# LOCATION, LOCATION, TAXATION – CORPORATE TAX RESIDENCE

*Kindly note that this guide is intended to provide general guidance and does not represent Jersey legal advice.*

*Do not allow non-Jersey residents to determine or dictate the decisions of Jersey companies. They can advise, recommend, research and suggest, but it can be dangerous for the company's tax health to do otherwise.*

*For further information, please contact your usual advisor at Lexstone Lawyers. We would be delighted to assist you.*

## INTRODUCTION

The property mantra "location, location, location" can easily be imported from the property world to the highly complicated world of corporate tax as demonstrated by the UK's Court of Appeal decision in Revenue & Customs v Development Securities plc and others [2020] EWCA Civ 1705, (the **Development Case**) which was decided by the Court of Appeal on 15th December 2020. The more appropriate modern version should probably be "*location, location, taxation*".

The Development Case was a highly complex action; not only has the decision been reversed twice but the three sitting Court of Appeal judges took three different views on the residence question.

This is the first Court of Appeal decision on corporate tax residence since 2006.

Under UK law, a company is a resident in the UK for corporation tax purposes if incorporated or centrally managed and controlled in the UK. The second test is purely a matter of fact.

In the Development Case, the Court of Appeal allowed HMRC's appeal. It affirmed the First-tier Tribunal (**FTT**) decision where it was held that a board of directors of several Jersey incorporated companies did not exercise management and control. Instead, they followed the instructions of the UK parent.

The key takeaway of this is that where a company resides is essentially a question of fact – it is paramount that a company can provide adequate evidence of where central management and control is exercised lest they face unintended tax consequences.


## THE FACTS

The Development Case facts were that transactions entered into by the Jersey companies (including acquiring assets at an overvalue) were part of a wider tax planning arrangement (a scheme to enhance latent capital losses), which Price Waterhouse Coopers devised in 2004. The total amount of money that the taxpayer stood to save from the tax planning was put at around £8 million, although it was reported that significantly less was saved in the end. The arrangement involved incorporating three Jersey companies as subsidiaries of the Development Securities UK plc (**DS**) and the transfer of assets to them, for consideration substantially more than their market value, the funding provided by DS. The Jersey companies needed to be resident in Jersey at the time the assets were transferred to them. The scheme's purpose was to enable the companies' group to take advantage of the indexation relief.

The Jersey companies' directors were DS's UK resident company secretary and three Jersey resident individuals employed by Volaw Trust and Corporate Services Limited, a Jersey corporate service provider associated with the Jersey law firm, Voisin & Co. The meetings took place in Jersey. The Jersey resident directors in person attended them, but the judgment observed that the company secretary from DS took the lead in setting out details of plans.

## THE CRUX

Crucial to the scheme was that the Jersey companies were residents in Jersey for UK tax purposes from incorporation until after acquiring undervalue assets. To defeat the scheme, HMRC argued that the Jersey companies' central management and control took place in the UK instead of Jersey, where most of the directors were based.

## THE DECISION OF THE FTT

The FTT found that the directors in Jersey were in reality, agreeing to implement transactions on the parent company's instructions (based in the UK). The FTT found that the directors had not acted improperly, but had not engaged with the substantive decision (an uncommercial transaction from the Jersey companies' perspective), and this was insufficient for the directors to be exercising central management and control. The FTT held that the Jersey companies had been centrally managed and controlled from the UK throughout because they had not engaged with the substantive decision but had been instructed by DS to carry out the transactions.

## THE DECISION OF THE UPPER TRIBUNAL (UT)

The UT overturned the FTT's decision and concluded central management was in Jersey. The UT viewed that the FTT's conclusion was founded on the directors having "failed to decline to do something that was improper or inadvisable, in that they had entered into so-called uncommercial transactions". The UT also thought that the FTT had erred by confusing shareholder authorisation with instruction. The UT determined that the FTT had erred in law and was not entitled to reach the conclusion it did base on the facts found by the FTT, because the directors had applied their minds to the transaction and did not abdicate their decision-making responsibilities.

## COURT OF APPEAL'S DECISION

The Court of Appeal considered the Upper Tribunal had mischaracterised the basis and, therefore, allowed the appeal. The UT was wrong to conclude the FTT had confused shareholder authorisation with instruction. The real reason for the FTT's decision was its finding of fact that the directors of the Jersey company had acted on what they perceived as an instruction from DS and did not engage with the substantive decision and, therefore, the central management and control of the Jersey company was really in the UK throughout.

The critical finding of fact was that DS instructed the Jersey companies to enter the transactions and the directors followed that instruction, subject to checking it was lawful to do so and therefore taking any actual decision themselves.

However, there was no notice seeking to uphold the Upper Tribunal's decision on an alternative basis, so the usefulness of the decision in assessing the question of residence is limited. There appeared to be a disagreement between the judges on the substantive issues considered by the FTT.

It is unfortunate that the appeal succeeded on technical grounds and arguably complicates, rather than clarifies, the test for corporate residence in circumstances where a subsidiary receives instructions from a UK resident parent.

## SUPREME COURT

Despite the need for further clarification on the test for corporate residence, and the "very considerable reservations" as to the FTT's reasoning from the Court of Appeal's Nugee LJ, The Supreme Court rejected Development Securities plc's request for an appeal. On 15th December, The Supreme Court laconically ruled that the Development case did not raise "*an arguable point of law" and that the case "turns on its particular facts,*" and therefore lacks the general public importance that warrants a Supreme Court decision. This is despite the fact that, by its very nature, corporate residence cases often depend entirely on their particular facts.

## SEVERE RAMIFICATIONS FOR JERSEY DIRECTORS

The Development Case highlights the difficulties in ascertaining a company's corporate tax residence. However, it offers no clarity. In the words of Mr Grodzinski (acting for the tax payer) as referred to by Nugee LJ: the "*FTT's decision was the first time in any case where the local board of directors of a company had actually met, had understood what they were being asked to do it, had decided it was lawful, had reviewed for itself the transaction documents, had found not to have acted mindlessly, but had nevertheless been found not to have exercised CMC*". In this one decision alone, the Court of Appeal has raised the bar to establish central managed and control being controlled outside of the UK.

Although there is one interpretation, there has been no change in principle as this case is an extreme case turning on extreme facts and should be limited to similar scenarios. There should be no read-across to other transactions.

However, the Court of Appeal did undertake a legal analysis of the judicial authorities. Below is a summarised snapshot of some of the commentary: -

The Court of Appeal did confirm that the correct starting point for consideration of a company tax residence is De Beers Consolidated Mines v Howe (Surveyor of Taxes) [1906] AC 455 where the House of Lords set out the test for corporate residence as being where the central management and control (real business) of a company takes place as a matter of fact and not as determined by a company's constitutional documents. This concept is known as the "*overarching principle*".

Here, Lord Loreborn explained: -

"*But it is clearly established that the majority of directors and life governors live in England, that the directors' meetings in London are the meetings where the real control is always exercised in practically all the important business of the company except the mining operations. London has always controlled the negotiation of the contracts with the diamond syndicates, has determined policy in the disposal of diamonds and other assets, the working and development of mines, the application of profits, and the appointment of directors. London has also always controlled matters that require to be determined by the majority of all the directors, which include all questions of expenditure except wages, materials, and such-like at the mines, and a limited sum which may be spent by the directors at Kimberley.*"

In that case, it was concluded that the "*head and seat and directing power of the affairs*" of the company were in London and the company was, therefore, resident in the UK.

Lord Loeburn then stated that the rule was "*a pure question of fact to be determined, not according to the construction of this or that regulation or bye-law, but upon a scrutiny of the course of business and trading*".

In United Construction v Bullock [1960] AC 351 the Commissioners found that the board of directors of three Kenyan companies "were standing aside in all matters of real importance and in many matters of minor importance affecting the central management and control" with "the real control and management" being exercised by" its parent in London.

Viscount Simons noted "Nothing can be more factual and concrete than the acts of management which enable a court to find a fact that central management and control is exercised in one country or another. It does not in any way alter their character that in greater of less degree they are irregular or unauthorised or unlawful".

Newey LJ considered Wood v Holden [2006] 1 WLR 1393 and concluded that a company is resident where its "constitutional organ" exercises management and control. If management and control is exercised independently of, or without regard to, a company's constitutional organ, or if any outsider dictates the company's decisions, then the company is resident wherever management is actually exercised. Newey LJ contrasted an outsider dictating decisions of the company (which would affect the company's central management and control) with somebody merely proposing, advising or influencing a company's decisions (which would not affect the company's central management and control).



## KEY POINTS AND THE TAKEAWAY

### The key points:

1. As a result of the pandemic, HMRC is now understood to be looking at corporate residence in other situations, so all Jersey companies with a UK nexus must conduct health checks.
2. A company's residence is essentially a question of fact.
3. The directors of the company must genuinely make the decisions rather than implementing decisions dictated by others.
4. A company may be UK tax resident but not registered in the UK. It is the actual place of management which fixes the residence of a company.
5. The overarching principle is that a company resides for UK tax purposes where its real business is carried on, and that is where control and management actually abide. This includes special purpose vehicles.
6. A company may be resident in a jurisdiction not only where a constitutional organ exercises management and control but if that organ is usurped and management and control are exercised independently without regard to its organs – in other words, someone in London dictates to the Jersey company what to do.
7. Determining factors include the place where important decisions are taken, the residence of majority directors, place of board meetings, control of negotiation of contracts, determination of policy, application of profits, the appointment of directors, and expenditure questions.
8. The company directors should ensure that they have appropriate qualifications and experience for the company's activities. Having three directors from the Jersey corporate service providers is not necessarily the answer.
9. The proposed directors of the company should be involved in the incorporation of the company and pre-incorporation planning.
10. Use the correct terminology: The loose use of words such as instruction or direction in communication rather than advice, recommendation, proposal, or suggestion can significantly impact. Such comments should be avoided by anyone connected other than a Jersey resident director.
11. Obtain information: The directors of the Jersey company should ensure that they have adequate information to decide.
12. Rationale: The directors of a Jersey company should ensure that the rationale for entering into a transaction, relevant duties of directors and decisions taken are recorded in the board minutes.
13. Tax: If there are any perceived tax benefits from the transaction, the Jersey company's directors should obtain tax advice on the benefits and risks.

14. Any UK activity between board meetings: The Jersey company's directors should authorise this in advance and still decide on any significant aspects.

15. Prepare for forensic analysis: The Jersey company's directors should ensure that any decision can withstand minute and meticulous detail. The level of disclosure can come as a surprise.

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