Information Sheet No. 15

UK Tax Residence Certificates - New Policy

A. GENERAL INFORMATION

1. UK Tax Residence Certificate

The UK company is a popular vehicle for the transaction of international business due to the highly developed services sector, the availability of a large number of Treaties for the Avoidance of Double Taxation, and the reputability it enjoys as an international business and financial centre.

It is also a popular jurisdiction for international tax planning. One reason for this is that by using a UK company, no or low withholding taxes apply on payments made from a taxpayer to a company resident in the UK. To access such low or no withholding taxes under the applicable Double Tax Treaty, the tax authorities from the payer's jurisdiction normally require evidence that the payee is fiscally resident in a treaty country. Hence the demand for certificates of tax residency from the UK Inland Revenue.

Circumstances in which HMRC will certify that a company is resident of the UK for the purpose of double taxation agreements entered into by the UK, can be found in *INTM162031: UK residents with foreign income or gains: double taxation relief - claims and procedures - certificates of residence and companies.*

Furthermore, if someone is asked to certify that a company is UK resident, it will need to know the use to which such a certificate will be put before providing it. Further information regarding this subject can be found in HMRC International Manual ITNM162032.

Inland Revenue's Policy

Until recently the Inland Revenue was forthcoming in providing applicants with certificates of tax residence provided that the company in question was indeed resident for tax purposes in the UK.

HMRC's International Manual 162032 provides detailed information on this subject.

Inland Revenue Guidelines

The Inland Revenue stipulate in their article that tax residence certificates will henceforth only be issued for the purpose of implementing the provisions of Double Tax Treaties.

Two conditions must be met before such a certificate is issued. The first is that the company is indeed a tax resident of the UK and the second is, in the case of the receipt of dividend, interest or royalty, the beneficial ownership of that income must lie with the UK company.

Whereas the first condition was not a novelty, the second condition was specifically included to avoid the circumstances where UK agency or nominee companies are in receipt of income to which an offshore principal is beneficially entitled. The article states:

"For example ... a residence certificate will not be given if the profits or income in question are not profits or income of the UK company concerned.

This will be the case if, for example, the UK company acts as an agent for another person rather than as a principal. We have also seen cases where a UK company has lent its name to a transaction when the beneficial owner of the profits or income resulting from that transaction is a different person.

It would be wrong for us to certify the resident status of a UK incorporated company if the certificate is likely to be used to support a claim to relief from another State's tax in such circumstances, since the proper person to claim such relief is the person who is the beneficial

owner of the income. This would be the case even if the UK company was rewarded by the other person, for example by a payment of commission or for the use of its name, since this would not be the income that was the subject of the claim under the Double Tax Treaty. It would also be wrong to certify UK residence if we have insufficient information to form a view on whether the profits or income concerned are profits or

income of the UK company or not."

This new policy will undoubtedly create problem for clients using the UK agent – offshore principal structure
since they will no longer be able to obtain tax residency certificates for the UK company in order to claim relief in the payer's jurisdiction.

Alternative

The solution lies in redefining the relationship between the UK company and the offshore principal. Under a new arrangement, the prior offshore principal becomes a subcontractor and the UK company becomes a contractor, acquiring thus contractual liability and acting as principal and not as agent or nominee.

In accordance with the sub contract agreement concluded between the two parties, the UK company agrees to pay a stipulated proportion of the revenue it receives as a finder's fee to the offshore sub contractor. This appears as a trading deduction in the UK company's accounts.

So, if the sales revenue of the UK company is 500.000 UK Sterling pounds and its profit is 200.000 UK Sterling, say 90% is due to the offshore subcontractor, the net profit in the UK is 20.000 UK Sterling. This is subject to taxation and the tax liability in the UK is 2.375 UK Sterling.

Since the whole sales revenue of 500.000 UK Sterling is beneficially owned by the UK company and reported as such in its trading account, there is treaty protection for this income and an application for a tax residence certificate will be granted.

To avoid transfer pricing difficulties, the UK company should be independently owned with respect to the offshore subcontractor.

B. TREATY NON-RESIDENT COMPANIES

Where a company is dual resident and;

- There is a Double Taxation Treaty (DTT) between the UK and the other country containing a residence tie-breaker for companies and;
- Under that tie-breaker, residence is awarded to the other country,

The company can now be called 'Treaty Non-Resident' (TNR).

The purpose of the TNR rules is to ensure that no mismatch arises between a company's residence status under domestic law and the relevant treaty.

How to deal with treaty non-residence cases

Cases will fall into two categories.

First, a company may claim that CTA09/S18 applies to exempt profits from tax. In these cases, the company should obtain a certificate of residence from the overseas authority and enable HMRC to satisfy itself that the company should be regarded as resident in the other country under the tie-breaker. Efforts should be made to find out where the business of the company is being carried on and if the facts support the claim that the business is carried on in the other country, the claim may be accepted.

Where the business is carried on in a third country, HMRC will need to be satisfied that the place of effective management is not also in that country, rather than that in which the company is a dual resident of with the UK. This may be the case, for example, in the one man incorporated type of business where the shareholder/director is conducting the business. If the company refuses to provide sufficient details to enable an informed decision as to the location of its place of effective management to be made, it will be impossible to establish that CTA09/S18 should apply and so the company should continue to be treated as a UK resident subject to the normal filing rules.

Second there will be cases where the company is claiming or surrendering relief as a UK resident, typically for losses made outside the UK, but is still considered that CTA09/S18 should apply. In the past, the central management and control of loss-making subsidiaries may have been brought to the UK simply to establish UK residence for group relief purposes. This result will be more difficult to achieve as a company would also have to demonstrate residence in the UK under the tie-breaker in the treaty.

Compliance considerations

When considering TNR cases it is important to check the wording of the residence article in the relevant treaty. Where it contains a non-standard tie-breaker based on bilateral discussion the outcome of any enquiries will be subject to agreement by the Competent Authorities. CTIAA, Double Tax Treaty Team should be consulted before opening enquiries into such cases. Where open enquiries already exist, contact Business International before issuing a closure notice.

Similarly where it is accepted that CTA09/S18 applies, such acceptance is necessarily subject to the outcome of discussion between the Competent Authorities where the relevant DTA contains a non-standart tie-breaker.

Place of effective management

Effective management will normally be located in the same country as central management and control but may be located at the company's true centre of operations, where central management and control is exercised elsewhere. The place of effective management is defined as:

'The place where key management and commercial decisions that are necessary for the conduct of the entity's business as a whole are in substance made. All relevant facts and circumstances must

be examined to determine the place of effective management. An entity may have more than one place of management, but it can only have one place of effective management at any one time'.
Other effects of the TNR rules
Where a company is resident in the UK, the tax consequences of non-residence apply in the normal way. Where the company's only connection with the UK has been UK incorporation then, where the CTA09/S18 DTT applies, the file may be closed. The company should be reminded to notify HMRC if it ceases to be resident for treaty purposes in another country under the the tie-breaker in the treaty between the UK and that other country. In that event, it would become resident by virtue of UK incorporation.

NOTES:

The above is intended to provide a brief guide only. It is essential that appropriate professional advice is obtained. P.G. Economides & Co Ltd will be glad to assist you in this respect. Please do not hesitate to contact us.

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