Tax aspects of proposed UK corporate re-domiciliation regime: time to make a move?

The UK government recently published a consultation seeking views on the introduction of a new UK corporate re-domiciliation regime. While the proposals primarily require changes to the UK corporate law regime, one of the drivers for the proposals is to assist groups wanting to come to the UK by helping to avoid the need to undertake transactions which might have adverse tax implications.

The consultation also asks questions about the UK tax consequences of the proposals. Areas for consideration include the relationship between domicile and residence, impact on realised losses, latent losses and latent gains, amortisation, SDRT and source.

As part of the Autumn Budget 2021, the UK government published a consultation seeking views on the introduction of a new UK corporate re-domiciliation regime. The domicile of a company is typically the jurisdiction under whose laws that company is incorporated or registered. Corporate re-domiciliation is the process whereby a company transfers its domicile from one jurisdiction to another whilst maintaining or continuing its legal identity as a corporate body (hence this process is also referred to as a "continuation" in some jurisdictions). While the proposals primarily require changes to the UK corporate law regime, it raises interesting questions about the tax consequences of this proposed regime and we explore a number of these below.

A company incorporated in the UK cannot currently re-domicile to another country (an "outward re-domiciliation") in this pure sense (including internal intra-UK re-domiciliation, for example from England and Wales to Scotland) as this is not provided for under the Companies Act 2006. Neither can a company incorporated outside the UK re-domicile to the UK (an "inward re-domiciliation"). Currently, this sort of direct re-domiciliation can only be done by submitting a private members bill to Parliament - which is not a straightforward process.

Part of the rationale for the re-domiciliation proposals is to bring the UK in line with other jurisdictions that already cater for corporate re-domiciliation regimes, including Luxembourg, Switzerland, Canada and some US states such as Delaware. Differing approaches have been taken to re-domiciliation regimes in other jurisdictions. Some are wide-ranging in terms of scope and allow both inward and outward re-domiciliation, however, some are more restricted, including the Irish regime which only caters for inward re-domiciliation of investment funds from a restricted list of jurisdictions. Hong Kong is also in the process of introducing an inward only regime for funds.

The UK government is considering taking a wider approach, with the proposed regime not restricted to certain sectors or industries. While the focus of the consultation is clearly on inward re-domiciliation, it is being considered whether the UK regime should also cater for outward re-domiciliation. The regime will be limited to a certain extent as it will only be possible to re-domicile to/from jurisdictions that allow inward and outward re-domiciliation as required, but this usefully includes several of the most common holding company jurisdictions.

As a point of detail, while the consultation refers to re-domiciling to/from "the UK", it is assumed this refers to re-domiciliation to/from each of England and Wales, Scotland or Northern Ireland as these are three separate places of incorporation, each with its own registrar – we adopt the same "UK" shorthand in this article as used in the consultation.

Why re-domicile?

Why might a company want to change its place of incorporation? There are a number of (generally not tax related) considerations:

- A company will be subject to the corporate laws of the jurisdiction in which it is incorporated and the requirements of some jurisdictions will fit better with a group's strategy and circumstances than others.

- Some groups may want to reinforce their credibility and transparency by being subject to the UK's comprehensive disclosure rules (including increasing ESG/stakeholder/governance disclosure requirements for annual reports).
- Place of incorporation is relevant to which regulatory regime applies (and hence why some re-domiciliation regimes focus on investment funds).
- Easier access to UK capital markets.
- Groups including companies that, for historic reasons, are incorporated in offshore jurisdictions such as the Cayman Islands or the BVI and tax resident in the UK may see this as an opportunity to tidy up their group structures - particularly in the wake of the Panama and Pandora Papers leaks groups may be keen to remove these offshore jurisdictions from their corporate structures to reduce the potential for reputational damage.

For companies that do want to change their place of incorporation, a re-domiciliation regime offers the potential for a smoother mechanism for achieving this as compared to those that are currently available. Depending on the reasons for wanting to re-domicile, these might include creating a new UK company and transferring assets from the foreign entity to the new UK company, or creating a new UK holding company to acquire the shares in/assets of the foreign entity, with the latter route also requiring a further group reorganisation to move assets/shares from the foreign entity. These mechanisms are complex and costly to implement, including dealing with a variety of cross-border legal, tax and regulatory issues.

Corporate tax residence and re-domiciliation

The consultation asks whether a non-UK company re-domiciling to the UK should be treated in the same way for tax residence purposes as a company originally incorporated in the UK, that is: automatically UK tax resident unless it is treaty non-resident. It would seem somewhat unbalanced for there to be different corporate tax residence rules for originally UK incorporated companies versus re-domiciled UK companies, but it is worth considering why the rules may differ and what the implications of this would be.

It is not intended that an economic substance test will be required in order to re-domicile to the UK, meaning that a non-UK company could re-domicile to the UK without moving any substantial functions to the UK. This raises the question whether it will always be appropriate to automatically classify a company re-domiciling to the UK as UK tax resident. In this vein the consultation asks whether instead a re-domiciled company should only be UK tax resident if its central management and control (***CMC***) is in the UK (the ***CMC route***).

How would the CMC route apply in different scenarios? Take the example of a company re-domiciling to the UK from Country X which intends for its CMC to remain in Country X. If Country X has a double tax treaty (***DTT***) with the UK including a basic place of effective management residence tie-breaker test, tax residence would remain with Country X in any event. The position is more nuanced where (as is now more common) the DTT includes a mutual agreement procedure (***MAP***) residence tie-breaker test. In that situation, the CMC route would mean that a MAP application would not be necessary to clarify that the tax residence remains in Country X. In a situation where it is clear that the MAP ruling would confirm the company's tax residence should remain in Country X this would be helpful for both the taxpayer and HMRC as it removes the administrative burden and time required for the MAP application.

However, if Country X is not a treaty jurisdiction (or is a state pursuant to which a MAP treaty tie-breaker may not necessarily result in residence being located where CMC is located) and the CMC route is followed, the UK could potentially miss out on taxing rights over a UK domiciled company in a way that it would not for an originally UK incorporated company that is automatically UK tax resident.

Where Country X is a treaty jurisdiction which does not use a CMC type residence test, the implications will be more reliant on Country X's domestic law position and so would need to be considered on a case by case basis. If the outbound jurisdiction has only an incorporation tax residence test and the UK adopts the CMC route – will the company be tax resident in neither jurisdiction? The US is perhaps the most obvious example of this. However, in this case the US anti-inversion rules may apply to mean that a company re-domiciling from, say, Delaware to the UK would continue to be US tax resident, unless it can satisfy the test for demonstrating that substantial business activities are carried on in the UK. In the event that the UK rules applied such that the re-domiciling company was treated as UK tax resident (either because CMC is moved to the UK, or the CMC route is not adopted), the company would be resident in the UK and resident in the US by virtue of the anti-inversion rules. It is thought unlikely that the US would accept this dual residence should be resolved by means of the UK/US DTT MAP residence tie-breaker, because the applicable US rule is a specific domestic deeming provision.

Where UK tax residence is not automatic on re-domiciling to the UK, re-domiciled companies that want to be UK tax resident will need to employ governance procedures to ensure that their CMC remains in the UK in a way that originally UK incorporated companies do not. That will be straightforward where assets and functions of the company are also moving to the UK and the company's activities are UK focussed, but gets more difficult when there is an international element to the activities and functions of the company. In such case, care would be needed to maintain UK CMC which can be burdensome in practice, as recently demonstrated when travelling restrictions imposed during the COVID-19 pandemic caused concerns about being able to maintain CMC in the "correct" jurisdiction.

The corporate tax residence implications of outward re-domiciliation will also need to be considered if permitted under the new UK regime. The consultation asks whether, assuming the CMC of the company is outside the UK, the company should cease to be UK tax resident by virtue of the re-domiciliation or continue to be treated as UK tax resident unless and until it is treated as non-UK resident by virtue of a DTT. The latter approach is in line with the treatment of SEs/SCEs that (prior to 31 December 2020) either were incorporated in the UK or moved their registered office to the UK from another member state – in both cases SEs/SCEs remained UK tax resident unless resident elsewhere under the terms of a DTT. HMRC may be in favour of this approach as it potentially keeps these companies within the UK tax net for a longer period of time, but there will be a consistency question if companies that have completed an inbound re-domiciliation are only UK resident if CMC is in the UK, whereas (potentially) companies that have re-domiciled out of the UK are still UK tax resident despite neither incorporation nor CMC being in the UK.

SDRT

On stamp duty reserve tax (***SDRT***), the consultation notes simply that the Government is considering the implications, including whether any anti-avoidance measures could be needed for any outward re-domiciliation regime.

SDRT is chargeable (broadly) on shares and securities issued by a company incorporated in the UK or registered in the UK. On that basis, one might expect that, without legislation changing the position, shares or securities of a company which re-domiciles to the UK would then become chargeable securities for SDRT purposes.

The consultation notes that one aim of the new regime would be to enable companies to access the UK's world-leading capital markets as UK firms. Currently, foreign incorporated entities must list in the UK through a Depositary Interest (***DI***) structure. One assumes the plan is that following a re-domicile to the UK the entity's shares will be capable of a direct listing. DIs are subject to their own SDRT regime: DIs in respect of "foreign securities" are not chargeable securities for SDRT purposes (the need for this rule is based on the premise that the DI would otherwise be subject to UK SDRT on the basis that it is a security which itself is issued/registered in the UK). The definition of "foreign securities" for these purposes is a rare case of tax residency being relevant to SDRT treatment: the securities are not foreign if the entity is incorporated in the UK, the shares are registered in the UK, or the company's CMC is exercised in the UK. Unless a policy decision is made to take the shares of re-domiciled companies out of SDRT, one would expect that re-domiciling to the UK would result in the shares then becoming chargeable securities for SDRT purposes, and any existing DIs also becoming chargeable securities for SDRT purposes. Any policy decisions in this area would need to take account of the DI regulations inclusion of residency as a factor in determining taxability.

It is worth highlighting that in respect of shares, SDRT chargeability will be relevant both to the 0.5% SDRT charge on transfers, but also to the 1.5% SDRT regime in respect of clearance services and depositary receipts services (the scope and future of which has been the subject of considerable uncertainty following EU case law).

Loss importation

On a defensive note, the consultation raises a concern about "loss importation" where the concern is expressed to be "non-UK resident companies becoming UK resident in order to set foreign losses against the UK profits of other group companies under the UK's group relief provisions". The consultation alludes to certain provisions which it says already exist in this area, including the rules on dual resident investment companies, and the rules which prevent the use of trade losses from a trade wholly overseas against wider total profits of the entity or its group (see ss 37(5), 45A(3)(b), 99, 100 and 109 CTA 2010). We can see that HMRC's general concern might be that the re-domiciliation proposals could make it slightly easier to now bring companies and businesses that generate loss reliefs within the scope of corporation tax.

A slightly different form of loss importation would occur if a company somehow brought particular assets within the scope of UK tax on a migration with a cost basis for tax purposes in excess of their market value. This behaviour is the target of the "imported loss" rule for loan relationships in s 327 CTA 2009. However, we think this sort of importation is quite a remote risk, provided the rules on cost basis when companies migrate do not allow for a UK cost basis *in excess* of market value (see below).

Finally, we would note that it is not currently the case that a company that migrates to the UK (e.g. via changing its CMC) can "convert" accrued foreign tax losses into UK corporation tax losses. It is worth asking whether this *should* be possible – the ability to use foreign carried forward losses in the UK could be quite significant in whether (for example) a start-up was able to come to the UK using the new re-domiciliation rules. However, we expect that would be a step too far, given HMRC's defensiveness in this area.

Base cost of assets on inward re-domiciliation

The consultation invites comment on potential changes to the rules on the base cost of capital gains and intangible assets on an inward migration. Currently, when these rules apply on a migration of a company's tax residence to the UK, the rules are not wholly consistent.

For chargeable assets within the capital gains rules, normal historic base cost will generally apply, unless an asset has been subject to an "EU exit tax charge" – one implementing the exit charge provisions of the EU Anti-Tax Avoidance Directive – in which case the company will be treated as acquiring the asset at its market value on the date that it became subject to corporation tax (s 184J TCGA 1992).

In the same situation, intangible assets are generally treated as acquired for its accounting value, noting that HMRC's view is that most internally generated goodwill and intangible assets cannot be capitalised and therefore have a book value of nil. Although again this is dependent on the intangible asset being subject to an EU exit tax charge in which case the company is regarded as having acquired the asset for its market value (ss 863 and 863A CTA 2009).

It would seem more logical if a market value base cost was given in each case. However, if a requirement for a foreign market value exit charge is maintained, it makes sense post-Brexit that this should be widened to include non-EU exit charges.

The rules in this area seem all the more inconsistent if one compares these results to the position that could be obtained (generally a market value tax basis) if the same assets were sold to a new UK company – which is an alternative that groups might employ to achieve a similar effect to a re-domiciliation. In such a case, no corresponding exit charge (EU or otherwise) is currently required.

There are also the rules for other kinds of assets, including loan relationships and assets eligible for capital allowances, where the tax values on migration could be made more consistent (that is, more consistent with the rules on other kinds of assets like intangibles, and more consistent with the treatment of a sale of the assets to a new connected UK company).

It is worth noting that the decision whether to move tax residence to the UK along with corporate domicile may (very commonly) need to take into account market value exit charges from the company's current jurisdiction of tax residence. Such exit charges may make a migration of tax residence very similar in that regard to a transfer of the assets to a new connected UK company.

Tax treatment of shareholders

The consultation invites comments on the personal tax treatment of shareholders in a migrated company. In this area, it should be clarified whether shares in a company which migrates to the UK will retain their old situs or would become UK situs assets – this will be significant for the capital gains and inheritance tax consequences of non-UK domiciled shareholders. Fundamentally though, the opportunity for companies to migrate to the UK, without needing, for example, complex share for share exchange transactions to insert a new UK holding company, is likely to be a welcome simplification for their shareholders.

Other points

One area not mentioned in the consultation is the question of "source". For instance, would the interest payments of a company which has re-domiciled to the UK change from non-UK source to UK-source simply as a result of the re-domiciliation? How will that be taken into account in the, often difficult to apply in practice, multi-factorial balancing act one is required to undertake in determining UK source?

Finally, it is noteworthy that in the proposed conditions to re-domicile, one suggestion is that the company be required to prepare a report - attested by the directors - that explains the full legal and economic impacts of the transfer and implications for key stakeholders. Whilst a listed group re-domiciling to the UK will naturally expect to communicate publicly with its shareholders on the implications of the move, and for directors to be comfortable on such communication, a separate formal report attested by directors for every company (including unlisted companies) would be interesting to deal with. Presumably, tax consequences would be both legal and economic and therefore this report may well require a detailed explanation of the tax implications for both the company and its shareholders. Potentially this will be useful/relevant to HMRC's approach to any anti-avoidance provisions - including if such a report is necessary in relation to any outbound re-domiciliation regime.

Next steps

The proposals in the consultation raise of number of significant issues from both a corporate law and tax perspective and a limited number of these tax issues are covered in this article. Further work will be required to ensure that all key tax issues are identified and addressed. Key policy decisions on both corporate and tax points will need to be made to be able to progress the introduction of a UK re-domiciliation regime, but the additional flexibility that this regime will bring is to be welcomed.

This briefing was originally published in Tax Journal on 3 December 2021.

Jill Gatehouse
Partner
T +44 20
E jill.gatehouse@freshfields.com

Josh Critchlow
Senior Associate

T +44 20 7427 3555
E joshua.critchlow@freshfields.com

Alison Dickie
Senior Knowledge Lawyer

T +44 20 7785 2031
E alison.dickie@freshfields.com