly 10 per cent);

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- the target company is a trading company or the holding company of a trading group or a trading subgroup; and
- the seller has held the substantial shareholding for a continuous 12-month period beginning not more than six years before the date of the disposal.

The availability of the SSE is not restricted to the disposal of shares in UK companies; the conditions are equally capable of applying to disposals of shares in foreign subsidiaries.

If the disposal would result in an economic loss for a UK corporate seller and the conditions for the SSE are met, no capital loss will be crystallised on the disposal. The seller may, therefore, prefer to dispose of the business assets in this scenario.

It is relatively uncommon for the disposal of a UK company carrying on a UK business to be effected by way of a sale of stock in a foreign holding company unless the disposal is part of a larger transaction comprising UK and non-UK operations.

Disposals of stock

16 | Where the disposal is of stock in the local company by a non-resident company, will gains on disposal be exempt from tax? Are there special rules dealing with the disposal of stock in real-property, energy and natural-resource companies?

Gains arising from the disposal of shares in a UK company by a non-resident are generally not subject to UK corporation tax. Special rules apply, however, in relation to disposals of shares in companies holding UK land or petroleum production licences.

In respect of disposals made on or after 6 April 2019, a new regime applies that, subject to limited exceptions, taxes gains arising on disposals of shares in entities that derive at least 75 per cent of their value from UK land if the person making the disposal holds a substantial indirect interest in the land (generally at least 25 per cent). In addition, there are certain anti-avoidance rules that may operate to tax a gain realised on the disposal by a non-resident of shares that derive at least 50 per cent of their value from UK land if the main purpose of the acquisition of the shares was to realise a profit or gain.

Non-residents are subject to tax in the UK on gains arising on disposals of shares deriving the greater part of their value from petroleum production licences for the exploration or exploitation of oil and gas in the UK's territorial waters or continental shelf.

Avoiding and deferring tax

17 | If a gain is taxable on the disposal either of the shares in the local company or of the business assets by the local company, are there any methods for deferring or avoiding the tax?

If a UK company disposes of shares, the conditions for the SSE are not satisfied (see question 15) and the UK company stands to make a chargeable gain on the disposal, the UK company may be able to defer paying tax on that gain if the consideration for the sale comprises shares or loan notes:

- if the consideration comprises qualifying corporate bonds (QCBs) in the purchaser, the chargeable gain that the seller would otherwise have realised on the disposal will be held over until the QCBs are redeemed or sold and, at that point, the UK company is subject to tax on the held-over gain; and
- if the consideration consists of shares issued by the purchaser or loan notes that are not QCBs, any gain will be rolled over into those shares or loan notes. This is because those shares or loan notes would be treated as the same asset as the shares disposed of and the seller's basis in those shares or loan notes would be the same as its basis in the shares disposed of.

SLAUGHTER AND MAY

Gareth Miles
gareth.miles@slaughterandmay.com

Tanja Velling
tanja.velling@slaughterandmay.com

One Bunhill Row
London
EC1Y 8YY
United Kingdom
Tel: +44 20 7600 1200
Fax: +44 20 7090 5000
www.slaughterandmay.com

If a UK company disposes of business assets, tax on any chargeable gains arising from the sale of land, buildings and fixed plant and machinery can be deferred by claiming business asset rollover relief, provided the proceeds of the sale are reinvested in qualifying assets. The gain is effectively rolled over into the new asset, as the basis in the new asset is treated as reduced by an amount equal to the difference between the UK company's basis in, and the consideration received for, the old asset. Slightly different rules apply if the new asset is a depreciating asset. A similar rollover regime applies to the disposal of intangible assets.

UPDATE AND TRENDS

Key developments of the past year

18 | Are there any emerging trends or hot topics in the law of tax on inbound investment?

The uncertainty created by the ever more likely prospect of a no-deal Brexit looms large. If this prospect materialises, it will no longer be possible to rely on the Interest and Royalties Directive to eliminate UK withholding tax on interest. On a more positive note, a no-deal Brexit may prompt the UK government to enact measures that benefit inbound investment, such as a further reduction of the UK corporation tax rate.

The UK government has published draft legislation that will extend the stamp duty and SDRT market value rule to transfers of unlisted securities between connected companies with effect from the date on which the legislation is enacted. This is expected to be during the first quarter of 2020. The market value rule currently applies only in respect of transfers of listed securities between connected companies (see question 6).

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