Ashurst London
April 2013

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Tax briefing

Choosing the UK as a headquarters location

More than half of the European headquarters of multinational groups are located in the UK. This briefing explains why, when allied to the numerous commercial benefits of the UK, recent tax changes make the UK the obvious choice.

What criteria are relevant?

Multinationals take into account a number of tax and non-tax factors in deciding where to locate their headquarter and holding companies. Principal among these are:

- a stable and consistent tax regime;
- proximity to customers, suppliers and markets;
- an educated workforce;
- a strong transport and IT infrastructure;
- a stable political environment;
- a business-friendly labour environment;
- a stable and strong currency;
- access to capital markets; and
- an internationally recognised legal system.

It has been the stated aim of the current Government to make the UK the most attractive destination for multinationals. The UK in general and London in particular rank consistently ahead of their European counterparts in satisfying all the criteria noted above.[1] Until relatively recently, the UK tax regime operated as a disincentive, when compared to the non-tax benefits of the UK and when compared to some tax regimes in European jurisdictions (Netherlands, Switzerland, Ireland and Luxembourg particularly). It had led to some multinationals choosing to redomicile abroad.

But significant changes have been made to the UK's tax regime, making it the most competitive in the G20 group of countries and precipitating increased inbound investment. According to the Financial Times (8 October 2012), at least 20 multinationals are drawing up plans to move their regional or global headquarters to the UK.

The UK's tax benefits

A low rate of corporation tax
The table below indicates the rate of corporation tax in the UK and the principal European countries. The UK has also committed to reduce its rate to 20 per cent by 2015.

Country	Rate
UK	23%
France	33.3-36%
Germany	30-33%[2]
Netherlands	20% for first £200,000 25% over £200,000
Italy	27.5%[3]
Luxembourg	29.22%
Spain	30%

This means that the UK rate of corporation tax provides one of the most competitive rates in Europe.

A large double tax treaty network
The UK has the most extensive network of double tax treaties of any jurisdiction, which means that

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the need to use sub-holding companies to minimise tax leakage on interest/dividend/royalty flows from overseas jurisdictions can be minimised.

A capital gains exemption

Prior to 2002, there was no equivalent to the European "participation exemption" in the UK, and gains from the sales of subsidiaries were subject to UK corporation tax. Tax relief in the form of the substantial shareholdings exemption (SSE) is now available where throughout a continuous 12-month period beginning not more than two years before the sale, the company selling the shares held a "substantial shareholding" (generally, a 10 per cent or greater interest) in the company whose shares were sold, subject to various additional conditions being satisfied, the principal of these being that the company being sold is a trading company or a holding company of a trading group. The company being sold may be a UK company or a foreign company and may even be resident in a tax haven as there is no "subject to tax" test.

The table below shows the existence of other capital gains participation regimes in Europe.

Country	Exemption
France	Gain is 90% exempt, subject to conditions
Germany	Gains are effectively 95% exempt
Netherlands	Gain is exempt, subject to conditions
Italy	Gain is 95% exempt, subject to conditions
Luxembourg	Gain is exempt, subject to conditions
Spain	Gain is exempt, subject to conditions

Similar participation regimes are also found in Sweden, Norway, Malta and Austria.

The UK regime is therefore particularly attractive, in that it offers relief against 100 per cent of the gain.

A dividend received exemption

Coupled with the availability of SSE on capital gains, the specific exemption for all UK dividends was removed in 2009, and there is now a new regime which exempts dividends from UK tax whether from a foreign source or UK if the dividend falls within an exempt category. This presents a better position for dividends paid by a subsidiary than that found in the various participation exemptions available in other European jurisdictions, of which many only exempt 95 per cent of the dividend paid.

An exemption for foreign branch profits

Colloquially known as the exemption for foreign branch profits, legislation introduced in 2011 provides an exemption from UK tax of the profits of a UK company's foreign permanent establishment. The exemption includes chargeable gains which are relevant in the calculation of the total taxable profits of the company, unless that company is close. The amount of profits which are exempt are those which are attributable to the permanent establishment pursuant to the relevant double taxation treaty with the jurisdiction in which the permanent establishment operates.

The exemption, which is optional, is claimed by way of an irrevocable election, and the adjustments necessary to exclude the foreign branch profits are made in the calculation of the total taxable profits of the company for the relevant accounting period. Once an election is made, it applies to all subsequent accounting periods and all foreign permanent establishments of the company.

There are specific rules that prevent the artificial diversion to an exempt permanent establishment, and from 1 January 2013, the exemption cannot be applied to "diverted profits". These are, largely, profits which pass through one of the CFC charge gateways (see below) where none of the CFC exemptions apply. In particular, profits attributable to a foreign territory where the rate of tax is less than 75 per cent of what would be payable by way of corporation tax in the UK cannot benefit from the exception, unless a motive test is satisfied.

Deductibility for financing expenses

There are no specific provisions which deny a company a deduction for interest expense on debt used to finance the acquisition of participations in subsidiary companies whether UK or foreign, even though the dividend income from those participations will generally be exempt from UK tax. The UK does have thin capitalisation provisions as part of its transfer pricing regime and some specific targeted anti-avoidance rules but these are less

prescriptive and generally less onerous than regimes in the main European jurisdictions. Interest paid on an arm's length amount of debt incurred for commercial purposes will generally be tax deductible.

An absence of withholding taxes
There are no withholding taxes on outbound dividends paid. This is a major distinction between the UK and most main European jurisdictions and a major attraction of the UK. Although withholding tax is payable in the UK on payments of interest, there are a host of exceptions which may mean that no withholding is required. In the context of headquarter companies in the UK, any interest paid by the company is exempt from withholding tax if it is paid on an advance from a UK bank, it is paid on a quoted Eurobond or it is paid to a UK tax resident company. An extensive double tax treaty regime and the availability of the EU Interest and Royalties Directive mean interest withholding tax should not be an issue.

Withholding tax applies on the payment of royalties, but the UK has implemented the EU Interest and Royalties Directive. This means that where the UK company making the payment reasonably believes that the payment is exempt from income tax by virtue of the recipient beneficially entitled to the payment being an EU company which is a 25 per cent associate of the paying company, the UK company can make the payment free from withholding.

The most favourable tax regime for international executives
International executives can benefit from the use of the remittance basis, which only charges their foreign earnings to UK income tax to the extent that they are "remitted" to the United Kingdom. Broadly, this means that foreign income and gains which are not used in the UK and remain offshore, are not taxed in the UK. UK-based earnings are still chargeable to UK income tax, no matter where they are received by the executive or in which tax year.

A business-friendly labour environment is one of the undoubted non-fiscal benefits of siting a headquarters and holding company in the UK

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Further, legislation was introduced in the Finance Act this year which means that foreign income or gains remitted to the UK for the purposes of investing in a qualifying investment are not treated as remitted. Qualifying investments include commercial investments into UK trading, stakeholder or holding companies, subject to the satisfaction of various conditions.

The remittance basis is therefore one of the principal tax benefits that attracts multinationals and their senior personnel to the UK.

A reformed controlled foreign corporation regime
The Finance Act 2012 has introduced a new controlled foreign company (CFC) regime that produces a tax system based on territoriality, and captures only foreign profits which are artificially "diverted" from the UK.

The regime operates to apportion income attributable to, for example, a UK company's subsidiary, back to the UK company. To be considered a CFC, the subsidiary would be tax-resident in a foreign jurisdiction, controlled by a UK person, and the tax payable by the subsidiary would be less than 75 per cent of the hypothetical tax that would be payable by the subsidiary in the UK.

A CFC charge only arises, however, where the profits of the CFC pass through one of the "CFC charge gateways" (without the benefit of an applicable exclusion) and where none of the specific exemptions are available. The gateways are, in essence, a test to assess whether the profits of a CFC are commensurate with its own activities or whether they have been artificially diverted from the UK; where there is no artificial diversion, the profits will be outside the scope of the regime. Along with the gateways and exemptions, there are also safe harbours by which if the necessary conditions are met, those profits are excluded from passing through the charge gateway.

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In particular, exemptions are available where:

- the CFC is resident in an excluded territory and satisfies various other conditions including having profits not exceeding a certain threshold;
- profits of the CFC are below a certain amount[5]; or
- profits are less than 10 per cent of the CFC's operating expenditure,

provided that in all cases to benefit from the exemption, the company must not fall foul of the particular targeted anti-avoidance tests which attach to each exemption.

It is the focus of the regime on UK activity, and whether or not profits are artificially diverted out of the UK, which fits with the move of the UK to a more territorial regime. If a foreign subsidiary does not have any such artificial diversions in place, all of its business profits will be outside the regime's scope. The UK's CFC rules should therefore constitute much less of an obstacle than previously for overseas-based multinationals looking to relocate to the UK.

Patent box

The introduction of a patent box regime for royalty income from patents and "embedded" income included in the price of patented products will enable eligible companies to elect to apply an effective 10 per cent corporation tax rate to profits realised from patents from 1 April 2013. This is intended to attract the relocation of high tech industries to the UK where value derives from the creation and exploitation of patents.

Conclusion

The recent initiatives to uprate the UK's tax regime complement the undoubted non-fiscal benefits of siting a headquarters and holding company in the UK. To find out how we can assist overseas-based businesses looking to relocate to or invest in the UK through the provision of legal and tax advice, feel free to contact any of the partners listed below or your usual Ashurst contact.

Notes:

1 See www.ukti.gov.uk.
2 This represents the effective rate. The corporate tax rate is 15 per cent plus a municipal trade tax ranging from between 14 per cent and 17 per cent and a solidarity surcharge of 5.5 per cent.
3 Plus regional tax on productive activities, generally around 3.9 per cent.
4 This represents the effective rate including national corporate income tax, municipal business tax and a contribution to the unemployment fund.
5 £50,000, or assumed taxable total profits or accounting profits are over £500,000 but the amount of profits representing non-trading income is below £50,000.

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