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Analysis Of The Criteria Used In Establishing Company Residence

A company's liability to UK corporation tax depends on its residence status in the UK. According to the Inland Revenue, every 'UK resident' company pays corporation tax on its world-wide profits (adjusted for tax purposes); including capital gains on the disposal of assets.

A company is 'UK resident' if it is incorporated in the United Kingdom (UK) or if its central management and control are in the UK. If the company pays tax abroad on any foreign income, it will still be liable to pay tax in the UK on the same income. However, the foreign tax paid can generally be credited against the company's UK tax bill, so reducing the amount that has to be paid in the UK (subject to relief for double taxation). If UK companies operate abroad through subsidiaries which are themselves non-resident, the parent is liable to tax only on their profits which they remit to it.

A company resident outside the UK is only liable to UK corporation tax in respect of the income or gains derived from carrying on a trade in the UK through a permanent establishment i.e. branch or agency (I*CT*A *1988*, s *11*). Accordingly, unless the property is used by or held for such a branch or agency (s *11*(*2*)(a)) the offshore company is liable to income tax in respect of a Schedule A business in accordance with the provisions of I*CT*A *1988* s *1*5.

Fundamental Weaknesses:

*T*here are two fundamental weaknesses in this approach. One is the concept of corporate residence. *T*his arises because the taxation of British companies grew out of the taxation of individuals. *T*he courts and Inland Revenue have struggled with the misconceived question of where a company is resident but there is still an absence of a clear basis of jurisdiction.

*T*he residence of a company whose central management and control of the business operations was in the UK company but incorporated outside the UK can be quite complex (Wood and another v Holden (Inspector of *T*axes) [*2*005]. One of the most widespread corporate tax avoidance schemes is –the so-called

Delaware Link- which involves the creation of companies in the US but also resident in the UK, enabling tax deductions to be obtained for the same interest payment in both countries. In normal cases control is identified with a company's board of directors, and hence a company is usually resident where its board of directors meets. However, as in the case of Unit *C*onstruction *C*o Ltd v *B*ullock, where African incorporated companies with African boards of directors were held to be resident in the UK. This was on the basis that the UK *C*ompany had effectively 'usurped the functions of the local boards' and controlled the subsidiary companies.

The basic test is the 'central management and control' (De *B*eers *C*onsolidated *M*ines Ltd v Howe *1906*). Ultimately, this emphasises the important difference between, on the one hand, exercising management and control, and on the other hand, being able to influence those who exercise management and control. The fact that someone may have a great deal of influence on the transactions carried out by a company does not automatically mean that central management and control has been usurped even if the directors of that company can ordinarily be expected to go along with their wishes.

The second weakness is that the relationship between a company and its wholly-owned subsidiary is completely under the control of the company itself and any attempt to distinguish the two entities for tax purposes is doomed to frustration. The Group loss relief, which allows companies to surrender their trading losses, which the claimant company can relieve against their own profits chargeable to corporation is currently been exploited by *M*arks & Spencer

The relationship between parent companies and their subsidiaries under UK tax law means UK groups can for tax purposes transfer losses within their groups, so that loss-making UK subsidiaries reduce the tax payable by profitable UK companies. This cannot be done with loss-making UK subsidiaries for the simple reason that they are not subject to UK tax (*M*arks & Spencer plc v H*M* Inspector of Taxes). *M*arks and Spencer sought to use the losses of the overseas companies to reduce their UK tax bill. The European Union has opened a door for

cross-border taxes where businesses could offset foreign losses against domestic profit.

The UK has put in place Double Tax Treaties, which attempt to sort out some of the disruptions to International trade and capital movements which would otherwise arise from multiple claims to jurisdiction. Double Taxation Treaties are conventions between two countries that aim to eliminate the double taxation of income or gains arising in one territory and paid to residents of another territory. They work by dividing the tax rights each country claims by its domestic laws over the same income and gains. The UK has one of the largest networks with more than 100

Evaluation Of The Principles & Basis Of Assessment Of Corporation Tax

If a company is a UK resident, it will have to pay corporation tax on its worldwide profits, adjusted for tax purposes. This includes capital gains tax (CGT) on profits from the sale of assets. A company will qualify as a UK resident if it is incorporated in the UK or its central management and
controls are in the UK. Any foreign income on which a company pays tax abroad is still liable to tax in the UK. However, the overseas tax paid can generally be credited against the companies, tax bill (If the same profits are taxable in the UK and in an overseas jurisdiction, double tax relief is generally available to prevent the same profits from being taxed twice). (ICTA 1988, s 8)

Non-resident companies with a permanent establishment in the UK from which it carries on a trade are charged on income from that permanent establishment, and on capital gains from the disposal of assets in the UK used for purposes of the trade or permanent establishment.
Non-resident companies are chargeable to income tax unless the non-resident is a company trading here through a branch or agency, in which case the charge is to corporation tax. The taxable profits in both cases are those that arise from that part of the trade exercised in the UK. In the case of companies trading through a branch or agency, profits that arise outside the UK on assets used by the branch or agency are also included within the charge.

Basis of Assessment

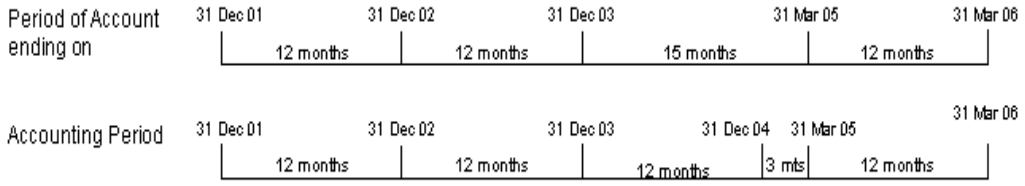
For the purposes of corporation tax for any accounting period, income is computed under Cases I to VI of Schedule D on the full amount of the profits or gains or income arising in the period (whether or not received in or transmitted to the United Kingdom), without any other deduction than is authorised by the Corporation Tax Acts. Where a company is chargeable to corporation tax in respect of a trade under Case V of Schedule D, the income from the trade is computed in accordance with the rules applicable to Case I of Schedule D.

Cases IV and V of Schedule D extend to companies not resident in the UK for corporation tax purposes, as long as the companies are chargeable to tax on income of descriptions which, in the case of companies resident in the United Kingdom, fall within these Cases

Companies prepare financial accounts periodically; these periods are known as Periods of Account. Periods of account are usually 12 months however they can be shorter or longer than this at a time when a company modifies its year-end date.

Corporation Tax is calculated on the basis of Accounting Periods. An Accounting Period starts when a company starts to trade, or immediately after the previous accounting period ends. An Accounting Period ends usually 12 months after the start, although it can end at the end of a period of account if it is earlier. So if a company has a period of account of say 15 months then it is split into two accounting periods the first of 12 months and the second of three months.

The diagram below outlines the assessment basis :



In this example it will be necessary to allocate profits (or losses) between the relevant accounting periods. There are rules for doing this. Trading income, before deducting capital allowances, is apportioned on a time basis. Capital allowances are calculated specifically for each accounting period. Interest paid or received in relation to non-trading loans (bank deposit interest is always non-trading) is accrued to each accounting period (using the appropriate rates of interest so is not necessarily time based).

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