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PRACTITIONERS' CORNER

Corporate Emigration From the United Kingdom

by Nick Thornton

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The United Kingdom's corporation tax system is a rare visitor to the front pages. Nevertheless, in recent weeks it has been making the news. Mainstream media interest has been generated by two announcements that London-listed, U.K.-headquartered businesses are, for tax reasons, moving to Ireland (or, more accurately, recommending to shareholders the creation of a new group structure with an Irish-resident ultimate holding company). Previously, it had been widely predicted that recent changes to the U.K.'s taxation of non-U.K.-domiciled individuals would lead to a significant migration out of the United Kingdom, and the recent corporate announcements have been seen as an extension of this potential trend.

Whether an exodus will occur remains to be seen. However, it doesn't seem likely that significant numbers of companies will follow Shire Pharmaceuticals and United Business Media (UBM) out of the United Kingdom in the immediate future. To the extent that other groups are considering a move, most can be expected to wait for the outcome of an ongoing consultation on the reform of the taxation of companies' non-U.K. profits before acting. Only then will it be possible for the potential long-term benefits of a move away from the United Kingdom to be properly assessed.

In any case, the U.K. is still a reasonably attractive place to locate a holding company. London is indisputably Europe's foremost financial center, and the U.K. tax regime for holding companies is not — currently, at least — grossly uncompetitive. There is no withholding tax on dividends, an excellent tax treaty network, an exemption for the disposal of trading subsidiaries by trading groups (the ''substantial shareholding exemption''), a (currently) relatively generous regime for the deduction of interest costs, and a headline corporation tax rate of 28 percent. The availability of advance rulings from HM Revenue & Customs has been expanded recently, and there is an exemption for non-U.K. dividends under discussion.

However, there is clearly concern about the planned overhaul of the existing controlled foreign company regime and interest deduction rules that may accompany the introduction of a dividend exemption.[1] The possibility of current taxation in the U.K. of passive income, such as interest or royalties, of non-U.K. subsidiaries is a particular worry. There is also uneasiness about the stability of the U.K. tax system, following recent legislative practice (with complex and apparently hastily drafted new legislation regularly hitting the statute books) and reports of an increasingly aggressive HM Revenue & Customs attitude toward taxpayers and perceived avoidance. Stamp duty is also a continuing source of annoyance for U.K. public companies.

So if a multinational, perhaps because it has significant non-U.K. passive income, is considering moving its holding company jurisdiction out of the U.K., how could this be achieved?

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[1] *See* ''Taxation of the Foreign Profits of Companies: A Consultation Document'' (June 2007) — *available at* http://www.hmrc.gov.uk/consultations/index.htm.

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True Migration

The U.K. tax system does allow U.K. resident companies to become non-U.K. resident. There are two alternative tests for U.K. residence to be considered by a would-be corporate emigrant, an incorporation rule and a central management and control rule, but even U.K.-incorporated companies can become non-U.K. resident if their central management and control is exercised outside the United Kingdom in the right circumstances. This can occur when such companies become tax resident in another jurisdiction with which the United Kingdom has a double tax treaty, that treaty has a residence tie-breaker, and, under that tie-breaker, the company would be treated as a resident of the other non-U.K. jurisdiction.[2]

So on the face of it, the easiest way to redomicile a U.K. holding company would be to transfer its central management and control to another jurisdiction, so that it becomes ''treaty nonresident.'' However, this apparently simple approach carries difficulties with it.

First, the place where the central management and control of a company is exercised is generally understood to be the place where its board of directors meets, although the matter is always a question of fact, and the place of board meetings is not in itself conclusive.[3] Great care would have to be taken to ensure that central management and control of the relevant entity was as a matter of fact exercised outside the U.K. A demonstrable change in decision-making procedure clearly would be necessary where central management and control had previously been exercised in the U.K. In practice, this may not be as easy as it sounds. It would also be necessary (in the case of U.K. incorporated companies) to ensure that the entity became tax resident in another treaty jurisdiction and that under the relevant tiebreaker provisions the entity would be treated as non-U.K. resident. This usually depends on the place of effective management, a different test from that of the place of central management and control.

Second, when a company ceases to be resident in the U.K. for tax purposes, it is under domestic U.K. tax law deemed for capital gains purposes to have disposed of all its assets for a market value consideration, triggering potential ''exit charges.''[4] (However, it may be that, on the facts, the substantial shareholding exemption would exempt any gains triggered.) Further, should the company also have a non-U.K. trade, it would also be deemed to have ceased that trade, again triggering potential tax charges.[5] Against the threat of these potential tax charges, it could be argued that when a U.K. resident company becomes resident in another EU member state, any attempt by the U.K. to levy the charges would be unenforceable because it is contrary to the principle of freedom of establishment in article 43 of the EC Treaty.

However, although the provisions of French and Dutch exit charges levied on individuals have been found to be in breach of that principle,[6] it remains unclear whether the U.K.'s corporate exit charge provisions are similarly unlawful. In this context, the 1987 European Court of Justice's *Daily Mail and General Trust* case[7] may be important. In that case, the taxpayer company was seeking a ruling that the refusal (under legislation that has now been repealed) of the U.K. Treasury to consent to the company's central management and control being transferred to the Netherlands was contrary to the principles of what is now article 43. In that instance, the court ruled against the company, and it would be dangerous now to disregard corporate exit charges on the basis that they are contrary to EU law.[8]

Some mention of the Societas Europaea, or European Company (SE), is worthwhile here. This newly legislated form of legal entity is permitted to transfer its jurisdiction of registration from one member state to another. Currently, U.K. companies cannot be reregistered outside the U.K. The conversion of an existing U.K. incorporated holding company into an SE,[9] and its reregistration in another member state together with a transfer of its central management and control to that state, could potentially strengthen arguments that such a migration should not be taxed by the U.K.[10]

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[2]Finance Act 1994, section 249. When the tiebreaker depends on agreement between the competent authorities, the rule in section 249 has effect only when an actual determination as to residence for treaty purposes is made. When the tiebreaker depends on an objective test, the rule in section 249 applies whether or not any claim for relief under the treaty has been made.

[3]*See* HM Revenue & Customs Statement of Practice on Company Residence, SP 1/90, for more detail of the official view on corporate residence.

[4]Taxation of Chargeable Gains Act 1992, section 185. There is also a similar rule in Finance Act 2003 Schedule 29 paragraph

(Footnote continued in next column.)

108 which applies in relation to intellectual property within the intangible fixed asset taxation regime.

[5]Taxes Act 1988, section 337(1)(b).

[6]*Hughes de Lasteyrie du Saillant v. Ministere de l'Economie, des Finances et de l'Industrie*, Case C-9/02; *N v. Inspecteur van de Belastingdienst Oost/Kantoor Almelo*, Case C-470/04.

[7]*R v. HM Treasury & CIR (ex p. Daily Mail and General Trust plc)*, Case 81/87.

[8]The *Daily Mail and General Trust plc* case was considered by the European Court of Justice in 2002 in its judgment in *Überseering BV v. Nordic Construction Company Baumanagement GmbH*, Case 108/00, and it was notable that although the decision was distinguished, there was no indication that it was vulnerable to being reversed.

[9]To be eligible, it must have had a subsidiary in another member state for at least two years.

[10]In particular, the *Daily Mail and General Trust plc* decision could be distinguished.

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However, the drafting of an amendment to the mergers directive that was implemented in connection with the establishment of the SE regime[11] is consistent with the view that the extent of EU-based exemption from exit charges on a transfer of registration may be limited.[12] Again, the position remains unclear.

Third, and potentially most significantly, transferring the central management and control of a U.K. incorporated holding company outside the U.K. is not in itself enough to avoid the potential application of the U.K.'s existing controlled foreign corporation regime to that company, as for the purposes of the CFC regime the ''treaty nonresident'' rule of Finance Act 1994 section 249 is disapplied.[13] As such, a ''true migration'' may not achieve what may be one of its key purposes — sidestepping the U.K.'s CFC charges.

New Holding Company

Rather than simply migrate their existing U.K. holding companies out of the U.K., both Shire and UBM have opted to reorganize their holding structures.

Under U.K. company law provisions facilitating ''schemes of arrangement,''[14] in each case the plan is that existing holding company (Oldco) shares will be cancelled and reissued to a new non-U.K. holding company (Newco), which will in consideration issue shares to the existing shareholders of Oldco. Such a reorganization should be tax neutral for U.K. shareholders, subject to an antiavoidance rule affecting any person holding, together with connected parties, more than 5 percent. Shire reports that it has been advised that this antiavoidance rule should not apply on the proposed transaction, although official clearance has not been sought. Whether this proposal is tax neutral for shareholders resident in other jurisdictions will vary from place to place. The cancellation of Oldco shares and issue of Newco shares should not attract a charge to stamp duty or stamp duty reserve tax.

Once Newco is in place, Oldco will presumably transfer one or more non-U.K.-resident subsidiaries to it, taking the taxation of those subsidiaries' profits out of the U.K.'s tax net, including the U.K.'s CFC regime (and whatever regime may replace it). If the group and subsidiaries are trading entities, then it is likely that the substantial shareholding exemption may well apply to the transfers to Newco, making them tax-exempt for Oldco.

Such a reorganization is not to be considered lightly. The need to avoid Newco having U.K. central management and control, referred to above, would be an issue just as it would on a pure migration. Assuming Oldco is listed, there would be a significant compliance burden involved in proposing and implementing the scheme of arrangement and listing the Newco shares. (For example, the public documentation for the Shire transaction runs to 418 pages.) The transfer of non-U.K. resident subsidiaries to an EU-resident Newco would involve a notification to HM Revenue & Customs, and importantly their transfer to a non-EU-resident Newco would be subject to U.K. Treasury consent.[15]

Nevertheless, it is clear that at least two groups have found these hurdles to be worth surmounting.

Where to Go?

Exiting the U.K. is of course only half of a plan. A new holding company jurisdiction would need to be found. This question poses tax and nontax issues.

For both Shire and UBM, Jersey was considered to have suitable company law, and a Jersey company will be used as Newco. Jersey has the advantage of being a relatively flexible jurisdiction, and also of being one that will not impose stamp duties on dealings in Newco.

As for a suitable jurisdiction for tax residence, relevant issues will include the rate of tax, the taxation of foreign subsidiaries, withholding taxes, the tax treaty network available, and stability. If there will be a significant number of U.K.-based directors of Newco, then geographical proximity to the U.K. will also be important if an appropriate decision-making process compatible with non-U.K. residence is to be established.

U.K. shareholders may be reluctant to sanction a scheme that will result in them receiving dividends from a non-U.K. resident company rather than a U.K. resident company, not only because there may be withholding tax issues, but also because for some classes of shareholder, U.K. tax treatment of the receipt may be

[11]1990/434/EC Title IVb, as inserted by Directive 2005/19/EC.

[12]Paragraph 1 provides that on the movement of an SE between member states, there shall be no tax on capital gains in the territory it is leaving on assets that remain effectively connected with a permanent establishment in that territory, but goes no further.

[13]Taxes Act 1988, section 747(1B).

[14]Companies Act 2006, section 895 to section 899.

[15]Taxes Act 1988, section 765. Transfers to companies resident in the European Economic Area would be subject to the notification rather than the consent requirement. This adds Norway, Iceland, and Liechtenstein to the European Union member states. The abolition of section 765 has been proposed by the government, and is expected to occur in 2009. Technically, HM Treasury could currently withhold consent and block the transfer of a subsidiary to a non-European Economic Area company, which makes the proposal of such transactions unattractive for the time being.

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less advantageous. To accommodate those concerns, an ''income access share'' arrangement may be built in to a new structure. This is designed to enable shareholders to elect to continue to receive their dividends from Oldco, or another U.K. resident member of the group, to the extent possible, rather than Newco. The arrangement may be structured so that a single income access share of Oldco is held by a trustee, with beneficial ownership of dividends on the share being owned by the electing shareholders and beneficial ownership of the share itself belonging to Newco. Both electing and nonelecting shareholders would receive the same gross dividend from the group. Each electing shareholder's entitlement to a dividend declared by Newco would be reduced to the extent that an Oldco dividend is also paid, but when the Oldco dividend is inadequate to satisfy the full entitlement of all electing shareholders they would receive a ''top-up'' Newco dividend. Both UBM and Shire are proposing income access share arrangements. The compatibility of such arrangements with the tax and company law regimes of Newco is another important issue for consideration at the planning stage.

Conclusion

What Shire and UBM have done by proposing a move to Ireland will clearly make it easier for other listed groups to follow suit. Only time will tell if significant numbers of other businesses consider that the possible tax savings are sufficient to justify such a move, and the as-yet uncertain outcome of the consultation on the taxation of foreign profits is likely to be an important factor. Further information on the government's plans in this area is expected over the summer. ◆

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