GNT 13 Expansion into New Territories

As a business expands its international footprint it will be better served by having a framework for establishing a presence in new territories. This Guidance Note includes a high level step plan which can be used for each new entity and which can be developed, in each case, for specific requirements in that jurisdiction.

Should your company be looking to expand into a new territory, our recommended step plan is as follows:

Step	Action
1	Understand what will trigger a tax presence / nexus (see below). Different principles may apply for: • Corporation tax • VAT (or the equivalent) • Payroll taxes
2	If a presence is likely to be created, assess what form of entity will be most appropriate. There will typically be an option to establish a branch or a subsidiary. In our experience, unless there are strong commercial or legal reasons, or there is a marked difference in cost, a subsidiary is more widely recognised and understood. It is also better aligned to transfer pricing rules. There is a perception that a branch costs less to establish and maintain. However, in our experience this is rarely the case.
3	Understand the domestic rates of tax in the new territory, both state and local. This should take into account corporation tax, VAT, payroll tax etc. Consideration should also be given to what constitutes the tax base and the deductibility of expenses. There may also be other taxes on revenues or profits unique to the territory in question. Consider what relief could be available for double taxation under the relevant tax treaty (if there is one). Assess whether any relevant eligibility criteria are met and if there are any compliance requirements for the treaty to apply.
4	For certain territories there may be advantages in investing through an intermediate holding company. Consider whether this might be applicable.
5	Research whether any tax incentives are available for new investment. Particularly pertinent for Life Science companies is the availability of tax relief on R&D expenditure.
6	Appoint a local adviser to register for all relevant compliance requirements: corporate income tax, payroll taxes and indirect tax (see below for an outline of the Year 1 requirements). Ensure that the company is fully supported in the early months. It is much easier to scale back services than remedy mistakes.
7	Document key transfer pricing principles aligned with the wider group policy. This will include the transfer pricing methodology and intercompany agreements. One essential aspect of the agreements will be clarity over the ownership of newly created intangible assets which a group would normally want to be owned by the principal operating company in the home territory. However, full documentation may not be needed in the first 12-24 months particularly if the longevity of the operation is not certain. The rules in the overseas territory may, nevertheless, require contemporaneous documentation notwithstanding the size of the operation.
8	Understand funding requirements. The options would include share capital, capital contributions, loans and/or via transfer pricing (see below for an outline of the key tax implications).
9	Ensure protocol is documented and understood such that tax residence is maintained in the local jurisdiction and that the UK company or other group companies do not create a permanent establishment in the new jurisdiction. To ensure that the company does not have dual residence, it should not have a majority of UK directors. Dual residency can create uncertainty from a tax perspective and may deny certain reliefs under the relevant tax treaty. For further guidance see GNT 43 Tax Residency. Additionally consideration will need to be given to the Controlled Foreign Companies (CFC) rules to ensure these do not apply.

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10	Ensure all correspondence and communication with local tax authorities is shared with the head office finance team.

Triggering a Tax Presence / Nexus

A tax presence in a jurisdiction is triggered when a "Permanent Establishment" (PE) is created there. Permanent Establishment means a fixed place of business through which the business of an enterprise is wholly or partly carried on.

By definition, a place of management, a branch, an office, a factory or a workshop are permanent establishments.

Under OECD principles permanent establishments specifically do not include:

- the use of facilities solely for the purpose of storage, display or delivery of goods belonging to the enterprise;
- the maintenance of a stock of goods belonging to the enterprise solely for the purpose of storage, display or delivery or for the purpose of processing by another enterprise;
- the maintenance of a fixed place of business solely for the purpose of purchasing goods or of collecting information, for the enterprise;
- the maintenance of a fixed place of business solely for the purpose of carrying on any other activity of a preparatory or auxiliary character for the enterprise

An agent acting on behalf of an enterprise to conclude contracts in the name of that enterprise within a jurisdiction can prompt a PE, known as an agency PE, in respect of any activities which that person undertakes for the enterprise, unless the activities are exempted. Agency PE could be created by independent agents in situations where they act exclusively on behalf of that company and/or under its strict direction. To be considered independent, the agent must be both legally and economically independent

Please refer to GNT 23 Permanent Establishments for further information.

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Local Compliance Requirements (Year 1 Checklist)

The list below is a summary of the generic compliance requirements in establishing new operations in an overseas territory. It should be adapted in each case for regulation specific to the territory in question.

- Establishment
  - Choosing the most suitable legal option for doing business in the choice country (i.e. branch, subsidiary)
  - Drafting legal documents required to set up the business which may be a permanent establishment, a registered branch or a subsidiary. There may be separate requirements for national and regional regulatory bodies.
  - Setting up the entity in accordance with corporate and regional legal requirements
  - Opening bank accounts
  - Registering for national VAT and corporate income tax.
  - Register, if appropriate, for local/regional taxes.

- Payroll accounting
  - Payroll registration
  - Preparation of payroll accounting and social security declarations

- Monthly financial accounting and reporting
  - Statutory financial accounting
  - Preparation and filing of preliminary VAT returns

- Preparation of statutory financial statements and filing of year-end tax returns

Key Tax Implications for Funding

The new operation is likely to require financing. Set out below are the options in declining permanence together with the associated implications

- Share capital
  - The issue of share capital may give rise to capital taxes in the territory of the subsidiary.
  - There may be legal and financial regulation to be considered before share capital can be repaid.
  - For a UK corporate shareholder the return of share capital is likely to be a capital receipt and may give rise to a tax liability in certain circumstances.

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- Capital contribution
  - Capital contributions are common in a number of overseas jurisdictions, and notably the US, though the concept is not recognised under UK law.
  - It is typically regarded as permanent funding but without the rights of ordinary share capital.
  - One of the main risks for the recipient is that the payment is treated as taxable income if it is not recognised under local corporate law.
  - The contribution is unlikely to be deductible or even to form part of its base cost for the payer. However, if the payment is treated as trading income for the recipient then, depending on the facts, the payer might be able to claim a deduction.
  - As capital contributions are not recognised under UK law their redemption is not catered for specifically. However, provided that they are not redeemed at a premium this should not give rise to a UK tax liability.
- Debt
  - The issue of debt allows greater flexibility in terms of repayment. It is likely to require interest to be charged at arm's length.
  - There may be an obligation to withhold tax on the payment of any interest.
  - Interest on debt is generally deductible for tax purposes, unless the deduction is denied or restricted due to:
    - thin capitalisation rules or general transfer pricing under the arm's length standard;
    - specific rules on the limitation of interest relief (often capped at a percentage of EBITDA or an equivalent); or
    - interest being re-characterised as a dividend or distribution

Note: in certain territories exchange controls may limit or prohibit the extraction of cash from the subsidiary.

For further guidance please contact Richard Turner (Tel: 020 3727 1506).
FTI can help groups appraise the tax framework from both the UK perspective and across other candidate territories. This can extend from modelling, to structuring, transfer pricing and implementation.

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