

International Business Review

Setting up in the UK

Avoiding technical and regulatory pitfalls

The UK is a premiere destination for international inward investment. Have you maximised your advantages and avoided all the potential pitfalls?

If you are contemplating establishing a business in the UK you will probably already have researched the market and discovered the many opportunities that exist. It is these which have made the UK a premiere destination for international inward investment. In 2008, the cumulative "stock" of foreign investment in the UK was the third highest level of FDI stock globally.*

The UK enjoys a relatively favourable tax regime. There are, however, a number of tax and regulatory issues which you should consider. To ensure that you take maximum advantage of opportunities you must avoid the potential pitfalls, which may impact on your business.

In the following we set out a checklist of some of the issues that we suggest any business looking to operate in the UK should consider as early as possible:

Do you, or will you, have a UK permanent establishment with UK taxation liabilities?

This can often happen in circumstances which have not been planned or foreseen. Any substantive activity, even if it is quite limited, can result in a taxable presence.

Should you operate in the UK as an establishment, limited partnership or limited company?

Each form of entity has corresponding obligations, advantages and disadvantages.

Have you considered your business model?

The UK tax position will be affected by whether the parent continues to act as principal.

Have any transactions between related parties been considered and documented by means of a transfer pricing study?

Such a transfer pricing study is required for the majority of companies setting up in the UK. This can rarely be approved in advance but must be prepared and retained, to be available as and when HM Revenue & Customs (HMRC) may require it.

Are you obliged to operate a PAYE payroll deduction system?

An obligation to operate a PAYE (pay as you earn) system can arise when you employ even only one employee. This may be the case even if the employee is paid outside the UK and/or many of the activities are overseas. PAYE may also apply if you do not have a UK permanent establishment but send someone to work for a UK employer. Sometimes an employee may have to apply these rules himself. Self-employed status claimed by a representative in the UK will often be challenged by HMRC and requires careful consideration.

* Source: UK Trade & Investment, "UK Economy at a glance", March 2010 (ref. UNCTAD:2009)

Are you sending any employees to the UK for less than two years?

There are special opportunities for tax-free benefits for employees from overseas seconded to the UK. This must, however, be carefully planned.

Are expatriate employees bound to pay UK national insurance contributions?

Unless the employee has a "certificate of coverage" or form "E101" in place, or where special treaty rules apply, UK national insurance should be paid on earnings in connection with the UK employment. Often this will require contributions from both the employer and the employee to be made.

Are employment benefits taxable and subject to employer's national insurance contributions?

The UK definition of taxable benefits is very widely drawn. This can include accommodation costs, expense allowances, medical insurance, cost of living adjustments and tax equalisation payments. Some of these may be subject to PAYE. Others, including reimbursed expenses, may require to be reported on a form 'P11D' each year. It is often the case that certain of these benefits and expenses are taxable and/or subject to employer's national insurance contributions when they would not be in your home country. A form P11D needs to be completed each year to report these expenses, whether or not they are taxable.

Can liability to UK income tax be reduced by use of overseas employment contracts for employees sent to the UK?

Where there are separate contracts with two group companies, "dual contracts" can sometimes help in reducing personal tax liabilities. The rules and practice in this area are complex, and specialist advice should always be sought.

Share schemes

If you are going to grant options to employees, careful planning is necessary to reduce the tax cost for both the individual and the employer.

Is the company undertaking any research and development in the UK?

If so, the company may be able to claim tax credits against this expenditure and potentially receive refunds from HMRC.

Have you suffered VAT in the UK or elsewhere in the EU, where you are not and have no requirement to be registered?

In such circumstances it may be possible for the VAT to be reclaimed. This can reduce the effective cost of VATable expenditure by 20% in the UK and up to 25% in some other EU countries.

Is the business expecting to have an annual UK turnover of over £73,000?

Where this happens the business is liable to register for VAT and must submit returns, which can be on a monthly or annual basis, but are typically prepared quarterly.

The above issues are intended to highlight some of the matters which you should consider in the area of UK taxation and corporate regulation.

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