

Setting up your business in the UK

The United Kingdom (UK) continues to be one of the world's leading locations for global business, as the prime business location in Europe for foreign direct investment.

However, there are a number of issues which you must consider when you are looking to set up your business in the UK. This document takes you through some of the common questions that we come across and it also gives you practical information about the issues that you need to consider.

What type of business structure should we use?

There are advantages and disadvantages to all of them, and there is no one correct answer. It is dependent on your specific business circumstances and needs, a brief overview of the main structures is below:

Establishment (a branch of your overseas company)

- Is not a separate legal entity but an extension of the overseas parent company.
- There is no limited liability or ring-fencing of the UK operations.
- If you have a permanent establishment (PE) in the UK, then profits from this PE are liable to UK corporation tax.
- Must file parent company accounts, prepared under UK company law, at Companies House for public inspection, even if these are not made publicly available overseas.
- Being a branch and not a separate legal entity may add complexity with regard to VAT – deciding which establishment is supplying or receiving services.

Limited company

- Provides limited liability and ring-fencing to UK operations.
- Gives a perception of a local business, with longevity.
- Corporation tax is paid on company profits.
- Have to file UK company accounts at Companies House for public view.
- Accounts require auditing if the **group** as a whole exceeds two of the following three criteria: Revenues >£10.2m; Gross Assets >£5.1m; Employees >50.

Limited Liability Partnership (LLP)

- Members (partners) have limited liability.
- Members can be companies, or individuals.
- Profits are allocated to members who then pay tax on these profits (the type and rate dependent on their own position)
- The tax residence of the member, and where the profits in the LLP originated, will determine in what jurisdiction and how these profits are taxed.

How much corporation tax will the business pay?

Companies which are tax resident in the UK are subject to corporation tax on their worldwide profits, however, various exemptions effectively limit this to tax on UK-related activities. Non-resident companies are generally subject to tax on activities carried out through a UK PE. It should be noted, however, that corporation tax is also imposed on non-resident companies that carry on a UK property business.

The current corporation tax rate in the UK is 19% for the tax year to 31 March 2021, no matter what the size of the company.

Trading losses can generally be offset against current year profits or carried back to the preceding year. If not, these losses can be carried forward and offset against total profits of the company and Group. However, the amount of annual profit that can be relieved by brought forward losses is limited to 50%, subject to a £5 million allowance per group. Group relief arrangements are also available to surrender these losses, subject to certain conditions, where there are several UK companies or establishments under common ownership of 75% or more by the parent company. Similar arrangements exist for consortiums.

What if we use the UK to set up our holding company?

The UK's competitive tax legislation means that it is a very attractive place to set up a holding company.

If a UK company holds shares in another company and these shares are subsequently sold after being held for at least a year, then the resulting gain is exempt from tax as long as the company held at least 10% of the share capital in the company sold and the company sold was a trading company or the holding company of a trading group.

Also, virtually all dividends received by a UK parent company, whether from the UK or overseas are exempt from UK taxation.

The UK also does not levy a withholding tax on dividends paid to its shareholders, whether they are based in the UK or overseas.

The UK also has an extensive network of double taxation treaties.

The UK does not have any foreign-exchange controls or restrictions on inward or outward investments.

All of which makes the UK a very advantageous location to set up a holding company.

What if we make cross-border transactions between group companies?

The UK follows internationally recognised Transfer Pricing (TP) rules where cross-border trading and financial transactions between affiliated entities have to be conducted on an arm's length basis.

The price and terms should be the same as if the transactions between affiliated entities have to be conducted on an arm's length basis.

The price and terms should be the same as if the transactions had been between completely independent parties.

Typical transactions between affiliated entities that are covered by TP regulations are:

- Sale and purchase of goods.
- Provision of management services.
- Property rental charges.
- Transfer of intangible assets e.g. trademarks, patents etc.
- Sharing of knowledge, expertise, business contacts etc.
- Provisions of financial support e.g. inter-group loans and charging a 'market' interest on loans.

A business will need to prepare a TP report proving the arm's length basis of transactions. The report will include a functional and risk analysis, analysis of the adopted pricing model and benchmarking of the arm's length base.

SMEs are generally exempt from the UK's TP regime, so only 'large' entities need to undertake detailed TP analysis. A 'large entity' for TP purposes is one with, or part of a group with >250 employees, or <250 employees but revenues >€50 million and gross assets >€43 million. However, even if an entity is exempt from the UK's TP regime it may fall under the scrutiny of the other international tax jurisdictions where it transacts. There may also be other tax regulations which ensure transactions are undertaken at a commercial value.

In addition to transfer pricing legislation, corporate interest restriction rules also cap the deductions available for interest. The rules are complex, but a group can always deduct net tax-interest expense of up to £2m per year, (subject to normal transfer pricing, thin capitalisation, and other anti-avoidance provisions).

It should also be noted that the UK does have strong anti-avoidance provisions to prevent artificial cross-border tax avoidance including:

- a general anti-abuse rule ("GAAR")
- anti-hybrid rules; and
- the diverted profits tax

What employment taxes and social security will need to be paid?

If an individual is resident in the UK, then they are subject to UK tax laws. The UK Statutory Residence Test comprises of three tests to determine whether an individual is resident or not in the UK – the 'automatic overseas test', 'automatic residence test' and 'sufficient ties test'. These tests can be complex, and we would advise any new entrant to the UK or person who spends time working in the UK to take professional advice to determine whether they are a UK tax resident.

Current **personal income tax** rates in the UK are:

Band of income (£)	Tax rate (%)
1-37,500	20
37,501 – 150,000	40
Over 150,000	45

NB: Rates are for the tax year to 5 April 2021

Employers and employees also have to pay UK social security, which is called National Insurance (NI)

Current NI rates are:

	Band of income	Rate (%)
Employer	Up to 8,788	0
	Over 8,788	13.8
Employee	Up to 9,500	0
	9,500 – 50,000	12
	over 50,000 on excess	2

NB: rates are for the tax year to 5 April 2021

It is the employers' legal responsibility to pay over employee's tax and social security deductions to the UK tax authorities.

The UK has a reciprocal agreement with the USA, EU countries and many others whereby when an overseas national of those countries is seconded to the UK for a defined period of time and continues to pay social security in their home country, then the employer and employee are exempt from paying UK NI.

What is Value Added Tax (VAT) and should the business be registered?

VAT is a 'goods and service' tax added to the value of 'taxable' supplies made, the standard rate of which is 20% (a reduced rate of 5% and even zero rate or exemption can apply to certain goods and services).

If a UK established business makes 'taxable' supplies in excess of £85,000 in any 12 months or single month, then it **MUST** be registered for VAT. A non-established business may also have an obligation to register for VAT as soon as it makes ANY supply of goods (and potentially certain services) deemed to take place in the UK; for example if it is the importer of goods into the UK which it then supplies to businesses or consumers. EU established businesses may not need to register, at least until Brexit, as they benefit from intra-community reliefs and a 'distance selling' threshold for consumer goods sold via mail order.

There are three categories of supply:

- Taxable – with a 'rate' of VAT being charged on supplies made at 20%, 5% or Zero rate and where VAT on related expenditure can be reclaimed from HMRC.
- Exempt – no VAT charged on services nor reclaimed on related expenditure.

- Outside the scope – not in the UK VAT system.

Most supplies of goods and services in the UK are taxable. However, when these are supplied to businesses outside of the UK, advice needs to be sought as to what rate of VAT, if any, to use and importantly the VAT implications in the country where the goods or services are received. There may be registration requirements there.

Also, from 1 July 2021 the EU is changing its VAT system so that VAT is due according to a destination based approach rather than where the supplier belongs. Sales to and from the EU will therefore require an understanding of the VAT treatment of supplies where goods and services are received, particularly for supplies to consumers.

If a UK entity sells goods or provides services to its non-EU parent company, then it is unlikely that VAT will be chargeable on these overseas supplies. However, the VAT it incurs on its UK expenditure may well be reclaimable; typically if the supply would ordinarily be subject to VAT if made to a UK recipient.

Can we provide share option plans to our staff?

Many companies see share option plans as being an important way of attracting, motivating, and retaining key staff.

The UK has a number of 'approved' share option plans which give tax benefits to employees and employers alike and it is often possible to adapt an overseas stock option plan to fit into one of these 'approved' plans.

However, this is a very technically complex area and careful planning needs to be undertaken as soon as share option plans are being considered for implementation in the UK.

What benefits can we provide to our employees?

The UK has a very comprehensive range of compensation and benefit options available for companies to offer their employees.

Employers must provide a workplace pension to their UK employees and make a minimum employer contribution of 3%. Other benefits such as private medical insurance, life and disability cover are now commonplace benefits provided by many UK businesses to their workforce. Flexible benefit packages are also gaining in popularity, giving employees options on how they wish to 'spend' their benefits allowance, which can range from 'purchasing' additional holiday entitlement to obtaining full family medical cover.

The UK also has legal requirements in relation to minimum wage and statutory holiday, vacation and leave.

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Our expertise with international business has also been recognised by the Department of International Trade (DIT), the government body which promotes the UK to overseas business. We are very proud to have been approved as members of the UK Investment Support Directory, which has been set up by the DIT to highlight businesses who have experience and expertise in supporting foreign investors looking to set up in the UK.



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