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CHOOSING A BUSINESS STRUCTURE

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Anyone wishing to set up business operations in the UK for the first time has a number of options for restructuring those operations. There are a number of different types of UK legal and reporting consequences. Different types of entity can also have different UK and home country taxation consequences.

OVERVIEW

This chapter gives an overview of the types of business entities that are available in the UK and the relevant registration and reporting requirements. It also describes and expands upon the following commonly used structures:

1. Small UK presence: representative office, service centre, independent sales agent, independent distributor
2. Branch
3. Subsidiary (limited company)
4. Joint Venture company
5. Limited Liability Partnership
6. Partnership.

All these business entities are liable to UK taxes and the chapter also sets out the key principles of UK corporation tax, UK Value Added Tax (VAT), UK payroll taxes that apply to them.

Most taxes apply throughout the UK but the Government has begun to devolve some tax powers to the Scottish, Welsh and Northern Ireland assemblies, eg land and property purchases taxes, some income tax rates and bands and corporation tax rates (in Northern Ireland only). These changes are being phased in over a number of years.

Special consideration, which modify the usual rules, may apply to specific industries and sectors, such as online gaming, oil and gas and investment management. These are not covered in this guide.

WHAT – **is the best structure for our business?**

The nature of a business's intended activities in the UK will help management focus on the most suitable UK business structure to consider in detail. The flowchart on the next page shows key questions to consider, and suggests the possible UK business structures.

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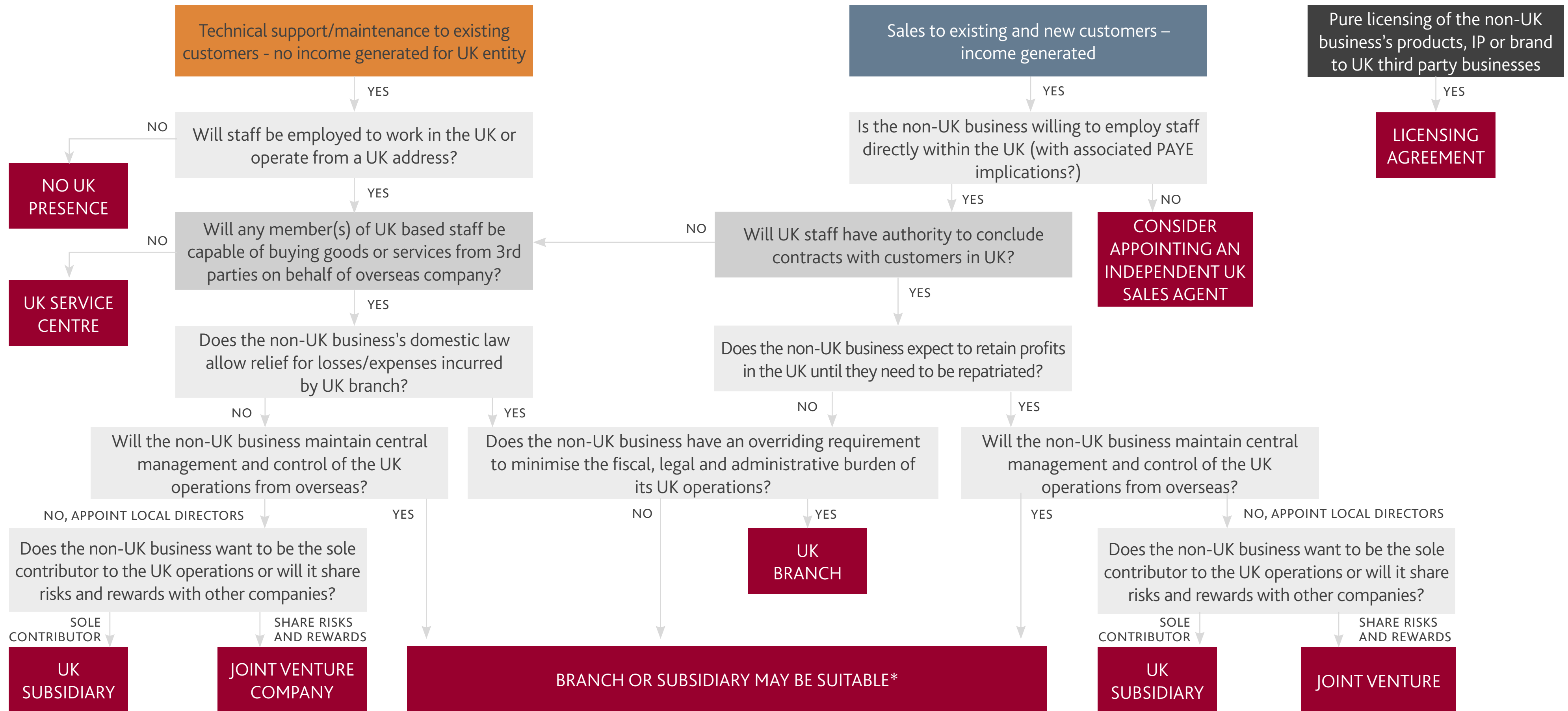
HOW A BUSINESS'S UK ACTIVITIES CAN HELP ITS MANAGEMENT DECIDE WHICH UK BUSINESS STRUCTURE TO CONSIDER



* The comparative tax positions of having a UK branch or subsidiary for the non-UK parent would need to be considered. Administrative requirements for a UK branch are less than those for a UK subsidiary.

This flowchart only provides an outline of the key issues. There are many further factors should be taken into account before deciding on the most efficient structure Expert, bespoke advice is essential to find the right UK business structure for a business.

Read about BDO's corporate international tax services.

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COMMONLY USED BUSINESS STRUCTURES

SMALL UK PRESENCE

Distance selling

In certain markets, it may be feasible to sell goods and services to UK customers without UK-based employees or infrastructure. In particular, direct selling from overseas to UK customers online or via mail order does not, of itself, create a corporation tax liability in the UK if none of the operations from which the profits are derived take place in the UK.

Licensing and distribution agreements with third parties

A common method for an overseas company to introduce their products to the UK market is to enter into a licensing or distribution agreement with a local manufacturer or retailer. The UK licensee typically produces and/or markets the product in return for a one-off and/or recurring payment.

Licenses may be exclusive (giving exclusive rights to produce or market the product in the UK) or, less commonly, non-exclusive.

Selling through a licensing or distribution arrangement in the UK with a completely independent third party should not result in corporate income tax liabilities for an overseas company. However, where a UK branch of the overseas company acts as a distributor, the branch will be taxed on its UK profits.

Where a licensing arrangement is entered into, it is possible that the fee paid by the licensee will constitute a royalty for UK tax purposes, notably where the licensee is granted rights to use patents, trademarks or intellectual property owned by the licensor. Here, the licensee may be required to withhold UK income tax from the payments made to the licensor, and pay this to HM Revenue & Customs (HMRC). Typically, the licensee will expect the licensor to inform if where a withholding tax requirement arises.

The UK rate of withholding tax on royalties is 20%, although this may be reduced or eliminated depending on the terms of the double tax agreement between the UK and the territory in which the overseas company is resident for tax purposes.

WHAT – **is the UK tax rate of withholding tax on royalties?**

The rate is 20% but the UK has a wide network of double tax treaties with other countries and most of these reduce or eliminate the withholding tax. However, intra-group royalty payments that relate to the exploitation or use of intellectual property in the UK and that achieve an 'artificially low' rate of tax are targeted with new withholding tax rules from April 2019 onwards.

From 6 April 2019, the offshore receipts in respect of intangible property (ORIP) regime has imposed an income tax charge on the gross income that certain non-UK resident persons receive from exploiting intangible property to 'enable, promote or facilitate' UK sales. The UK authorities are reviewing these new rules as they are currently flawed and incomplete. Draft secondary legislation and guidance has recently been published, and further legislation in this area is expected to apply to intangibles related payments from April 2019.

Independent sales agents

Overseas companies frequently use UK-based agents to provide sales staff on the ground in the UK, but without the need to deal with the tax and legal implications of employing staff directly in the UK. The agent will typically fulfil the role of accepting sales orders and referring them back to the overseas principal. An agent is therefore different in nature from a distributor who purchases and resells goods on his own account.

A permanent establishment (PE) will not be created if the agent acts on behalf of the company in the ordinary course of the agent's business and is 'independent' from the company.

UK representative office

There are a range of preparative or auxiliary activities that an overseas business may wish to perform in the UK which falls short of directly making sales. For example, it may wish to collect information on the UK market, carry out technical research, or advertise the overseas business to potential UK customers. A 'representative office' may be opened in the UK for those purposes. The term is commonly used in practice but not found in tax legislation.

No corporation tax liability will be created provided there is no UK PE. Particular care must be taken with business development functions undertaken by the representative office to ensure that these do not constitute a PE.

UK service centre

A physical base in the UK may, in some cases, be required as a service centre from which the overseas business provides support and maintenance services. Typically, the UK base will operate as a cost centre and will not directly generate additional revenue for the business.

As for representative offices, a PE and corporation tax liability will arise if the service centre generates profits on sales through the UK (or the diverted profits tax may be triggered if profits from such trading arise overseas). This will not usually arise if sales and service functions are strictly separated, but expert advice is recommended on such structures.

Read about BDO's business planning and advisory services.

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UK BRANCH OR SALES OFFICE

Many overseas companies find that they can only develop their UK sales effectively if they employ staff directly in the UK. This could consist of one or two sales staff working from home, a sales office, or a full-blown operation. With the exception of VAT, the tax and legal implications are essentially the same – whatever the extent of the UK operations.

Where only a small number of sales staff are employed in the UK, it may be possible to prevent a corporate income tax presence of the overseas company from being created here. In order to achieve this, it is important that no contracts with customers are concluded in the UK. However, in such circumstances the diverted profits tax may well apply (at a higher rate that corporation tax). In other words, sales staff must refer all contracts to head office for approval and signature.

Business tax issues

Where there is a taxable presence in the UK, the profits attributable to the branch operations will be subject to UK corporation tax. In most cases, a UK branch permanent establishment will be taxed in the same way as a UK resident company, benefitting from various reliefs available to companies in a group relationship.

The company will be required to register in the UK for corporate income tax purposes by filing an online form within three months of the start of doing business in the UK (having first obtained a Unique Taxpayer Reference (UTR) for the company). Annual Confirmation Statements are required to be filed at Companies House at least annually thereafter.

Profits of the UK branch subject to corporation tax must be calculated on a yearly basis. It is necessary to calculate the profits as if the branch is a separate legal person acting on arm's length terms with the rest of the company. Its profits are calculated by attributing to the branch turnover earned from sales generated by its activities. Expenses incurred in carrying on the UK taxable activity may be deducted, and it is possible to claim a deduction for recharges from head office for management services provided to the branch.

There is no requirement for the branch to withhold tax on the repatriation of funds back to the territory in which the company is resident.

A US company began making sales to customers in the UK. It recruited three UK sales representatives but had no fixed place of business. It was not sure whether its operations gave rise to PE and was also worried that it could be caught by the UK's new diverted profits tax which had received global press attention in the wake of the Base Erosion and Profit Shifting (BEPS) project.

BDO met with the sales director to discuss its current UK activities and review its UK business plan. It soon became apparent that a permanent establishment had been created and BDO assisted the company in making a disclosure to HMRC.

UK SUBSIDIARY (LIMITED COMPANY)

Many subsidiaries set up in the UK tend to include one of the two following functions:

- Sales and distribution centres – through which the UK sales of the group are made using UK based sales staff
- Shared service centres – which carry out functions for the benefit of the rest of the group on which they earn an arm's length rate of remuneration (eg group R&D function).

Although setting up and running a subsidiary generally entails far greater time and cost commitments than a branch arrangement, there can be considerable benefits.

Customers and suppliers often feel more comfortable dealing with a separate UK incorporated company than a branch operation. There are also benefits in limiting the domestic tax payable by the overseas company on profits generated in the UK.

Legal requirements

The incorporation of a UK company involves drafting and filing a number of constitutional documents. The process can seem daunting to the inexperienced, but can be completed relatively quickly and painlessly with the help and advice of a professional adviser. Read more in Chapter 3.

Business tax

It is likely that the subsidiary will be treated as resident in the UK for tax purposes if it is incorporated here, although residence may be determined elsewhere if the company is effectively managed from overseas. This is a complex area and it is essential that professional advice is sought before the company is registered in the UK. If the company is UK resident it will be taxed in the UK on its worldwide profits.

Read about BDO's corporate international tax services.

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JOINT VENTURE COMPANY

Many overseas companies find it beneficial to set up a separate company through which they can establish a commercial presence in the UK. Clients and customers alike sometimes take more comfort from dealing with a UK incorporated company than a branch operation.

However, some businesses lack the funds or expertise to establish a wholly owned subsidiary, or wish to share the risk inherent in a new venture with other parties. For these reasons, they may wish to set up a UK joint venture company held jointly with one or more other companies.

The issues arising on setting up a UK joint venture are broadly the same as those for UK subsidiaries.

LIMITED LIABILITY PARTNERSHIP (LLP)

LLPs are commonly used in the UK for various forms of commercial and investment activity such as professional services (eg legal, accounting), collective investment schemes and private equity backed businesses. As LLPs must have at least two members, they may also be used as a vehicle for a joint venture in the UK. For more on the legal requirements read Chapter 3. Read about BDO's services for partnerships.

Business tax issues

Despite having a separate legal personality from its members, LLPs - like partnerships - are transparent for UK tax purposes. There is one exception: where the LLP ceases to carry on business, the LLP will be taxed as if it were a separate company.

This transparent treatment means that everything done by the LLP is deemed to have been done by its members for tax purposes. Therefore, each member (with the exception of 'salaried' members) will be treated as self-employed and will be taxed on their share of profits, whether or not drawings are made by the member from the LLP.

In the same way, if the LLP disposes of assets, those assets are deemed to have been disposed by the members for tax purposes and the members will be allocated shares of gains or losses under the LLP's asset sharing agreement.

The LLP does not have its own tax liability. However, a partnership tax return does need to be completed, from which the members' tax may be calculated.

Where a non-resident company is a member of an LLP, it will only be subject to tax on a share of the UK profits of the LLP. If the LLP has trading activities outside the UK, non-resident members will not be subject to UK tax on the profits arising from these activities. However, specific anti-avoidance rules exist to tax profits on the individual partners where profits are artificially allocated to corporate entities.

PARTNERSHIPS

Unincorporated partnerships may exist where two or more individuals carry on business in common with a view to a profit. There are no formalities relating to the setting up of a partnership under the Partnership Act 1890. However, an overseas company wishing to enter into partnership with one or more other individuals should ensure that a written partnership agreement clearly specifies the profit- sharing and other arrangements intended.

Partnerships have unlimited liability for losses of the business, and this is borne by the partners. It is, therefore, unusual to find partnerships used by overseas companies wishing to set up in the UK.

Partnerships are transparent with relation to corporation tax, so if the partnership is carrying on a trade in the UK through a PE, the overseas company will be liable for corporation tax on its share of the partnership profit.

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KEY TAX PRINCIPLES

CORPORATION TAX

It is necessary to establish whether the overseas incorporated company is UK tax resident and, assuming it is not, whether or not it has a PE in the UK.

UK tax residence of companies

A UK resident company is liable to corporation tax on its worldwide profits, including capital gains. A company is resident in the UK if it is incorporated in the UK, or if it's central management and control is in the UK. A non-UK resident company is liable to corporation tax on the profits of a trade carried on through a PE in the UK. The UK authorities are also considering introducing a new tax on digital services supplied to UK residents by non-UK resident companies: this is expected to be some form of tax on global turnover to reflect the 'value' created by the UK service users (even if the service is 'free to use'). This is unlikely to be introduced before April 20202 at the earliest and is likely to be similar to EU proposals on the taxation of digital services.

It will be liable for corporation tax on capital gains on assets situated in the UK relating to that trade.

Read about BDO's corporation tax services

Permanent establishment (PE)

There are two types of UK PE:

- A fixed place of business through which the business of the overseas company is carried on, or
- A dependent agent which possesses, and0habitually exercises in the UK, authority to do business on behalf of the overseas company.

A company is not regarded as having a PE where the activities at the fixed place of business are only of a preparatory or auxiliary nature. This might include the purchase, storage, display or holding of goods for processing by the company or another person. For an overseas company not subject to diverted profits tax (see page 25), a PE represents the minimum level of substance in the UK, below which there should be no liability to UK tax on profits at all.

Base Erosion and Profit Shifting (BEPS)

BEPS is a term used to describe tax planning strategies that rely on mismatches and gaps that exist between the tax rules of different jurisdictions, to minimise the overall tax payable - either by making tax profits 'disappear', or shifting profits to operations in low tax jurisdictions where there is little or no genuine activity.

Any overseas company setting up business in the UK will need to be aware of the impact of the substantial outputs from the Organisation for Economic Cooperation and Development (OECD) in relation to BEPS.

The OECD has published reports covering 15 identified areas for action, including the digital economy, artificial avoidance of permanent establishment status, and transfer pricing. Although the OECD reports are 'soft law' without direct effect, the UK Government is a lead sponsor of the BEPS project, and legislation enacting many of the recommendations is already being implemented in a number of areas.

For example, the UK has introduced new concepts into its law, and in some cases tax treaties, in a number of ways including:

- Introduction of new measures to counter the use of hybrid entities and instruments aligned to the recommendation of OECD BEPS Action 2 on hybrids
- Introduction of new Corporate Interest Restriction provisions aligned to the recommendation of OECD BEPS Action 4 on interest deductibility
- Reform to the UK Patent Box regime aligned to the recommendation of OECD BEPS Action 5 on harmful tax practices and related political tensions within Europe
- Introduction of the Diverted Profits Tax, as part of the response to OECD BEPS Action 7 on permanent establishments
- Broadening of the PE concept to incorporate 'anti-fragmentation' provisions, as recommended in OECD BEPS Action 7 on permanent establishments.

Are you ready for BEPS?

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DIVERTED PROFITS TAX (DPT)

DPT applies to large businesses which enter into arrangements to divert profits from the UK in two situations:

- A person carries on activity in the UK in connection with sales, but that activity does not create a PE in the UK. An exception applies if UK-related sales are less than £10m, or UK-related expenses are less than £1m
- A UK resident company, or a UK PE of a non-UK resident company, is party to one or more transactions with a connected company with little economic substance in order to exploit tax mismatches.

The rate of DPT is 25%, which is higher than the rate of corporation tax (currently 19%, and 17% from April 2020). Companies have a duty to notify HMRC that they are within the regime, and registration is required within three months of the end of the accounting period in which chargeability arises.

Read more on DPT.

VALUE ADDED TAX (VAT)

An overseas business may have VAT obligations in respect of its UK activities, whether or not it has a physical business establishment in the UK. A 'business establishment' in the UK for VAT purposes is either:

1. The place where essential management decisions are made, and the business's central administration is carried out, is in the UK, or
2. The permanent place with the human and technical resources to make or receive taxable supplies, is in the UK.

This is not necessarily the same thing as a PE for corporation tax purposes. An overseas business without a business establishment in the UK must also register for VAT in the UK if:

- It makes taxable supplies of goods and services in the UK in the course of its business (irrespective of the value)
- • The business is registered for VAT in another EU country, sells and delivers goods in the UK to customers who are not VAT-registered ('distance sales'), and the value of those distance sales exceeds the relevant threshold
- The business acquires goods in the UK directly from a VAT-registered supplier in another EU country, and the total value of the acquisitions exceeds the acquisitions threshold.

There is no need to register if the only UK supplies are supplies of services on which the customer is liable to account for any VAT due under the 'reverse charge' procedure.

The rules governing cross-border supplies of goods and services are complex and depend, among other things, on whether the overseas company is based within or outside the EU; whether it is goods or services that are being supplied; and whether the customer is a business or a consumer. Professional advice is essential.

The UK's existing VAT legislation is based on core EU law, so the Government may decide to make some changes when the UK formally leaves the EU. However, VAT has proved a highly efficient way of gathering tax in the UK and it is therefore unlikely that major changes will be implemented, in the short term at least. Once the UK has left the EU, UK businesses may still need to operate the cross-border VAT rules, depending on the agreed end state of Brexit. Read more on VAT.

PAYROLL TAXES

UK employers, including UK subsidiaries and UK branches, are required to register with the UK tax authorities (HMRC) as a new employer under Pay-As-You-Earn (PAYE). A payroll system will also need to be operated through which the salaries of UK staff are paid, and income tax and national insurance contributions are withheld and sent to HMRC. Read more in Chapter 8.

COMPANIES HOUSE REGISTRATION REQUIREMENTS

If the overseas company does not maintain a place in the UK at which it may be contacted, there is no requirement to register the company with UK Companies House. However, and irrespective of whether or not a PE has been created for corporation tax purposes, registration with Companies House will be required if there is physical location in the UK at which the overseas company may be contacted. Read more in Chapter 3.

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