CHAPTER 1

COMPANY RESIDENCE

This chapter outlines the issues surrounding company residence including:

− the rules used to determine whether a company is resident in the UK;
− the interaction of domestic law with Double Taxation Treaties;
− dual resident companies.

1.1 Introduction

The question of a company’s residence is important in that it will determine the extent to which it is within the charge to UK Corporation Tax.

UK resident companies are taxable on their worldwide income.

Non resident companies will be chargeable to UK corporation tax only if they are carrying on a trade in the UK through a permanent establishment. The profits chargeable to corporation tax will be trading income arising directly or indirectly from the permanent establishment (PE), together with income from property or rights held by or held for the PE and chargeable gains within s.10B TCGA 1992. We will look at the taxation of non resident companies in more detail later.

Special rules apply to companies known as Societas Europaea. We will look at these in a later chapter.

1.2 History

In the UK, the residence of companies was decided by case law until legislation was introduced by Finance Act 1988. Residence status for the purposes of a Double Tax Treaty (DTT) did not affect residence for UK tax purposes until Finance Act 1994.

We will look at each of the above and the rules that apply where a company is held to be dual resident.

1.3 Case Law

The test for determining a company’s residence was set down in De Beers Consolidated Mines v Howe. It was stated in this case that “......a company resides where its real business is carried on ......and the real business is carried on where the central management and control actually abides”.
The company was established in South Africa and its main business was carried on there, however the controlling board of directors exercised its powers in the UK. The company was held to be resident in the UK.

A later case, Bullock v Unit Construction Ltd (1959), again involved companies operating in South Africa. The constitution of each company gave control to the board of directors who had to hold their meetings outside the UK. However, as a question of fact, it was found that real control was being exercised by the directors of the parent company in the UK, even though this was unconstitutional.

The cases of Untelrab Ltd v McGregor (Inspector of Taxes) ; Unigate Guernsey Ltd v McGregor (Inspector of Taxes) ; Unigate Overseas Ltd v McGregor (Inspector of Taxes) are interesting as they looked at the amount of influence a parent could have and stated that the burden of proof lay with HMRC.

In summary the facts were that: Untelrab Ltd (the subsidiary) was incorporated in Jersey in December 1979 for the specific purpose of receiving a sum of money which was to become due to its parent, Unigate, a company resident in the United Kingdom. The subsidiary’s business consisted of receiving the money due to the parent, investing that amount on short-term bank deposits, and making loans to other companies in the Unigate group, usually at the parent’s request.

Board meetings of the subsidiary were held two or three times a year in Bermuda attended by two out of its three directors at which investment policy was reviewed and requests for loans were considered. The minutes were signed in Bermuda and sent to the third director in Jersey, where the minute book was kept. The day-to-day management of the subsidiary was carried out in Bermuda. The parent’s guidelines for the operation of overseas subsidiaries emphasised that, although advice could be given from the United Kingdom, no major decisions were to be taken there.

There was no occasion when a request for funds from the parent was refused and the revenue contended that this showed, prima facie, that control was exercised by the parent company in the UK. It was shown that no request was improper or unreasonable, but if it had been, it would have been refused. The subsidiary’s directors would not have carried out directions from the parent if they considered that such instructions were to the subsidiary’s detriment.

It was held that –

(1) The burden of proving residence lay on the Revenue. If they failed to establish that the company’s residence was within their jurisdiction then the company ought not to be taxed.

(2) Although a board might do what it was told to do, it did not follow that the control and management lay with another, so long as the board exercised its discretion when coming to its decisions and would have refused to carry out an improper or unwise transaction.
The subsidiary’s board met in Bermuda and transacted the subsidiary’s business there and would have refused to carry out any proposal which was improper or unreasonable. Although the subsidiary was complaisant to do the parent’s will, it did function in giving effect to its parent’s wishes and the parent did not usurp the control of the subsidiary. The subsidiary’s central management and control was in Bermuda and it was therefore resident there.

The decisions in these cases demonstrate that the question of central management and control is one of fact.

SP 1/90 sets out the Revenue’s view quite clearly. They will look to the highest level of control - the place of central management and control is to be distinguished from the place where the main operations are carried on, although often they will be in the same place. There is no minimum level of activity required; control can be exercised passively as well as actively. Factors which influence a decision in one case may carry no weight in another case.

Where the board of directors meet will be important, however it is not necessarily conclusive. It will be significant only in so far as the meetings are the medium through which control is operated. It is possible for control to rest in the hands of one person, such as a chairman or a major shareholder.

The Revenue outlines the following approach:

i) They will try to ascertain whether the directors actually exercise central management and control;
ii) If they do, then they will seek to establish where it is exercised;
iii) If they do not, then they will seek to establish who does exercise central management and control, and where.

The Revenue recognises that the situation regarding subsidiary companies is not straightforward. A parent company will have some degree of influence over the actions of a subsidiary. It is necessary to distinguish between the parent exercising the normal powers of a majority shareholder in general meetings and the parent overriding the powers of the directors in the subsidiaries, as in the Unit Construction case. The Revenue will look at the amount of autonomy the subsidiaries have as regards decisions on marketing, investment, production and procurement.
Wood v Holden

A scheme was set up to reduce capital gains tax on the sale by the Wood family of Ron Wood Greeting Cards Ltd. The scheme was complex and involved a number of offshore companies and trusts. It is not necessary to explain how the scheme worked, as the court had to decide a single issue: the residence of one of the companies.

Eulalia Holdings BV was a dormant Dutch company pressed into service for the scheme. It was made a subsidiary of CIL, a British Virgin Island company. A Dutch trustee company (the AA Trust) was appointed director. Simplified, the structure was as set out in Figure 1.

**Figure 1: Structure after Eulalia introduced**

Eulalia did two things:

- it bought from its parent, CIL, its shareholding of just under 50% in Holdings Ltd; and
- three months later it sold that shareholding to the outside purchaser.

The shareholding was bought on 23 July 1996 for £23.7 million (with an upwards adjuster so that the price would equate broadly to just under the price to be received on the sale). The price was left outstanding as a loan.

The shareholding was sold on 21 October 1996 for £30.8 million, along with the other shareholdings totalling just over 50% owned by the Wood family.
For the scheme to work it was essential that Eulalia was tax-resident in The Netherlands. The Revenue argued that it was not. It said it was managed and controlled from the UK; the two transactions it entered into were choreographed from the UK by Mr Wood and his advisers.

The special commissioners found in favour of the Revenue. They had been struck by the lack of activity at director level during Eulalia’s short active life. They said “We do not consider that the physical acts of signing resolutions or documents suffice for actual management. Nor does the mental process which precedes the physical acts.”

However Park J observed that the decisions had nonetheless been made by the board. There was no evidence that they had acted mindlessly. They had certainly been influenced by what they understood to be the wishes of the Wood family.

Referring to an Australian case he distinguished between the advisers having wielded influence but not exercising control. Therefore Park J concluded that Eulalia was not resident.

*Laerstate BV v Revenue and Customs Commissioners and other appeals [2009] UKFTT 209 TC*

Dutch incorporated and resident company (BV) was bought by German Resident individual (Mr Bock). The company had two directors Mr Bock and Mr Trapman (Mr T).

The BV bought shares in Lohnro. According to the company’s articles one Director could bind the company. Mr Bock moved to London and later Mr Bock became UK Resident. Just before the sale of the Lohnro Shares Mr Bock resigned as Director of BV.

HMRC questioned the residence of the BV claiming it was UK resident.

At the time of writing the case was being heard at the Upper Tribunal but the decision had not been announced. The lower tribunal found in favour of HMRC.

The approach taken by the tribunal was to look at two separate periods, before and after the resignation of Mr Bock as a director.

Many board meetings were held outside of the UK, however it still needed to be determined whether this was the place where resolutions were actually made, i.e. the place of CM&C.

Board minutes were not very detailed, Mr Bock did not go to most of the meetings.

The court considered the importance of De Beers commenting that:

‘the actual question must be considered "upon a scrutiny of the course of business and trading"’.
The court also looked at whether Wood v Holden was relevant and concluded that the case was not relevant whilst Mr Bock was a director but was relevant when Mr Bock had resigned.

For the period when Mr Bock was a director the court found that he was taking all the decisions and mainly these were taken outside of the board meetings.

After Mr Bock resigned as director the court found that things didn’t really change, he was still making decisions. Mr T was merely signing documents.

The fact Mr Bock was UK resident did not on its own mean the BV was UK resident but looking at the facts the main decisions were being taken in the UK by Mr Bock.

With regard to the question of residence under the double tax treaty, the judges found that the place of effective management (that is, the jurisdiction in which the real management of the company was taking place) was in the UK. Mr Bock’s activities were concerned with policy, strategic and management matters throughout the time when he was a director of the company and also after he ceased to be a director. As such his activities constituted the real top level management of the BV, and Mr T’s activities were limited to signing documents when told to do so and dealing with routine matters such as accounts. Accordingly Laerstate BV was resident in the UK both in domestic law and under the double taxation agreement throughout the relevant period.

It followed that the appeals would be dismissed. The company appealed the decision to the Upper Tribunal in November 2009. Following the death in 2010 of Mr Bock, the appeal to the Upper-tier Tribunal was struck out. This means that the decision of the First-tier Tribunal (above), which found for HMRC after a detailed factual analysis of the roles of the named director and Mr Bock in management and control of the company, is now final.

Laerstate reinforces the message that questions of corporate residence depend on a very close examination of the facts. Viewing central control and management as meaning just board resolutions and the signing of documents was too narrow an interpretation and wider management activities need to be considered.

1.4 Statute

A company incorporated in the UK will be regarded for the purposes of the Taxes Act as resident there.

1.5 Interaction of statute and Double Tax Treaties (DTTs)

CTA 2009 s.14 states that if a company is incorporated in the UK but a different place of residence is given by any rule of law, the company is not resident in that place for the purposes of the corporation taxes act.
Thus, a company incorporated in the UK will be resident in the UK even if the laws of the country where it operates its business deem it to be resident in that country. These companies are known as dual resident companies. In general, a company's overseas tax status is not relevant in determining its residence in the UK.

Without this rule a company could be non UK resident for the purposes of a DTT but UK resident for all other purposes.

CTA 2009 s.18 provides for companies held to be non UK resident under a DTT to be non UK resident for the purposes of the Corporation Tax Acts (exception in the case of the controlled foreign company provisions where such a company is still regarded as being UK resident – see s.747 (1B) ICTA).

Most, but not all DTTs have a tie breaker clause that will determine the residence of a company. Thus s.18 will operate where there is a tie breaker clause in the treaty.

We will confine our studies to the tie breaker clause that is in the OECD model treaty. We will look at the OECD model DTT in a later chapter in more detail.

The tie breaker clause in the model treaty looks to the place of effective management of the company. Certain commentators argue that this is a test that takes place at a lower level i.e. where the business is effectively carried on. The Revenue used to hold the view that the place of "effective management" and "management and control" would be the same, they now accept that the head office will often be the place of "effective management", which can be in a different location to the place where "management and control" is exercised. However the Revenue still hold the view that it is very difficult to divorce the two, and as a result they think that the place of management and control and effective management will often coincide.

1.6 Dual resident companies

It is still possible for a company to be dual resident if the residence rules of the UK and another country are both satisfied.

In the past, dual resident companies have been used to gain a tax advantage in the UK, particularly in relation to group relief and thus the legislation contains anti-avoidance rules relating to dual resident companies.

The rules only apply to dual resident investment companies.

A dual resident company for these purposes is one that is resident in the UK and is also within the charge to tax under the laws of a territory outside the UK either:
• because it derives its status as a company from those laws; or
• because its place of management is in that territory; or
• because under those laws it is regarded for any other reason as resident in that territory.

A dual resident investment company is a dual resident company that is not a trading company throughout the accounting period, or one that is a trading company, but whose trade consists of acquiring and holding shares, securities or other investments in other companies or financial activities - for example the group banker or financial services company.

The restrictions for dual resident investment companies relate to the following:

1. Group relief - no relief is available if the surrendering company is a dual resident investment company. CTA 2010, s.109

2. CTA 2010 s.948 relief - the transfer of assets at TWDV for capital allowance purposes on the transfer of a trade under common ownership does not apply to dual resident investment companies. CTA 2010, s.949

3. Capital gains - no gain/no loss transfers do not apply if the disposal is to a dual resident investment company. The rules relating to a group being treated as one trade do not apply if the company acquiring the new asset is a dual resident investment company. TCGA 1992, s.171 (2)(d)

4. Capital allowances - an election cannot be made for transfer at TWDV. CAA 2001, s.570(2)

1.7 Entity Classification

The fact that an entity may have separate legal personality under the domestic law of a foreign country does not mean that it should be regarded as "opaque" for UK tax purposes.

An entity that is not regarded as a separate person under the domestic law of a foreign country will not necessarily give rise to a "transparent" entity for UK tax purposes. If the entity has features to suggest that when profits arise they are automatically allocable to the owners of the entity without taking on a different form in the hands of the owners then the entity is likely to be transparent.

Revenue Interpretation RI 279 (June 2006) outlined that besides the important profit attribution factor mentioned above a number of other factors are taken into account in deciding the nature of an entity. These include:

1) whether the members/owners of the entity are regarded as separate from that entity or inherently a part of it; the latter would tend to suggest transparency, but as discussed above not necessarily conclusively so,
2) whether there is something like or equivalent to share capital, suggesting opaqueness,

3) whether the members jointly carry on business or the entity itself does so,

4) whether the entity is responsible for servicing debts or the owners,

5) whether the assets directly beneficially belong to the owners or to the entity itself,

6) whether profits are automatically attributable to the owners, as discussed above, or whether the entity is required to distribute them in some way.

Some of the factors may point in one direction; others may point in another. An overall conclusion is reached by looking at all factors together.

HMRC stated that particular merit will be given to items 3) and 6).