REDOMICILIATION AND THE SEMIFREDDO RABBIT

By Nikhil V. Mehta

Introduction

When I was a junior tax solicitor in my first year of practice many years ago, I made the mistake of walking into a tax partner's room. Well, the real mistake was walking into an empty room and fielding the ringing phone. At the other end of the line was a very senior finance partner from one of the firm's overseas offices. When I told him his intended call recipient was absent, I thought he would just ask me to leave a message for a return call. But instead, I heard the following words:

"Can a dual resident company do a bond issue?"

The rabbit in me froze in the aural headlights (thank goodness there was no Zoom in those days). I really did not know the answer. But rather than try and bluster my way around the question, I put up my hands and pleaded ignorance. When I got round to reporting the question to the tax partner, he simply shrugged as if the answer was a piece of cake and we called the finance partner together. Well, I listened to the answer and learnt. I now know that the literal answer to the question is "Yes, if it really wants to". But the tax literate answer (at least then) was: "Yes, but whether it gets a double dip of tax deductions in both its jurisdictions of residence for the financing costs of the bond issue requires careful investigation". This was in the days before anti-arbitrage rules and so forth. Indeed, it was in the days before the UK had a statutory test of corporate residence in the form of incorporation. The answer is a lot simpler today, if not exactly taxpayer-friendly.

Many years on, in 2020, I have had a touch of the returning rabbit when I was asked, on more than one occasion in the year:

" Can a company redomicile from one country to another?" Implicit in the question, but somewhat hidden, is the follow-on question of what are the tax implications, if any, of redomiciliation. Well, by now the rabbit was not so much like a frozen ice cream as a semifreddo dessert with years of practising tax law and lore behind him. But the question startled him and continues to startle for this simple reason: redomiciliation comes in different shapes and sizes and it all depends on what you mean by the word. The "It all depends" sounds like a cop-out to give my rabbit time to cross the road. It could be, but actually it isn't.

The question also appears to have taken on greater significance with BREXIT and the implications for UK groups with interests in different EU markets. But it is also of interest outside those parameters. For example, companies incorporated in low tax jurisdictions have to think about external pressures like OECD-driven rules requiring companies in such jurisdictions to have economic substance: if a company is in the "wrong" jurisdiction, then redomiciliation to a better jurisdiction makes good fiscal and commercial sense.

In this article, I discuss the ways in which an English company can redomicile, as well as some of the issues arising when a company in a low tax jurisdiction moves to another.

Can an English Company Redomicile by Changing its Citizenship?

The most recent variant of the question posed above came to me from a tax lawyer practising in an EU jurisdiction, let us say Eutopia. He started talking about how it was possible for a company to change its passport and he naturally assumed there was nothing objectionable about our mutual client, an English holding company of an international group, switching its corporate citizenship to Eutopia. The proposal is not BREXIT driven as such, but the coincidence of the finality of BREXIT gives it added purpose and flavour. But we are not into fancy measures like setting up a Societas Europaea: this is a young and highly successful privately-owned international financial services group looking simply to relocate its holding company away from the UK and to remain private: the ultimate shareholders are from Eutopia and most of the active businesses are carried on in different countries outside the UK.

So, what my Eutopian tax colleague meant by redomicilation is a company being able to change its country of incorporation and to remain in existence as the same legal entity. It is almost like an individual changing from a domicile of origin to a domicile of choice. But there is more to it than that: it involves changing the domicile of origin itself, which of course an individual cannot do. If one equates incorporation with origin for an individual, the change of corporate citizenship involves the outgoing country agreeing that a company ceases to be incorporated there from a particular date and the incoming country agreeing that the company is treated as incorporated there from that date onwards. I look at this route in a little more detail towards the end of this article, when I look at redomiciliations between low tax jurisdictions. Let's call this redomicilation route the "change of corporate passport" or "CoCP" route.

The key to the CoCP route is that the legal personality of the company is recognised by both outgoing and incoming countries as remaining intact i.e. it is the same company before and after the change.

This route is possible in a number of jurisdictions, not just low-tax jurisdictions. But it is not possible under English company law, both in terms of outward movement from, and inward movement to, the UK. Once a company is incorporated, it stays incorporated in the same place until it is liquidated.

It cannot change its place of incorporation. My Eutopian tax colleague was incredulous when I gave him this news, as it is apparently quite straightforward for a company to get a new passport in Eutopia. In fact, he double-checked my response with an English company law solicitor also working on the transaction, who endorsed my advice. I did not take this second opinion exercise too personally-after all, it was not a tax issue as such, and what does a tax lawyer know about company law? I might have been more concerned if he had double-checked with the corporate lawyer our corporate tax residence rules after asking me first.

So, one thing is clear: an English incorporated company cannot redomicile by changing its corporate passport. So how can it redomicile, if at all?

Redomiciliation by Corporate Inversion

Towards the end of the noughties, a number of public corporate movements occurred involving companies supposedly leaving the UK. Some were quite high profile, and were influenced to a large part by tax considerations where a group had built up substantial overseas operations. The trend involved relocations to countries like Ireland, Switzerland or Bermuda with a view to simplification of tax compliance matters as well as substantive reductions in tax on non-UK profits. Some of the thinking had to do with the then Labour Government's aggressive approach to taxation of offshore royalties, and more generally, the regime, as it was then, for controlled foreign companies.

So, what did this form of redomiciliation involve? The first company to "go", in 2008, was Shire plc, which was the UK holding company of an international biopharmaceutical group. Over the years, the business of the group had shifted from UK-centric activities to offshore operations to such a degree that the vast majority of profits were generated overseas. In its press release on the move, the company said that its business and shareholders "would be better served by having an international holding company with a group structure that is designed to protect the group's taxation position, and better facilitate the group's financial management."

To achieve the objective of an international (in tax language, non-resident!) holding company, the group set up a new company which was incorporated in Jersey but tax resident in Ireland. The corporate mechanics involved an English statutory scheme of arrangement. Under the scheme, the shares in the existing English holding company (OldCo) were cancelled, and the cancellation reserve applied in issuing new ordinary shares to the new offshore holding company, NewCo. NewCo in turn issued its ordinary shares to the former shareholders of OldCo. Putting a new holding company on top of another is known as a corporate inversion.

The next stage involves a reorganisation of group subsidiaries held by OldCo so as to put offshore controlled foreign companies directly under NewCo's ownership. Provided NewCo is run as a true non-resident company, this eliminates the application of the CFC rules to the group so as to maximise post-tax foreign profits. While CFC exposure is less of an issue since the revamp of the CFC legislation in 2012, there are still good tax reasons, including the increasing burden of tax compliance for multi-national groups, to reorganise group structures where the top company redomiciles as above. Of course, any reorganisation itself should be done in a tax-efficient manner. The substantial shareholdings exemption is a valuable tool to facilitate this.

The main tax reason for a Jersey incorporated company is to mitigate stamp duty, which would otherwise apply on shares in an Irish company. Of course, it needs to be non-UK incorporated anyway to avoid being UK resident under the place of incorporation test of residence.

Ireland was chosen as a place for non-residence partly because of its physical proximity to the UK so as to facilitate the running of the company as a non-UK resident (and Irish resident) even if some UK resident individuals remained as directors. Also, its attractive tax regime for holding companies was a big factor in selection. Other groups which relocated to Ireland included WPP (advertising), United Business Media (media) and Henderson (asset management). Famously, once the UK had introduced a more liberal CFC regime, WPP returned to the UK after a 4-year Irish sojourn. Chancellor George Osborne had publicly suggested that they should come back, and they responded positively. The mode of return, incidentally, involved another corporate inversion where a UK resident holding company was put on top of the group.

So, this form of redomiciliation involves swapping one top holding company for another. There is no question of the same legal entity continuing as the head of the group. It may continue to exist, but only as a subsidiary of the new offshore holding company, and holding only UK resident subsidiaries. An important point about this route is that it is tax neutral. No UK tax charges arise in relation to the scheme of arrangement itself, either for the holding companies or for the shareholders: UK resident shareholders will get rollover relief for giving up shares in OldCo and getting shares in NewCo under Section 136 of the Taxation of Chargeable Gains Act 1992. No stamp duty or stamp duty reserve tax charges arise on the cancellation scheme as no transfers are involved.

One might ask why a straightforward cross-border takeover of one group by another does not amount to a redomiciliation. If one takes the example of a bidder group in Country X acquiring shares in the target group's holding company in Country Y for cash and/or shares, what is the difference between that and the holding company swap discussed above? Well, there is a fundamental difference: the holding company swap is an internal transaction to a single group and its shareholders:

all the shareholders in the first holding company will become the only shareholders in the new holding company. In the takeover context, the shareholders may not even get shares in the bidder, for example, in a cash bid. And if shares are issued as consideration, the shareholders would join the existing shareholders in the bidder group i.e. there would not be parity of identity of shareholders before and after the takeover.

On the other hand, in the privately held context, a corporate inversion could be achieved without a scheme of arrangement: there would simply be a share-for-share exchange whereby the new company acquired shares in the existing company in exchange for issuing its own shares to the shareholder(s). In transactions involving public companies, the scheme route is preferred to get 100% shareholder approval.

The corporate inversion route was, however, of not much use to the privately held group which my Eutopian tax colleague and I were advising. Our clients still wanted the holding company to continue as the same legal entity for their own commercial reasons. So, is anything left in the UK which could get us there? The answer is found in our tax code, and involves a tax migration.

Redomiciliation by Tax Migration

It is possible for a UK resident company to cease being resident here and to take up residence elsewhere. But this is not without tax consequences. If a company ceases to be UK tax resident, various tax charges can arise by way of "exit" charges. For a UK incorporated company, it is quite difficult to cease to be tax resident because, as I said earlier, it will always be incorporated in the UK. That makes it tax resident under our domestic test of incorporation. If its central management and control moves abroad, it would technically become dual resident (my rabbit remembers dual residence well!)

But in our set of facts, if the holding company moves its management and control to Eutopia, I understand that it will be tax resident there under the local tax law. Eutopia has a double tax treaty with the UK. The fact of dual residence triggers the residence "tiebreaker" test under the treaty. The relevant tiebreaker test involves finding the place of effective management. This test of effective management will lead to Eutopia and not the UK, as essentially, there will be no management in the UK, let alone effective management. Section 18 of the Corporation Tax Act 2009 then comes into play. That imports the treaty tiebreaker into our domestic law so that, for all corporation tax purposes, the company will be regarded as resident outside the UK and non-UK resident. That in turn means it has ceased to be UK tax resident, so the exit charges become relevant.

For the purposes of the exit charges, the company is treated as disposing of specified assets and reacquiring them at market value. Any profit or gain arising on the deemed disposal is taxable. The most relevant assets for a holding company are capital assets, loan relationships, derivative contracts, and intangibles.

So, unlike the corporate inversion route, there could be a significant tax cost of migration. However, this can be significantly reduced in relation to a holding company's principal assets, which are usually the shares in its subsidiaries. The deemed disposal of these shares on exit may qualify for the "substantial shareholdings exemption" and if it does, then no tax would be payable in relation to gains arising on these assets. Where the SSE is relevant, it is critical to carry out a detailed study of the group to ensure it applies.

Apart from tax in relation to exit charges, the company also has to settle any "normal" tax liabilities like income tax (PAYE) as part of the migration arrangements with HMRC.

But because of the SSE, it is quite feasible for a holding company to redomicile by migration without incurring substantial exit charges.

If exit tax charges are payable, then the tax administration allows for arrangements to be entered into for settlement including an instalment plan, if required. This has been amended to deal with BREXIT and companies migrating to somewhere in the EU.

So, corporate tax migration is the only form of redomiciliation available to an English company if the idea is for it to remain in existence after the redomiciliation. Company lawyers may not recognise this as a true redomiciliation, particularly as the company will continue to have obligations under the Companies Acts by virtue of remaining incorporated here.

Redomiciliation by CoCP

Having established that the CoCP route is not available to an English company, I would like to look at some of the issues that arise where offshore companies use this route. For this route to get off the ground, both the outgoing and the incoming countries must recognise its validity. A number of Caribbean countries permit this route. These include common law countries where the company law is to a large extent based on English law. But where redomiciliation is concerned, the laws diverge. The British Virgin Islands, Bermuda and the Cayman Islands permit both inward and outward redomiciliation with countries where there is reciprocity.

Once there is reciprocity between two countries the procedure is pretty straightforward. Typically, in the outgoing country, the following steps would be required:

- The passing of appropriate board resolutions approving the redomiciliation proposal;
- Compliance with the redomiciliation process under local law and satisfying the requirements as to good standing;
- External counsel's legal opinion;
- The making of the required filings resulting in

certificates of continuance as a legal entity and discontinuance as to place of incorporation.

In the incoming country, the steps would include:

- Approval of the beneficial owners of the company;
- Evidence that all required authorisations and approvals have been obtained in the outgoing jurisdiction (this may require an external counsel's opinion);
- Filings with the relevant authority including as to continuance as a company in the new country;
- Evidence of solvency (usually in the form of financial statements);
- Adoption of local bye-laws.

Depending on the countries involved, I understand the process can be carried out within two to three months.

The effect of redomiciliation is that both countries treat the company as no longer incorporated in the outgoing country, and newly incorporated in the incoming country. All the assets and liabilities remain intact and continue to belong to the same entity. But unlike tax migration, the company will no longer have to comply with the company law of the outgoing country. It is interesting to note that if both countries used the test of incorporation as a test of tax residence, this type of redomiciliation would result in a change of tax residence by virtue of the change in incorporation, which seems somewhat remarkable to a UK tax lawyer. If the company has an ultimate UK resident parent company, that provides some interesting results under our controlled foreign companies legislation, particularly if the change means the company undergoing a difference in CFC status from one country to another. Even without incorporation being an actual test of tax residence e.g. because a relevant country is a nil-tax jurisdiction, the rules for determining residence of CFCs in Part 9A Chapter 20 TIOPA 2010 could still have the effect of importing or exporting a company into or out of CFC status; the place of incorporation is part of the tiebreaker rules in Section 371TA for determining residence.

The fact that both countries recognise the new status of the company, does not bind a third country. The important question is whether the change results in a disposal of any assets by the company, coupled with a reacquisition, like our corporate tax migration rules. Where there are UK resident shareholders and the company is a close company, that would require consideration of the attribution rules in Section 3 of the Taxation of Chargeable Gains Act 1992. Similarly, the question arises whether a UK resident shareholder makes a disposal of shares in the company and acquires new shares of the company now incorporated in a different country.

The key to the answers to these questions is that nothing has affected the legal status of the company. Its continued existence means that nobody disposes of anything. The offshore treatment should be respected for UK tax purposes. Of course, the documentation needs careful inspection to ensure the tax neutrality of the redomiciliation, and a local legal opinion as to the effect of redomiciliation in both countries is essential. Things might be very different if, for example, the outgoing and incoming countries had non-tax laws which deemed the company to dispose of its assets at market value and reacquire them in the new country also at market value. But I do not know of any jurisdictions which do this and, frankly, it is hard to think why they should, particularly if there are no local taxes.

An interesting issue arises in relation to India, with perhaps even more far-reaching consequences. The Indian tax charge on capital gains extends to transfers of shares in foreign companies where a substantial part of the foreign company's assets consists of shares with an Indian *situs*. Offshore structures for foreign investors investing into India frequently involve the use of sub-holding companies in zero tax jurisdictions, which hold the Indian investments. If such a company were to redomicile, the question arises whether that involves a "transfer" of shares in that company for Indian CGT, or even whether the company itself is treated as disposing of Indian assets. A "transfer" is the Indian equivalent of "disposal" but has a statutory definition.

The definition includes the following:

(i) the sale, exchange or relinquishment of the asset ; or

(ii) the extinguishment of any rights therein.

Again, it is difficult to see how the redomiciliation process falls within any of these on the basis that the shareholder continues to have the same shares in the same company, and the company itself continues to own the same assets. There are other technical reasons in the Indian tax code why the charge may not apply anyway, but the starting point is to identify whether there is a transfer in the first place, and the answer is no.

But the Indian situation is a good example of how redomiciliation can have wider third country implications where the company concerned is part of an international group.

Concluding Remarks

Change of tax residence is an important factor in both inversions and tax migrations: in the former, the new holding company needs to be resident in the right jurisdiction, and in the latter, the existing company needs to shift its residence successfully without becoming dual resident. It could be equally important in a redomiciliation by CoCP between countries which have corporate taxes as opposed to those which have none. It is easier to start off as a new company with residence in a particular place than for a company with an established status of residence in one jurisdiction to change to another. The issues involved in changing tax residence should not be underestimated, and a clear timetable should be drawn up to achieve the change of non-residence. Where the test is effective management under a treaty, in many cases that will equate with central management and control through the board of directors. The composition of the board will need to change in order to ensure decisions are taken in the new jurisdiction. But it would be quite normal for some directors to be resident in the outgoing country if they are already serving as directors and the intention is that they should continue to do so. Clearly, they should be in a minority and not have any dominant influence over new offshore directors. It would also be sensible for management and control to be located in a single location, so as to make the new place of residence clearly identifiable.

The reasons for redomiciliation continue to evolve, and are not simply tax driven, although tax can play a significant part. Even in cases where tax is not a main motivation, it is clearly important to ensure that the structuring is tax efficient. Equally importantly, the new structure should operate sensibly from the tax viewpoint; not only should there be good practice regarding governance at the outset, but it should be followed consistently on an ongoing basis.

So, my rabbit has now moved from a semifreddo temperature to something resembling a warm apple crumble, when it comes to redomiciliation questions. But please do not encourage his American cousin, Harvey, to ask him how the UK views forward and reverse triangular mergers and the magic of the disappearing company in those transactions. Thereby hangs another tail…