Introduction

The UK has long been an attractive location for overseas businesses and it is now the leading destination for foreign direct investment in Europe. Its geographical location, economy, and business-friendly legal system have encouraged businesses across the world to look to the UK for investment opportunities, to access the UK market and to find new customers, suppliers and partners.

The UK is often also a crucial springboard to doing business in other European countries and accessing their markets.

Businesses looking to operate in the UK will need to consider their position carefully. The UK is generally an easy and business-friendly environment, but preparation before investing is essential to avoid potential pitfalls.

This guide sets out some of the most common UK tax issues that overseas companies may need to consider.

UK tax reform

Foreign businesses looking to the UK for business opportunities will find a competitive, business-friendly tax regime.

Recent UK governments have introduced significant reforms to the corporate income tax system, with the aim of making the UK the most competitive regime in the G20. This has been driven by:

• A decrease in the headline rate to 20% from April 2015 (additional reductions to 19% in 2017 and 18% by 2020 have been announced);
• Reforms to the taxation of foreign profits, moving to a largely territorial regime;
• Incentives for innovation activity and research and development conducted in the UK.

These reforms make the UK a very attractive option for overseas businesses at all stages in their life cycle. The UK tax regime is now very competitive and complements the many non-tax reasons why businesses choose the UK to do business.

The UK taxation system broadly follows OECD guidelines. The OECD, with backing of the G20 and others, is currently producing detailed reports based on previously agreed action plans in an attempt to tackle Base Erosion and Profit Shifting (BEPS).

In addition, the UK government has begun transferring various levels of power from UK Parliament to the UK’s regional assemblies (Scotland, Wales and Northern Ireland). This devolution of powers includes certain controls over taxes.

Taxation of non-UK residents

Foreign businesses selling or operating in the UK need to consider their exposure to UK taxation, including corporate income tax, value added tax (VAT) and employment taxes.

Non-residents can become subject to UK taxation in a number of ways:

• Establishing a formal taxable presence in the UK, via a subsidiary company or permanent establishment (PE);
• Being charged UK VAT on purchases of UK assets or services (although they may be able to reclaim);
• Suffering UK withholding tax at 20% on interest or royalty income received from a UK resident company (although withholding tax may be reduced via the relevant double tax treaty, or creditable in the recipient’s jurisdiction);
• Non-UK resident landlords who own UK real estate are subject to UK taxation on their rental receipts.

However, the sale of UK shares or UK based assets by a non-UK resident should not usually give rise to UK taxation for the seller, although UK stamp duty may be chargeable on the purchaser. Certain rules exist regarding the sales of residential property, which should also be considered to the extent they may apply.

It is important to note that a foreign business operating in the UK does not necessarily create a taxable presence in the UK. In order to fall within the charge to UK corporation income tax, an overseas business will need to be trading in the UK through a permanent establishment. The distinction is drawn between ‘trading with’ and ‘trading in’ the UK.

Recent UK governments have introduced significant reforms to the corporate tax regime, with the aim of making the UK the most competitive regime in the G20.
Business life cycle 1: Remote selling

A non-UK business looking to expand into the UK market can do so either by having a physical presence in the UK (for example, opening an office or shop or hiring UK employees) or by selling to UK customers remotely, perhaps online.

Businesses might often start off with the latter approach, as a way of testing the market without too much initial commitment and risk, before later moving to establish an actual physical presence.

A company merely selling to UK based customers (or purchasing from UK based suppliers), without establishing a permanent establishment as defined below, is unlikely to create a UK taxable presence for corporate income tax purposes.

Companies may be able to undertake limited activity in the UK (e.g. hiring a UK employee, opening a representative office in the UK, using a warehouse facility) without creating a taxable PE in the UK.

However, such businesses may inadvertently create a UK PE. This concept is explored further below, but advice should be sought based on the specific facts for each case.

In the event a UK PE is not created, a business could nevertheless trigger a UK tax charge by virtue of the UK’s new Diverted Profits Tax, which came into effect from 1 April 2015. Although this is a new tax for groups to consider, it is primarily aimed at businesses with sophisticated tax driven arrangements which HMRC considers have resulted in the erosion of the UK tax base.

Permanent establishment
In order to fall within the charge to UK corporation tax, an overseas business will need to be trading in the UK through a PE. A non-resident company has a UK PE if:

- It has a fixed place of business through which the business of the company is carried out; or
- An agent acting on behalf of the company has and habitually exercises the authority to do business on behalf of the company.

The threshold for creating a UK PE may alter depending on the outcome of the OECD’s BEPS initiative, as outlined at the beginning of this document.

Fixed place of business PE
It is important to determine where the business is actually carried out. A fixed place of business is as defined in the OECD Model Tax Convention and specifically includes: a place of management, a branch, an office, a factory, a workshop and a place of extraction for natural resources. However, storage facilities such as a warehouse will not necessarily create a fixed place of business PE.

Agency PE
Where an agent is considered to be independent of the company, it should not create a UK PE. This aspect requires careful attention wherever there is anyone physically in the UK (whether a formal employee or not) that is conducting any activity for a non-UK company. It is important to consider the agent’s ordinary business, economic reliance on the contract, level of autonomy and entrepreneurial risk borne.
Certain preparatory and auxiliary activities are explicitly excluded from the definition of PE. Examples of activities which may be preparatory or auxiliary include: researching local markets, maintenance of customer relationships, financial analyses, etc. Also, merely taking orders from UK customers, delivering goods to UK customers, and purchasing goods from UK suppliers should not give rise to a UK PE.

**VAT requirements**

VAT is chargeable by a taxable person on most supplies of goods and services made in the UK in the course of business regardless of whether the sale is made by a UK or EU supplier. It is also chargeable on the importation of goods and some services imported from countries outside the EU.

Businesses act as VAT collectors, paying the UK tax authorities (HMRC) the tax paid by their customers and receiving a credit for the tax they pay to suppliers. VAT is offset at each stage until the goods or services reach the final consumer or an exempt business.

Registration is compulsory for businesses if their taxable turnover exceeds £82,000 in the previous 12 months or in a 30 day period. Voluntary registration is also available.

**Employment tax requirements**

Where a non-UK business takes on employees in the UK, it should consider whether or not it is required to operate employment tax withholding. The UK withholding tax rules for employment taxes do not require there to be a corporate income tax PE in the UK but focus on concepts of ‘tax presence’ (for income tax) and ‘place of business’ (for social security contributions). In most cases, income tax and social security withholding are required in tandem, but the different definitions do allow for circumstances where one is due but not the other. It is mandatory for a business to register if it meets the criteria. In addition to withholding social security contributions on an employee’s remuneration, there is an obligation to make employers’ social security payments to HMRC.

Where a non-UK company has employees in the UK but is deemed not to have a UK ‘tax presence’ or ‘place of business’ under those definitions, and therefore is not required to withhold income tax and social security contributions, the employee may be required to personally withhold and pay them over to HMRC on a monthly basis. However, subject to HMRC agreement, it may be possible to account for income tax via self-assessment at the end of the tax year.

Potential visa and immigration issues should also be considered when seconding employees to the UK from overseas.

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**UK as a holding company location**

The taxation of foreign profits has undergone extensive reform in recent years, which has made the UK an attractive holding company jurisdiction. This includes:

- **Participation exemptions** for capital gains on shares and dividends (subject to certain conditions).
- **No withholding tax** on dividend payments.
- A **CFC regime** focused on taxing only profits that are artificially diverted out of the UK, including a 5% effective tax rate for CFC finance income.
- **Generous interest deductibility rules** that permit a tax deduction on interest used to finance foreign acquisitions, subject to anti-avoidance provisions.
- An **elective branch exemption** regime.
- An extensive **tax treaty network** (over 125 treaties).
Establishing a presence

Choice of entity

Once a business has decided to establish a formal presence, its main consideration will be the choice of vehicle through which to operate. The usual method for a foreign company operating in the UK is a subsidiary or a branch.

The main differences in these entities are outlined in the table below. Note this is not intended to be exhaustive, but rather seeks to identify the critical points that may influence a decision – legal protection, administrative burden (accounts and audit requirements), tax exposure and ease of exit.

<table>
<thead>
<tr>
<th>Subsidiary</th>
<th>Branch</th>
</tr>
</thead>
<tbody>
<tr>
<td>Legal</td>
<td>Distinct legal personality. Parent company’s liability limited to initial capital invested</td>
</tr>
<tr>
<td></td>
<td>Not a separate legal personality from head office company.</td>
</tr>
<tr>
<td>Accounts</td>
<td>Must file financial statements annually for the company only</td>
</tr>
<tr>
<td></td>
<td>Must file financial statements annually; however these can be the head office company’s accounts (if the head office company is required to submit accounts in its home territory).</td>
</tr>
<tr>
<td>Audit</td>
<td>Independent UK audit required (unless an exemption for small businesses is met).</td>
</tr>
<tr>
<td></td>
<td>Independent UK audit not required.</td>
</tr>
<tr>
<td>Tax base</td>
<td>Subject to UK corporation tax on worldwide profits. Overseas parent company typically not subject to tax on profits until distributed (and no UK tax at that point).</td>
</tr>
<tr>
<td></td>
<td>Subject to UK corporation tax on UK activities, under ‘separate entity principle’, the head office company may also be subject to tax on branch profits in head office jurisdiction, possibly with relief for UK tax.</td>
</tr>
<tr>
<td>Exit</td>
<td>Exit achieved by disposing of shares in the subsidiary; no UK tax should arise. Entity can also be eliminated via liquidation or strike-off, typically with minimal UK tax consequences if structured correctly.</td>
</tr>
<tr>
<td></td>
<td>Exit achieved by disposing of individual assets. UK chargeable gains may arise on the disposal of such assets. A branch operation can be shut down relatively easily if structured correctly.</td>
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</tbody>
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Location

Companies should also consider where in the UK they wish to operate. Tax considerations are typically not a priority, although there will be some regional differences in the future following the devolved powers, mentioned earlier. There may be regional grants and other tax benefits in certain ‘Enterprise Zones’. The main considerations are likely to be: availability of skilled labour, costs of rent and salaries, proximity to customers and suppliers, etc. Deloitte can assist with advice on location considerations.

Method of trading and financing

The proposed method of trading in the UK will have tax consequences, and may also influence the choice of entity. For example, will the UK entity engage and contract directly with local customers or will it act as an ‘agent’ for the parent company?

- Will the entity require funding – does it need ongoing financing support from the parent company or is it intended to be self-sufficient?

- How will funds be advanced to the UK operations? Capital investment, lending of debt or a mixture of both?

If structured appropriately, businesses may be able to finance their UK operations to reduce the risk of tax leakage. Advance planning in this regard will be important.
Business life cycle 2: Branch incorporation

Just as an expanding business might initially start to sell 'remotely' into the UK before establishing a presence, when the time comes to take that step, many businesses might similarly prefer to operate first via a branch – as a way of testing the market with a lower level of up front commitment and cost.

Such businesses may later choose to ‘incorporate’ the branch into a subsidiary, once the operation is more established. The conversion of a branch into a subsidiary can generally be completed on a tax neutral basis in the UK. The parent company’s tax position, however, needs to be considered.

Transfer pricing

Whatever remuneration basis is chosen, appropriate transfer pricing documentation support will need to be in place. For UK tax purposes, transfer pricing regulations dictate that transactions between related parties are deemed to have taken place on an arm’s length basis. There is a requirement to comply with transfer pricing documentation requirements if the worldwide group exceeds certain size criteria. Note that similar rules also apply to transactions carried out by a PE, which is taxed under the ‘separate entity’ principle, as if it were a standalone entity trading with its head office entity and other members of its group.
Practical matters

Set-up and registration
A new UK company can typically be incorporated in less than 24 hours and is a relatively simple process. ‘Off-the-shelf’ companies are also common. The paperwork is not overly onerous, although certain statutory documents are required (such as Articles of Association).

A newly incorporated company is automatically registered with UK Companies House via the incorporation process. A newly set up branch must register with Companies House within one month of commencing business.

Both a UK company and a UK branch (permanent establishment) must also register for corporate tax with HMRC within three months of starting to trade. Generally, HMRC is automatically informed of a company’s existence from Companies House and will write to the company’s registered address to request certain information. Separate registrations for VAT and employment taxes may also be required.

Ongoing compliance and reporting – company secretarial
As noted above, the annual filing requirements for a UK company are slightly different to those of a UK branch of a non-UK company:

• Accounts: a UK company must file annual financial statements with Companies House within nine months of the end of an accounting period. The financial statements must generally be audited independently, unless the group meets an exemption for small businesses.

• UK branches must also file financial statements annually with Companies House; however, these can be the financial statements of the non-UK entity, if the non-UK entity is required to prepare and submit accounts annually in its home jurisdiction. The normal deadline for submission is three months from the filing date in the non-UK entity’s jurisdiction. Crucially, there is typically no requirement for the accounts of the non-UK company to be audited separately in the UK.

• Annual Return: further, a UK company must also file an Annual Return with Companies House (different from a tax return), which is a snapshot of certain core company information at a certain date. It is a separate document from a company’s annual accounts. It is required every 12 months, within 28 days of the anniversary of incorporation (or on the anniversary of the last return, if different). A UK branch is not required to submit an Annual Return.

UK as a centre for innovation
A number of incentives have been introduced in recent years to encourage innovation and R&D activity in the UK:

• An opt-in patent box regime was introduced with effect from 1 April 2013, taxing profits arising from the use of patented products or processes at a reduced rate of 10%. The current regime will be closed to new entrants from 2016, and will be phased out entirely from 2021. A new regime will be brought in to replace the current regime.

• An enhanced tax deduction is available for research & development (R&D) expenditure of 225% for small or medium-sized companies and 130% for large companies.

• In addition, from 1 April 2013, an ‘Above the Line’ R&D tax credit regime was introduced for large companies, which will provide a P&L credit of 11% of qualifying expenditure. The credit regime is currently optional but will replace the existing large companies deduction scheme fully from 1 April 2016.
Ongoing compliance and reporting – tax
Both companies and UK branches have similar tax compliance obligations. For corporate income tax, UK companies and UK branches must file an annual tax return within 12 months of the accounting period end. This must be accompanied by supporting documentation and certain financial data. For companies this should be the annual accounts, but for branches, this may be financial information of the branch only (e.g. management accounts).

Further details of tax compliance and return filings for corporate income tax, VAT and payroll taxes are included in the tax summary over the page.

Legal issues
There are a number of legal issues that non-UK companies investing in the UK need to consider, such as employment law, immigration, privacy/data protection, intellectual property protection, etc. It is important that such companies take independent legal advice to be prepared in these areas.
Overview of the UK tax regime (as at 8 July 2015)

<table>
<thead>
<tr>
<th>Tax Type</th>
<th>Rate</th>
<th>Description</th>
</tr>
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</table>
| Corporate tax          | 20%  | • Chargeable on companies’ worldwide profits. However there are number of wide exemptions which mean that companies are effectively taxed on a territorial basis.  
  • The main rate for 2015/2016 is 20%; a reduced rate applies to profits from certain qualifying intellectual property (additional reductions in the headline rate to 19% in 2019 and 18% by 2020 have been announced).  
  • The corporate tax return must generally be filed within 12 months of the accounting period end.  
  • Large companies pay tax quarterly whereas small companies must pay their tax liability 9 months and 1 day after the end of their accounting period.  
  • Certain industries have additional rules/regimes to those described in this publication. These industries include oil and gas (ring fence rate at 50% replaces the main corporation tax rate), financial services (bank levy rate, a tax on banking groups’ balance sheets) and real estate. |
| VAT                    | 20%  | • VAT applies to most sales of goods, the provision of services and imports.  
  • The standard VAT rate is 20%, with a reduced rate of 5%. There are also some specific zero-rated reliefs and exemptions (most notably for financial services).  
  • Registration is compulsory for businesses if taxable turnover exceeds £82,000 in the previous 12 months, or will exceed £82,000 over 30 days. Voluntary registration is also available.  
  • VAT returns are generally due on a quarterly basis. |
| Withholding tax (WHT)  | 0%   | • Dividends: no WHT on dividends under domestic law, regardless of recipient.  
  20%                                                                  | • Interest and royalties: 20% WHT under domestic law, subject to exemptions (in many cases reducing to zero) under double taxation agreements and EU directives.  
  • Certain types of loan instrument and royalty arrangements do not attract WHT under UK domestic law. |
| Stamp duty             | 0.5% | • On the purchase of shares in UK companies (exemption for intra-group transfers).  
  0-4% for non-residential properties                                 | • On the purchase of UK (excluding Scotland) based real estate (exemption for intra-group transfers). Different rates apply to the purchase of residential properties in different geographical areas.  
  • Properties in Scotland became subject to the Land and Buildings Transaction Tax rather than stamp duty from 1 April 2015. Properties in Wales will be subject to Land and Buildings Transaction Tax rather than stamp duty from 2018. |
| Customs duty           |      | • Customs is regulated by EU legislation and customs duty is an EU-wide tax levied on the importation of goods into the EU.                      |
| Diverted Profits Tax   |      | • The Diverted Profits Tax came into effect from 1 April 2015. Although this is a new tax for groups to consider, it is primarily aimed at businesses with sophisticated tax driven arrangements which HMRC considers have resulted in the erosion of the UK tax base. |
| OECD BEPS initiative   |      | • The OECD is currently producing detailed reports based on previously agreed action plans in an attempt to tackle Base Erosion and Profit Shifting (BEPS). With political consensus and backing from the G20 it is likely that some significant changes will be forthcoming, although the timeframe for these varies depending on the relevant subject matter. |
**Personal tax**

- Individuals who are resident and domiciled in the UK are subject to tax on their worldwide income and gains. Income tax is charged at progressive rates and varies depending on the type of income. The first £10,600 of income earned (2015/2016) is a tax free ‘personal allowance’. Income earned above this amount is charged at the following rates for 2015/2016:
  - 20% on taxable income up to £31,785
  - 40% on taxable income £31,786 – £150,000
  - 45% on taxable income of £150,001+

- Different regimes apply to individuals who are UK resident but not UK domiciled. Specific advice should be sought in such circumstances.

- Social security contributions are payable by employers, employees and the self-employed. Various rates and thresholds apply depending on circumstances.

- Employment taxes typically need to be operated monthly via Pay As You Earn and there are a number of related filings (monthly and annual) that need to be considered.

- From 1 April 2016, following introduction of The Scotland Act 2012, rates of income tax and quantum of personal allowance in Scotland may differ from the rest of the UK.