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International tax planning post Brexit and during the Covid-19 pandemic

Introduction

Now that the UK has passed the implementation period completion date of 31 December 2020 to withdraw from the EU, there are several areas of UK tax law affecting companies that are likely to be significantly impacted.

EU law that is not retained by the UK will cease to apply to the UK, potentially generating significant consequences for the corporate tax treatment of cross-border activities between the UK and other member states. Some of these are discussed further below.

Withholding taxes

The application to the UK of the EU parent-subsidiary and interest and royalties directives came to an end on 31 December 2020.

The EU parent-subsidiary directive applies a 0% withholding tax on the payment of dividends, interest and royalties between associated companies. This means that certain payments to and from UK companies from 1 January 2021 will become subject to withholding taxes.

The UK has a number of double tax treaties with European countries which apply reduced withholding tax rates with an appropriate application being required in many cases. The treaty withholding tax rates may not be as low as the 0% that applied under the EU parent-subsidiary.

Certificates of residence from HMRC may be required in order that the benefit of a double tax treaty can be applied to withholding tax suffered by a UK company that is in receipt of interest, royalties or dividends from an overseas source. A certificate of residence is only valid for one year and some foreign tax authorities require the certificate or clearance to be updated every year. Certificates should be obtained from HMRC in good time so that the certificate may be submitted to the relevant overseas tax authorities for the following year.

A certificate is valid for one company and only for income of the same nature. Where there are several companies in a group, a certificate of residence must be obtained for each company, and also for each stream of income.

Not all overseas jurisdictions will require a certificate of residence. Instead, they will have their own application process in place which will be detailed in the relevant double tax treaty.

Branch exemption

A UK company can elect for its foreign branches to be exempt from corporation tax. The election must be made before the start of the first accounting period to which it will apply.

The benefit of an election will depend on the rate of overseas tax which is paid on the profits of the foreign branches and whether losses may arise in the future in the company's foreign branches.

If the overseas tax is greater than the UK corporation tax on the same profits, this will be sufficient to fully credit any UK corporation tax such that there would be no benefit in making the election.

Risk of creating a permanent establishment (branch) during the Covid 19 pandemic

During the pandemic, many employees have been required to work from home for extended periods of time. From a corporate tax perspective, there is a risk that permanent establishments may have been created inadvertently, due to the employees creating a taxable presence in the host country. This will be of particular concern where the employee has a senior role and/or enters into contracts on behalf of the non-resident employer. As a result, the employer company may have to attribute associated profits to a branch in the host country, which could in turn lead to a corporate tax liability, double taxation and compliance obligations.

Employers should ensure that such tax risks are identified.

Transfer pricing

OECD guidance recommends that transfer pricing documentation is regularly updated. In practice, HMRC will expect transfer pricing documentation to be updated every three years. However, economic or commercial changes may mean that transfer pricing policies and documentation must be updated sooner.

Some foreign tax authorities may require that transfer pricing documentation is prepared every year.

Transfer pricing documentation should also be updated whenever the nature of a company's activities has materially changed. For example:

- a marketing support company may start to make sales in its own name
- a contract manufacturing company may start to source its own raw materials

If a group has become large (having previously been small or medium sized), it will need to comply with the UK transfer pricing rules for the first time. A company will become large if its turnover, assets or employees breach the specified limits i.e. if the group has more than 250 employees or an annual turnover of more than €50 million and a balance sheet total of more than €43 million.

Impact of the Covid 19 pandemic on transfer pricing policies

Many groups are experiencing a major change in circumstances due to the Covid 19 pandemic. It may be the case that transfer pricing policies negotiated pre-pandemic are no longer appropriate and should be reviewed. Some of the following points may be relevant:

- how is the company renegotiating terms and pricing with third parties and should these be reflected in intra-group transactions?

- are the comparables used to set the original transfer pricing policies still appropriate given the changed circumstances, or is an alternative now required?
- is the business model or supply change the same or have changes been necessary?

Action may be required for inter-company transactions to reduce margins, amend funding arrangements such as interest rates and guarantee fees, consider payment deferrals or royalty holidays and adjusting services fees.

How can Beavis Morgan help?

To find out more please contact Fiona Cross, Tax Partner, Beavis Morgan on T. 020 7417 0417 or E. fiona.cross@beavismorgan.com for a no obligation discussion.

If you wish to discuss this matter in further detail, please don't hesitate to get in touch:

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