Tax on Inbound Investment 2022

Contributing editors
Will Smith and Peter North
White & Case LLP

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Lexology Getting The Deal Through is delighted to publish the sixteenth 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 Chile and Greece.

Lexology Getting The Deal Through titles are published annually in print. Please ensure you are referring to the latest edition or to the online version at www.lexology.com/gtdt.

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, Will Smith and Peter North of White & Case LLP, for their assistance with this volume.

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Introduction

Will Smith and Peter North

White & Case LLP

We are pleased to present the 16th edition of *Lexology Getting The Deal Through – Tax on Inbound Investment*.

This updated volume comprises a user-friendly set of tax guides for inbound investment into 15 of the world's key capital importing jurisdictions, presented in a Q&A format for ease of use and comparison across potential options. This should serve both tax and finance professionals alike who require up-to-date and accurate summaries of the fundamental tax considerations on which tailored advice that maximises the tax effectiveness of planned inbound investment may be sought.

We trust that readers will find this a timely update in light of the tax and investment environment existing in 2021, which among other factors is particularly notable to tax professionals for reasons we now summarise below.

Though global foreign direct investment (FDI) on an annual basis regularly exceeds flows of US$1 trillion, it is understood that 2020 was a comparatively challenging year for FDI with global flows materially decreasing by an understood 35 per cent (from US$1.5 trillion to US$1 trillion) because of the impact of the covid-19 pandemic. Within this global picture, it is understood that the fall was heavily weighted towards developed economies (source: UNCTAD's World Investment Report 2021). Looking to 2021 and beyond, it is expected that FDI will start to rebound with an increase (on a global basis of between 10 to 15 per cent), with a focus on Asia and expected uncertainty around areas such as Africa, Latin America and the Caribbean.

Both the uncertainty and investment challenges created by the covid-19 pandemic provide important context to the role that tax does, and will, play in FDI. Virtually all national and regional governments remain focused on securing FDI; it is well understood that FDI can generate new jobs, bring in new technologies and, more generally, promote growth and employment. All of these are important when looking to manage the current situation, and then looking to expand the economy in the future.

To this end, national and regional governments continue to face a difficult balancing act. On the one hand, given the potential benefits that FDI brings, policy makers continue to re-examine their domestic tax rules to ensure they remain attractive for FDI. However, at the same time, the same policy makers need to balance the desire to offer a competitive tax environment with the need to ensure that an appropriate share of domestic tax is collected from multinationals and other investors.

As a result, domestic fiscal pressures continue to drive domestic tax change. For example, some jurisdictions may seek to lower statutory corporate tax rates; this tends to be a simple change, is very easy for investors to understand, and can lead to tax efficiencies when linked to broader tax changes. However, given that such measures can be expensive in terms of forgone tax revenues, other jurisdictions may seek to employ more targeted tax relief to promote investment in certain activities or geographies; for example, exemptions relating to holding companies or group service functions.

Further to any domestic drivers behind tax change, many jurisdictions are also taking into account wider international tax developments.

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Many readers will already be very familiar with the ongoing OECD Base Erosion Profit Shifting (BEPS) initiative and the impact this has had on both international and domestic tax planning. Further to this, the European Union has implemented a series of tax changes that have resulted in relatively material changes being made to the domestic tax systems of member states. Looking to the future, the OECD's continuing work on the Inclusive Framework on Pillar One and Pillar Two will likely result in further tax changes that may eventually include the taxation of operating income, investment income, interest income, dividends received and dividends paid.

Such changes substantially progressed between OECD member states already include new taxing rights to be asserted by 'market jurisdictions' over the residual profits of large 'consumer-facing' and digital services multinationals, and agreement in principle to a global minimum corporation tax rate of at least 15 per cent. Assuming, as currently planned, final decisions on the various design elements of each framework are made by October 2021 and consensus between member states is retained, we would expect significant upheaval in the domestic tax settings of signatories over the coming years as bespoke legislation to implement the frameworks are designed and enacted. However, stakeholders should not expect symmetrical approaches by each jurisdiction, which will add significant complexities; as with previous OECD BEPS projects (eg, Action 3 CFC Rules), it is likely members will interpret their public commitments as flexibly as possible to protect their own tax base and critical industries or, potentially, simultaneously enact additional rules that reduce the practical effectiveness of those frameworks, such as the repeal of digital services taxes or targeted reliefs for certain enterprises.

Beyond future changes, tax laws already enacted and the attitudes of tax authorities to multinationals are also posing present and ongoing challenges for FDI. For example, over recent years, fairly prevalent changes across the FDI space have included:

- ever-increasing restrictions on the ability to secure local tax deductions for interest paid on debt through interest limitation rules such as EBITDA-linked restrictions or similar unilateral measures that many jurisdictions have introduced to augment existing thin capitalisation and transfer pricing regimes;
- the introduction of wide ranging and complex 'anti-hybrid' rules (which can limit the ability to secure deductions for a range of payments) that can require taxpayers and authorities to investigate the tax treatment of upstream transactions not directly impacting the tax base in question;
- a wider range of domestic tax regimes that seek to tax non-resident investors' capital gains arising from the disposal of resident situs assets (interests in land, natural resources or other immovable property, as well as shares deriving the greater part of their value from such assets);
- aggressive audits over the cross-border arrangements of multinationals, with tax authorities evidently buoyed by the weight of popular opinion and political rhetoric demanding that overseas businesses should contribute more to the local tax take; and
- increased scrutiny of tax authorities towards the entitlement of enterprises to benefits conferred by tax treaties, particularly following BEPS Action 6, Prevention of Tax Treaty Abuse and several landmark Court of Justice of the European Union rulings on beneficial ownership. Such scrutiny requires that cross-border structuring that relies on claiming tax treaty benefits, or on directives agreed between EU member states, must do more to prevent such benefits from being denied (and costly tax disputes) by ensuring the structures contain sufficient economic and legal substance in the relevant jurisdictions.

Consequently, while market participants will undoubtedly seek to capitalise on the expected rebound in FDI flows now and in the immediate future, care must be taken to ensure any resultant investment decisions are informed by an understanding of both current tax laws as well as anticipated tax changes. Readers tasked with achieving this should find these and other issues reflected in more detail throughout each of the jurisdiction tax profiles presented in this volume.

We and our fellow contributing authors thank you for reading and hope you find the answers you need.

United Kingdom

Will Smith and Peter North

White & Case LLP

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?

Broadly, an arrangement to acquire company stock is more likely to be tax advantageous for the seller, whereas an arrangement to acquire business assets is more likely to benefit the buyer.

Acquisition of company stock

UK-resident sellers are likely to prefer disposing of shares owing to the substantial shareholding exemption that can exempt the seller from tax on chargeable gains arising from the disposal. From the buyer's perspective, this may not be preferable because:

- tax liabilities of the target company will remain with the target company following an acquisition of shares in that company; and
- the target company's historic base cost in its assets is generally unaffected by the transfer of ownership of its shares (subject to de-grouping charge).

However, other tax attributes of the target company will also remain, which may be valuable to the buyer if, for example, they are carry-forward trading losses that will still be available to set off against future profits (this is subject to various restrictions and anti-avoidance rules).

The acquisition of stock should be exempt from VAT. Stamp duty/stamp duty reserve tax (depending on the method of transfer) charged at a rate of 0.5 per cent of the stampable consideration paid will apply.

Acquisition of business assets and liabilities

Tax attributes do not transfer with an asset purchase, which can be tax-efficient for the buyer as it allows:

- depending on the purchase price, an uplift in the base cost of those assets rather than a carryover of the seller's tax position; and
- the benefit of that uplift to be realised through increased claims for capital allowances in respect of expenditure incurred on plant and machinery (and certain other assets) and amortisation relief in respect of intangible fixed assets (excluding goodwill and customer-related intangible assets).

Unless the sale constitutes the transfer of a going concern, an asset sale may be subject to VAT, depending on the nature of those assets. The acquisition of assets other than land will not, however, be subject to stamp duty; the transfer of interests in land are subject to stamp duty land tax.

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?

When a buyer directly acquires business assets and liabilities from a third party (compared with company stock), the buyer's base cost in such assets should be the amount paid for such assets (plus the incidental costs of acquisition that can be capitalised), which can be greater than the seller's base cost in those assets.

This includes the acquisition of intellectual property and certain other intangible assets, for which amortisation relief in line with the purchaser's accounting treatment may then be claimed according to the purchase price. The acquisition of goodwill and customer-related intangibles are excluded from this, but for assets of this nature acquired after 1 April 2019 a fixed writing-down allowance at 6.5 per cent may be available.

A buyer's base cost may be different from the purchase price in the context of connected party transactions where market value overrides apply. However, these usually apply in the context of inadequate consideration (ie, where connected parties attempt to defer the seller's realisation of a chargeable capital gain), so would usually result in a step-up basis for the buyer.

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 is generally regarded as an attractive holding company destination owing to its stable economic, legal and political systems, as well as the following beneficial tax settings:

- the UK's current corporation tax rate of 19 per cent is below the OECD average and one of the lowest in the G20. However, the Chancellor of the Exchequer has confirmed this will increase to 25 per cent with effect from 1 April 2023;
- the UK has an extensive tax treaty network. This has become increasingly important post-Brexit: though Brexit has generally not impacted the UK's attractiveness as a holding company jurisdiction, from 1 July 2021 UK holding companies no longer benefit from the EU's Parent-Subsidiary and Interest and Royalty directives, which previously applied to exempt dividends, and interest and royalties respectively from withholding tax when received from other EU nations. UK holding companies will now need to rely on the UK's various tax treaties to relieve or reduce withholding taxes on these payment flows;
- the UK generally does not impose a withholding tax on dividends, and an acquisition company can usually benefit from a tax

exemption on dividends it receives. However, no tax deduction is available for the holding company for dividends paid to investors (though this is also uncommon elsewhere);
- subject to transfer pricing, anti-hybrid and other interest limitations, a UK acquisition company can claim deductions for the finance costs of acquiring the target company; and
- the substantial shareholding exemption will often apply to exempt the UK acquisition from tax on capital gains derived from a subsequent disposal of those shares.

When acquiring shares in a UK company, it will generally be preferable to a use a UK acquisition company. In addition to the points outlined above, the use of a UK acquisition company will allow for tax grouping with the UK target (which can provide for certain UK tax advantages). In addition, to avoid UK stamp duty being due on a future sale of the shares in the acquisition company, it is not uncommon to use an acquisition vehicle that is incorporated in the Channel Islands but tax resident in the UK.

With respect to asset acquisitions, it generally remains preferable to also use a UK acquisition company. This may assist with managing UK VAT on acquisition, but also reflects the fact that a non-UK acquisition company would often end up being subject to UK tax in any event (owing to the fact that the assets and related operations are located in the UK).

Company mergers and share exchanges

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

The UK does not allow for a form of merger. Further to this, the EU cross-border merger directive no longer has effect in the UK.

It is, however, common for an acquisition of a UK company to be implemented by way of a 'share-for-share' exchange (ie, the acquiring vehicle issues its stock to the target shareholders in consideration for the shares in the target). Many target shareholders often desire such an arrangement because they are generally able to exchange shares in the target for shares in the acquiring vehicle tax neutrally.

Tax benefits in issuing stock

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

Other than potentially facilitating a tax-neutral exchange for target shareholders, there is no tax benefit to the acquirer in issuing shares as consideration. In particular, the value of non-cash forms of consideration is still subject to UK stamp duty.

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?

The application of documentary and other transaction taxes differs between the acquisition of stock and business assets.

Acquisition of company stock

Either stamp duty or stamp duty reserve tax (SDRT), both charged at a rate of 0.5 per cent of stampable consideration paid, is chargeable on the transfer of existing company stock.

Stamp duty becomes payable only on presentation of a physical stock transfer form to HMRC for stamping and, therefore, is not strictly enforceable if the buyer does not elect for the stock transfer forms to be stamped. However, unless a physical stock transfer form is duly stamped, it cannot be presented as evidence in any civil judicial proceedings.

In contrast, SDRT is chargeable when an unconditional agreement to transfer shares is made. Therefore, unlike stamp duty, SDRT captures electronic share transfers, such as use of CREST, where there is no physical instrument of transfer. However, the SDRT charge is not normally paid. This is because, if stamp duty is paid on the stock transfer form 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 has already been paid, it would be refunded).

As of August 2021, HMRC is undertaking a review with a view to modernising the stamp taxes on shares framework.

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

Acquisition of business assets

The transfer of interest in land in England or Northern Ireland is subject to stamp duty land tax (SDLT). The top rate of SDLT is 5 per cent, applying to transactions where the consideration exceeds £250,000. No other stamp duties should apply to the transfer of business assets, unless these assets include an interest in a partnership (in which case stamp duty may be relevant if the underlying partnership assets include shares).

Depending on the nature of the assets transferred, VAT at a rate of 20 per cent may be chargeable unless the transfer meets the conditions for classification as a transfer of a going concern. However, 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?

The following commentary does not necessarily apply to banks or building societies, which are subject to separate rules.

Net operating losses

Net operating losses are subject to change-of-control limitations. These limitations only apply to carry-forward loss relief (ie, carry-back loss relief is not impacted).

Generally, no time limits apply to the carry-forward of losses. However, the anti-avoidance rules in Part 14 of the Corporation Tax Act, which are designed to prevent loss-buying, limit the ability of companies that have undergone a change in ownership to use, or surrender, losses that arose before that change. As a result, these pre-change losses may never be available to the acquiring group, or may not be available for the first five years after the acquisition.

From 1 April 2017, Part 14 may prevent the carry-forward of losses where there has been a change of ownership within three years before, or up to five years after, the losses were incurred and, inter alia, there is a major change in the nature or conduct of:
- the company's trade, or the company's trading activities become small or negligible;
- the business of the company, or of any related company that is transferred with it, or in the case of a company with investment business, there is a significant increase in the amount of the company's capital; or
- the company's UK or overseas property business, or the company's UK or overseas property business becomes small or negligible.

Part 14 is complex, and also includes additional rules relating to: surrender losses to other members of the acquiring group using group relief; transfers of chargeable gains by election; transfers of trade before changes of ownership; and shell companies.

In addition to Part 14, a variety of further rules apply to carry-forward capital and trade/income losses:

- Corporate loss restrictions:
  - From 1 April 2017, and subject to a de minimis of £5 million, most carried-forward income losses cannot set off more than 50 per cent of the otherwise taxable profits of a company (or group where relevant).
  - From 1 April 2020, relief for carried-forward losses may be restricted in a similar way to income losses; in other words, companies that derive chargeable gains can only offset up to 50 per cent of those gains using carried-forward capital losses. Furthermore, the annual £5 million deductions allowance must be shared between income and capital losses in proportions chosen by the company.
- Capital losses:
  - Pre-entry loss/anti-loss buying rules: where a specific tax avoidance test is satisfied, the benefit of capital losses on assets incurred by a company before joining or leaving a group are lost, and cannot even be applied to gains realised on assets owned before the change of ownership.
  - Loss-streaming rules: where the specific tax avoidance test is not met, capital losses can only be set off against either assets owned by the company before it joined the group, or assets acquired for the purposes of the company's pre-existing trade or business.
- Pre-1 April 2017 trading losses:
  - Subject to similar streaming rules as capital losses; carry-forward trading losses cannot be used by other companies in the same group and can only be applied against profits from the same trade. Subject to the corporate loss restrictions discussed above, post-1 April 2017 trading losses can be used more flexibly, insofar as they can be used by other companies in the same group and applied against profits from different trades.

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?

Deductions against corporation tax are available in respect of corporation interest expenses generally, subject to a series of restrictions and general anti-avoidance rules. These include:

- corporate interest restriction: the UK has enacted a corporate interest restriction based on earnings before interest, tax, depreciation and amortisation (EBITDA) that applies to a company (or group where relevant) with more than £2 million in UK net interest expenses. Pursuant to this rule, corporate interest deductions are limited to 30 per cent of a group's UK EBITDA (fixed ratio rule). Furthermore, the group's net UK interest deductions cannot exceed the global net third-party interest expense of the group (modified debt cap);
- UK anti-hybrid rules: the UK has enacted a suite of complex anti-hybrid mismatch rules as part of its participation in the OECD BEPS programme. These rules may apply to deny deductions for interest expenses where there is no corresponding interest income realised by the lender (deduction/no inclusion mismatch) or another entity is also eligible to claim deductions in respect of that same interest payment (double deduction mismatch). Generally, the rules only apply to arrangements between connected parties, or where the arrangement is enacted to achieve the benefit of a hybrid mismatch (structured arrangement); and
- transfer pricing and thin cap regime: if funds are borrowed or guaranteed from a connected party, the UK's thin capitalisation rules (which sit within the transfer pricing regime) will generally limit interest deductions to the level of deductions that would have arisen had the borrowing been an entirely third-party arrangement. This requires consideration of the quantum of debt, interest rate and other terms that would have been agreed between the borrower and third-party lenders or guarantors.

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?

Acquisition of company stock

Purchasers will generally seek to negotiate/include a tax covenant (or indemnity) and a suite of tax warranties in share acquisition arrangements.

The tax covenant will generally seek to protect the buyer from historic tax liabilities of the target company (and secondary tax liabilities and other specifically identified risks). The tax covenant can be contained in a separate document that is executed as a deed, or included in the share purchase agreement itself. Though it will be subject to various limitations, a tax covenant provides stronger protection than warranties, as the buyer does not need to show loss to make a claim.

Tax warranties can elicit information about the target company. However, if the seller breaches the warranty and the purchaser suffers loss as a result, this breach can form the basis of a breach of contract claim by the purchaser.

Acquisition of business assets

Fewer warranties and no tax covenant will be given on the acquisition of business assets given that the seller's tax liabilities and attributes remain with the seller.

Warranty and indemnity insurance

Warranty and indemnity (W&I) insurance can provide cover for losses arising from a seller's breach of the tax warranty and for claims under the tax covenant. These policies are becoming increasingly common on share acquisitions, and will be necessary in the event the seller requires a 'zero recourse' arrangement whereby it has no residual liability under the sales and purchase agreement (SPA) (eg, because the seller is a private equity fund that intends to immediately distribute all disposal proceeds and then liquidate).

The coverage available under W&I insurance is often subject to strict limitations and will generally not extend to the full suite of warranties or full scope of the tax covenant that an agreement will usually include. For example, coverage for liabilities arising from transfer pricing or secondary tax liability is typically excluded or only available at additional expense.

Recovery under the tax warranties or tax indemnity

To prevent tax on receipt and withholding obligations, the SPA should provide that such recoveries should be made by the purchaser itself as an adjustment to the purchase price (compared with recovery by the

target company). In this instance, taxable receipts should only arise where the quantum of a warranty or indemnity claim exceeds the purchase price (a tax liability that can covered by the standard buyer-friendly gross-up obligation in SPAs).

POST-ACQUISITION PLANNING

Restructuring

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

The nature of post-acquisition restructuring will largely depend on the nature of the acquirer's existing business and the nature of the target company. Common considerations driving the need for restructuring include:

- whether the target company's operations are similar to the acquiring business, such that they will be fully integrated into the same value chain, compared with being retained as a separate standalone business;
- whether the acquirer intends to retain the entirety of the acquired business or seek to dispose of certain parts of it in the immediate or medium term; and
- the extent of pre-transaction entity rationalisation that had already occurred pre-transaction or needs to occur post-transaction; in other words, winding up otherwise dormant finance and special purpose vehicle companies that were incorporated for the present or previous acquisitions.

In all cases, restructuring will be undertaken so that the resulting corporate structure is easy to administer (ie, reducing compliance expenditures payable for each active company) and minimises tax leakage (ie, reducing quantum of both domestic transactions between entities not in the same tax-consolidated group and cross-border transactions subject to withholding tax). Tax-efficient transactional arrangements may also be implemented, such as ensuring that each entity is financed by debt up to its maximum deductible allowance and maximises available deductions elsewhere such as through intercompany royalty or sale and leaseback arrangements.

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?

Achieving tax-efficient spin-offs is possible but may be complex depending on the existing tax attributes of the relevant companies and their existing corporate structure. However, in broad terms, tax-efficient spin-offs can be achieved through reliance on the various reliefs and exemptions available to UK-resident shareholders:

- reorganisation treatment and rules exempting intra-group asset transfers can enable capital-reduction demergers to be tax neutral. However, tax neutrality for capital-reduction demergers requires that:
  - the demerger is not being implemented in preparation for the disposal of either the demerged or retained businesses; and
  - the demerged or retained businesses are carrying on trading activities; and
- where the relevant conditions are satisfied, a direct dividend demerger involving the intermediate parent's distribution of shares in a subsidiary to its own parent can be treated as an exempt distribution.

In either instance, trading losses may be preserved provided care is taken not to breach the change of ownership restrictions on trading losses in Part 14 of the Corporation Tax Act 2010.

Depending on the demerger steps, it may be possible to mitigate the application of stamp duty through transferring shares for no consideration, implementing a share cancellation scheme or through reliance on stamp duty reconstruction relief.

Migration of residence

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

Migration of UK tax residence

The migration of UK tax residence will always require that a company does not have its centre of management and control in the UK (ie, the highest level of decision-making in the company takes place outside the UK):

- where a company is tax resident in the UK because it is incorporated there, residence can only be migrated to another jurisdiction if, similar to the UK, that jurisdiction treats an entity as tax resident there if it is centrally managed and controlled there, and it has a double tax treaty with the UK that, if both jurisdictions assert residency, contains either a residence tiebreaker or mutual agreement procedure that prioritises the place of effective management and control over the location of incorporation (as per the OECD Model Tax Convention); and
- where a company is only tax resident in the UK because it is managed and controlled there, UK residence can be terminated by moving that management and control elsewhere. In this instance, whether residence is migrated to the new location of management and control will likely depend on if the company is also incorporated in that location and, if not, whether there is a double tax treaty between the incorporation state and new location of management and control.

Whether an entity is centrally managed and controlled from the UK or elsewhere is a question of fact. From the UK's perspective, in resolving questions of residency, HMRC and the courts will usually look to:

- where the majority of directors physically reside or are tax residents;
- where the majority of board meetings and strategic decision making occurs; and
- whether decisions made in one jurisdiction are circumvented by decisions made elsewhere.

Various corporate controls can be put in place to manage this, depending on the preferred residency location for an entity.

Tax consequences of migration

The UK imposes an exit charge on companies ceasing to be UK resident. Broadly, the company is treated as having 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. This exit charge may, however, be deferred on any assets that remain within the charge to UK corporation tax; that is, assets that are attributed to a UK permanent establishment of the migrating company. The substantial shareholding exemption may also apply to relieve tax on the deemed disposal of any shares held by the migrating company.

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

In general, for all other loans longer than one year, the UK imposes withholding tax (WHT) at a rate of 20 per cent on interest payments with a UK source.

The UK does not impose WHT on loans capable of being outstanding for less than one year (short interest). In addition, there are various domestic exceptions to withholding obligations on longer loans, including, inter alia:

- the recipient or beneficial owner of the interest is a UK-resident company or permanent establishment that is subject to UK tax on that income;
- the interest is paid by a bank in the ordinary course of its business; or
- the interest is paid on a quoted Eurobond or qualifying private placements.

Payments of interest to EU countries were previously exempt from WHT by the Interest and Royalties Directive, but this was repealed with effect from 1 June 2021. For these outbound interest payments, companies must now rely upon the WHT provisions in the double tax treaty entered into with the relevant EU member state to reduce or eliminate UK WHT, consistent with the position of payments to non-EU member states.

Dividends

The UK does not impose WHT on dividends unless dividends are paid by UK real-estate investment trusts. In this case, dividends are subject to WHT at a rate of 20 per cent if paid to non-resident shareholders, which can be reduced by double tax treaties.

Royalties

The UK imposes WHT at a rate of 20 per cent on any royalties paid in respect of intangible assets (patents, copyright, design, model, plan, secret formulas, trademark, brand names and know-how). However, no withholding obligation arises where the recipient or beneficial owner of the royalty is a UK resident company or permanent establishment that is subject to UK tax on that income.

Similar to interest payments, royalties paid to EU member states no longer benefit from the Interest and Royalties Directive and therefore such relief is limited to the UK's tax treaty network.

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 through a variety of means, including dividends, interest and royalty payments, and other intercompany arrangements such as service fees.

As a base case, though not deductible for corporation tax purposes, the UK generally does not impose WHT on dividends. In contrast, though tax deductible (tax benefit equal to 19 per cent), WHT applies to both interest and royalties at a rate of 20 per cent. Therefore, at a high level both payment streams result in similar net tax burdens for the company (ie, because the 20 per cent withholding tax is largely offset by the 19 per cent tax deduction). However, further considerations are necessary:

- payment of dividends is subject to various company law requirements such as solvency tests, and therefore may not always be available. It is also more difficult to stream dividends to a particular recipient; and
- the UK's double tax treaty network may reduce or eliminate the headline 20 per cent withholding rate applied to both interest and royalty payments, which can result in these being more tax efficient. However, limits on the quantum of interest and royalties are imposed by the UK's thin capitalisation, transfer pricing and anti-hybrid rules.

As an alternative to dividends, interest or royalties, in certain circumstances intercompany arrangements such as service fees may be the most tax-efficient method of repatriating funds from the UK. This is because such payments are generally deductible and usually not subject to either withholding tax, thin capitalisation or anti-hybrid rules. Such payments usually form the basis of common transfer pricing-driven structures, where an entity's quantum of taxable profits is reduced to a target level through these payments. However, such structures clearly depend on the UK entity receiving sufficient value from entities outside of the UK (eg, management services), for which such payments can be made without breaching the UK's transfer pricing rules.

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?

UK corporate sellers will usually prefer to dispose of shares and rely on the substantial shareholding exemption (SSE) to exempt from corporation tax any chargeable gains realised from that disposal. The SSE applies to the disposals of shares in both UK resident and non-UK resident companies, subject to a number of exceptions.

However, because the SSE can also prevent a capital loss from arising to the seller, which could be used to offset future chargeable gains, a seller may prefer to dispose of assets if this is expected to result in the realisation of a loss.

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, unless the shares derive their value from underlying UK land or UK petroleum production assets.

Gains arising from the indirect disposals of interest in UK land (ie, the disposal of shares in entities that derive at least 75 per cent of their value from UK land) are subject to capital gains tax if the person making the disposal holds, or has held in the past two years, a 25 per cent or greater interest in the company.

Non-residents are subject to UK tax on gains arising from the disposals of shares that derive 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. This tax liability may, however, be relieved under a double tax treaty or the SSE if certain conditions are met.

Mitigating 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 mitigating the tax?

The primary relief available is the SSE, which, subject to certain conditions being met, will relieve a shareholder from tax on any chargeable gain realised on the disposal of shares. An annual exemption also applies to exempt individuals and trusts from a tax on gains up to a certain amount accruing in a year of assessment.

Beyond this, it is only possible to defer the instance of chargeable gains. For example:

- roll-over or re-investment relief can defer chargeable gains from arising on the disposal of certain business assets (land and buildings and fixed plant and machinery) if the proceeds of that disposal are reinvested in qualifying assets;
- group relief can defer chargeable gains from arising where the asset is transferred between UK-resident members of the same corporate group;
- various reconstruction and reorganisation reliefs are available if the consideration for the disposal of shares is shares or securities in another company; and
- the use of qualifying corporate bonds (QCBs; assets that represent a loan relationship if owned by a company) as consideration will defer the realisation of any gains on disposal until such QCBs are redeemed or sold.

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?

Owing to the increased restrictions on interest relief, as well as the impact of the anti-hybrid rules, the ability to efficiently utilise debt funding has become more challenging.

In addition, partly because of the changes to the taxation of non-resident investors in UK land as well as increased scrutiny of off-shore acquisition vehicles, there has been a greater number of UK acquisition vehicles.

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