Cooley

COVID-19's Potential Impact on UK Corporate Tax Residence and Permanent Establishments

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Travel restrictions due to COVID-19 are having an unprecedented impact on the way that many businesses operate. Companies need to consider whether this could affect the countries in which they are liable to pay tax. The UK tax authority, HM Revenue & Customs, and the Organisation for Economic Co-operation and Development have both published helpful guidance on this issue, but care still needs to be taken to ensure that travel restrictions do not result in unexpected tax liabilities.

Corporate tax residence

Under UK domestic law, a company is UK tax resident if it is incorporated in the UK or if its place of "central management and control" is in the UK.

A company resident in the UK could potentially also be resident in another jurisdiction, under the domestic law of that other jurisdiction. If there is a double tax treaty between the two jurisdictions, this may contain a tiebreaker provision to determine where the company will be treated as being resident, which will usually depend on the company's place of effective management or otherwise require the relevant tax authorities to agree the position.

The disruptions caused by COVID-19 mean that there is a risk that the place of central management and control (and/or the place of effective management) of a non-UK incorporated company could unintentionally shift to the UK, for example, if UK-based directors are unable to travel outside the UK for board meetings.

HMRC has published **guidance** setting out its approach to corporate tax residence during the COVID-19 outbreak. The tone is helpful, with HMRC saying that they are "very sympathetic to the disruption that is being endured" and making clear that they "do not consider that a company will necessarily become resident in the UK because a few board meetings are held here or because some decisions are taken in the UK over a short period of time."

However, in contrast to the approach being taken by some other tax authorities, HMRC will not automatically disregard time spent in the UK because of COVID-19. HMRC plans to rely on flexibility in existing legislation and guidance, rather than to introduce any new concession. In the short term, this should be sufficient for companies which, until now, have implemented best practices to manage their residence position. However, if travel restrictions remain in place for a prolonged period, it may be worth considering steps such as appointing additional directors based outside the UK or restricting the participation in board meetings of UK-based directors (whilst ensuring that board meetings remain the forum in which key decisions affecting the company are taken).

If a non-UK resident company does, unintentionally, become UK resident under UK domestic law, some assistance may be found in recent OECD **guidance** on the interpretation of tax treaty tiebreaker clauses in relation to COVID-19.

Of course, some companies may have the converse problem to that described above, i.e., a UK incorporated company might also become resident overseas or a non-UK incorporated company may be at risk of losing its current UK tax resident status, if overseas-based directors are unable to travel to the UK for board meetings. Companies in this situation will also need to consider the relevant law and guidance in the UK or relevant overseas jurisdictions, as well as the provisions of any relevant double tax treaties. The OECD guidance referred to above may also assist.

Permanent establishment

A non-UK resident company may be subject to UK tax if it has a permanent establishment in the UK. Under UK domestic law a PE may be created, broadly, by having either (i) a fixed place of business in the UK or (ii) a dependent agent who habitually exercises authority to do business on behalf of the company in the UK. Where a double tax treaty applies, this may include its own, slightly different definition of PE.

If travel restrictions mean that a key individual in relation to a non-UK company is confined to the UK, there is a risk that a UK PE could be created. Alternatively, if a company already has a UK PE, this could result in a greater proportion of the company's profits being treated as attributable to the PE.

HMRC has published **guidance**, which, again, is helpful in tone. It makes clear that HMRC are sympathetic and consider that a fixed place of business will not be established after a short time and that whether an agent has habitual authority is a matter of fact and degree. However, as in relation to tax residency, HMRC plans to rely on flexibility in existing legislation and guidance, rather than to introduce any new concession. **Guidance** published by the OECD goes a little further, stating "the exceptional and temporary change of the location where employees exercise their employment because of the COVID-19 crisis, such as working from home, should not create new PEs for the employer." It is not yet clear whether HMRC fully accept this positon put forward by the OECD.

In the short term, again, most companies should find that HMRC's guidance is sufficient to prevent difficulties arising. However, if travel restrictions remain in place for a prolonged period, the positon may become less straightforward. In any event, companies may wish to take steps to seek to manage the position, for example, by thinking carefully about where and by whom key contracts are entered into and by keeping records of who holds relevant authority.

As is the case with corporate residency, UK resident companies should also consider the inverse position, i.e., whether similar considerations may result in a PE being created in an overseas jurisdiction.

Other noteworthy COVID-19-related UK tax developments

Personal tax residence

HMRC has also published **guidance** on the effect of COVD-19 on the tax residence status of individuals. This is determined on the basis of a statutory residence test, which takes account of the number of days spent in the UK. Days can be disregarded for certain purposes in exceptional circumstances. HMRC has helpfully set out situations in which COVID-19 travel restrictions will be treated as exceptional circumstance. Note, however, that the guidance does not cover all situations and that days cannot be disregarded for some aspects of the statutory residence test (for example, in calculating the number of work days spent in the UK).

R&D expenditure funded through loans under the CBIL scheme

Receiving a loan under the UK Coronavirus Business Interruption Loan scheme could potentially impact on the ability of a company to obtain tax credits under the small or medium enterprise Research and Development regime. HMRC has confirmed that the CBIL scheme is a notified state aid. Subsidised expenditure does not qualify for SME R&D tax relief, and where notified state aid is obtained in respect of expenditure, that expenditure is treated as subsidised. When applying for a CBIL loan, it will be helpful to make clear that the loan is not being sought to fund R&D expenditure and to keep records (and potentially consider using separate bank accounts) to show that the loaned money is not used to fund R&D expenditure. This issue relates only to SME R&D relief – the same concern should not arise in relation to the (less generous) R&D Expenditure Credit scheme, which is also available to SMEs.

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