

# UK TAXATION OF NON-RESIDENTS: LIABILITY OF UK REPRESENTATIVES

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## 1 The Changes In Outline

### 1.1 The Background

Important changes to the taxation of non-United Kingdom residents and their agents were announced in two Inland Revenue 1994 Budget Press Statements of 29th November 1994. The first of these was called "*Investment Managers*" ("the Investment Manager Statement")<sup>1</sup> and the second "*Self-Assessment*" ("the Self-Assessment Statement").<sup>2</sup>

The Press Statements indicated that the changes would be fully operational only by 6th April 1996. The Press Statements are to some extent misleading, in that the terms of the 1995 Finance Act sometimes conflict with them. There were also substantial changes to the Finance Bill provisions concerning investment managers. The Press Statements are important in that they apparently contain Extra Statutory Concessions which so far have not been published elsewhere.

In this article, I consider the liability of agents of non-United Kingdom resident persons. In *UK Taxation of Non-Residents: The New Substantive Rules*, the previous article in this issue, I consider the equally important question of the substantive liability of such persons.

### 1.2 Liability of Agent

#### 1.2.1 Pre 6th April 1995

Prior to 6th April 1995, an agent could himself be assessable on behalf of his principal. There were complicated rules contained in Taxes Management Act 1970

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<sup>1</sup> Reproduced in Appendix A to this article.

<sup>2</sup> Reproduced in Appendix B to this article.

rendering a branch or agent liable on behalf of his principal if he carried on a regular agency, with two important exceptions for certain investment transactions carried out through an investment manager and certain transactions carried out through a broker. There are several judicial authorities which are relevant to these provisions.

#### 1.2.2 6th April 1996 Onwards

Taxes Management Act 1970 Part VIII is being repealed and replaced by new rules, contained in Finance Act 1995, which will apply only where the non-resident is carrying on a trade or profession in the UK through a branch or agent.

#### 1.2.3 6th April 1995 - 5th April 1996

The liability of agents is unaffected, despite the statement in the Investment Manager Statement para 12: "These changes will apply to income arising on or after 6th April 1995." The new rules will be in force for the purpose of determining whether the principal is liable to tax. In certain cases where the agent was relieved from liability as agent under the Taxes Management Act 1970 provisions, by ESC B40 the Revenue did not charge the principal either. ESC B40 has only a limited operation in 1995/96.<sup>3</sup> Thus it is possible that an agent may escape liability for tax for that year, because the Taxes Management Act rules apply to him, but the principal will not.

## 2 Relevance of (UK) Agent

### 2.1 Representative Liability

An agent may find that he is himself assessable on behalf of the principal or, under the new regime, liable to civil penalties or even criminally liable as respect his principal's tax affairs. The scope of this liability is discussed in the remainder of this article.

A wise agent will ensure that he has an enforceable indemnity, adequately secured. It is desirable that the indemnity should be a contractual one, and not simply based on English statute, as the agent might well need to enforce the indemnity abroad, yet a foreign court would probably refuse to give effect to an indemnity contained in a United Kingdom Revenue statute on the grounds that it was an indirect method of enforcing a UK Revenue claim.

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<sup>3</sup> See my article on the substantive rules at 3.6.

## 2.2 Indirectly creating liability of Principal

The agent may exceptionally cause his principal to become liable, whether or not he also becomes liable on behalf of the principal. For example, the existence of an agent carrying on activities in the United Kingdom may turn a trade of dealing in property situate in the UK into a trade which is itself *carried on* in the UK; the carrying on of a trade by a non-resident company through a branch or agency may render it liable to corporation tax rather than income tax;<sup>4</sup> or the agent may constitute a permanent establishment for the purposes of a Double Taxation Arrangement and thus deprive the principal of treaty relief.

## 2.3 Removing Liability of Principal

The agent may cause the principal to escape liability from tax on trading income. Until 6th April 1995, this is by extra-statutory concession only.<sup>5</sup> Thereafter, see Finance Act 1995 section 128.<sup>6</sup>

# 3 Pre 6th April 1996

## 3.1 Taxes Management Act 1970 section 78 - Method of charging non-residents

Taxes Management Act 1970 section 78 provides:

- "(2) Subject to subsection (2) below and section 43 of the principal Act (Schedule A etc) a person not resident in the United Kingdom, whether a British subject or not, shall be assessable and chargeable to income tax in the name of any such trustee, guardian, tutor, curator or committee as is mentioned in section 72 of this Act, or of any branch or agent, whether the branch or agent has the receipt of the profits or gains or not, in like manner and to the like amount as such non-resident person would be assessed and charged if he were resident in the United Kingdom and in the actual receipt of such profits or gains."

This will remain in force until 6th April 1996.

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<sup>4</sup> See Taxes Act 1988 section 11.

<sup>5</sup> B40.

<sup>6</sup> See 3.5.5.

"branch or agent" is to be construed in accordance with "branch or agency", which is defined, by section 118(1) to mean "any factorship, agency, receivership, branch or management".

"any such trustee, guardian, tutor, curator or committee as is mentioned in section 72 of this Act" is a trustee etc. of an incapacitated person. Section 72 provides:

- "(1) The trustee, guardian, tutor, curator or committee of any incapacitated person having the direction, control or management of the property or concern of any such person, whether such person resides in the United Kingdom or not, shall be assessable and chargeable to income tax in like manner and to the like amount as that person would be assessed and charged if he were not an incapacitated person."

### 3.2 Taxes Management Act 1970 Section 78(2)-(5) Exception for Investment Managers

This exception is repealed as from 6th April 1996.

#### 3.2.1 The Statute<sup>7</sup>

Taxes Management Act 1970 section 78 provides:

- "(2) Subject to the following provisions of this section, a person who is not resident in the United Kingdom shall not, by virtue of this section, be chargeable in the name of an agent in respect of profits or gains arising from *investment transactions* carried out by the agent if -
- (a) the agent is carrying on a *business of providing investment management* services to a *number of clients* of whom the non-resident person is one; and
  - (b) the investment transactions concerned were carried out in *the ordinary course of the business* referred to in paragraph (a) above; and
  - (c) the *remuneration* which the agent receives for the provision of investment management services to the non-resident person is at a rate which is *not less than* that which is *customary* for that class of business; and

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<sup>7</sup> Italics supplied.



- (d) *in the case of* profits or gains which are chargeable to tax as the profits or income of the non-resident person from carrying on a *trade* in the United Kingdom through a branch or agency, the agent carrying out the investment transaction is *also the agency through which the trade is carried on*;

and in the case of an agent who provides investment management services as part only of a business, paragraphs (a) to (d) above shall apply as if that part were a separate business."

### 3.2.2 "not by virtue of this section"

"a person who is not resident in the United Kingdom shall not, *by virtue of this section*, be chargeable in the name of an agent ..."

*In practice*, no assessment is made either under Taxes Management Act 1970 section 79 or Taxes Act 1988 section 59. See ESC B40:

"However, where in a case otherwise within TMA 1970 s.78(1) the agent is specifically protected from assessment by the terms of s.78(2) (investment managers) or s.82(1) (brokers and general commission agents), the Revenue neither assesses the non-resident directly nor exercises the option of assessing the agent under TMA 1970 s.79 or TA 1988 s.59."

But what of Taxes Management Act 1970 section 72? If the principal happens to be incapacitated, e.g., a minor, then the agent is still assessable under section 72. The position will be the same under the new law.

### 3.2.3 "carrying on a *business of providing investment management services*"

This condition is reproduced in terms in the new rules: see Finance Act 1995 section 127(3)(a).

### 3.2.4 "to a *number of clients* of whom the non-resident person is one"

This condition is not reproduced in the new rules.

### 3.2.5 "the investment transactions concerned were carried out in *the ordinary course of the business*"

This condition is reproduced in terms in the new rules: see Finance Act 1995 section 127(3)(b).

3.2.6 "the *remuneration* which the agent receives for the provision of investment management services to the non-resident person is at a rate which is *not less than* that which is *customary* for that class of business"

This condition is reproduced in substance in the new rules: see Finance Act 1995 section 127(3)(e).

Revenue SP 15/91<sup>8</sup> states:

"5. In considering whether the agent is remunerated at not less than a normal rate ..., the Revenue looks primarily at whether the arrangements for remuneration are of an arm's length nature and are generally in line with what is acceptable in the investment management industry. Management for an incentive or performance fee is acceptable provided the terms are not abnormal."

3.2.7 "*in the case of profits or gains which are chargeable to tax as the profits or income of the non-resident person from carrying on a trade in the United Kingdom through a branch or agency, the agent carrying out the investment transaction is also the agency through which the trade is carried on*"

This is not reproduced in the new rules as a condition of an investment manager not being a UK representative, as he cannot *prima facie* qualify as such (before considering whether he falls within the exception) unless this condition is satisfied.

3.2.8 "investment transactions"

3.2.8.1 The Statute

Taxes Management Act 1970 section 78 further provides:

"(3) In subsection (2) above "investment transactions" means-

- (a) transactions in shares, stock, futures contracts, options contracts or securities of any description not mentioned in this paragraph, but excluding futures contracts or options contracts relating to land,
- (b) transactions on a recognised futures exchange, within the meaning of the 1992 Act<sup>9</sup>, and

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<sup>8</sup> The Statement of Practice is set out more fully in Appendix C to this article.

<sup>9</sup> Taxation of Chargeable Gains Act 1992.

(c) the placing of money at interest,

and for the purposes of that subsection an agent carries out such a transaction on behalf of his client whether he undertakes the transaction himself or by giving instructions to another person.

(3A) For the purposes of subsection (3) above a contract is not prevented from being a futures contract or an options contract by the fact that any party is or may be entitled to receive or liable to make, or entitled to receive and liable to make, only a payment of a sum (as opposed to a transfer of assets other than money) in full settlement of all obligations."

These subsections are reproduced in the new provisions<sup>10</sup> except for section 78(3)(b), which is replaced by a new provision relating to the buying or selling of any foreign currency.

#### 3.2.8.2 Trading Transactions

The Revenue expressed in SP 15/91 their views on when transactions constitute trading transactions. They have expressly stated, in note 4 to the Investment Manager Statement, that the SP continues to provide guidance as to the circumstances in which investment transactions carried out through an investment manager would be regarded as forming part of a trade carried on in the UK by the non-resident. SP 15/91 provides:

"9. The effect of TMA 1970 section 78(2)(d) is that the investment manager is protected from assessment by TMA 1970 s.78(2) even where the transactions are transactions in the course of a trade carried on by the non-resident client provided that trading in the UK is limited to the investment transactions within the investment management agency. The protection is lost if the transactions can be taxed as part of a wider trade carried on in the UK, eg insurance carried on in the UK through the same agent or another agent or by a branch of the non-resident. In the last two cases an assessment would normally be made on the branch or agent; exceptionally the investment manager might be assessed where eg there was difficulty in making contact with the non-resident through the branch or other agent. The protection of TMA 1970 s.78(2) is not lost simply because the investment transactions in question are carried out by more than one agent each of whom otherwise satisfies the terms of the section.

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<sup>10</sup> Finance Act 1995 section 127(12) and (13).

10. Where the activities consist only of the investment transactions the question whether they amount to trading is relevant only where the investment manager does not have the protection of TMA 1970 s.78(2) as in the case where the client is a connected person. If transactions carried out through the investment manager by such clients amount to trading, profits from the realisation of securities etc are taxable as profits of a trade carried on in the UK. If the transactions do not amount to trading, the profits from realisation are capital gains (including those treated as capital gains by [TCGA 1992 s.143 (formerly Finance Act 1985 s.72)]) on which the non-resident client is not liable to tax.
11. Whether or not a taxpayer is trading is a question of fact to be determined by reference to all the facts and circumstances of the particular case. This applies as much to financial transactions as other activities.
12. In determining the question of trading, the transactions carried out through the investment manager are to be considered in the context of the status and worldwide activities of the non-resident. An individual is unlikely to be regarded as trading as a result of purely speculative transactions. For a company a transaction will generally be either trading or capital in nature. (This may also be the case for non-resident collective investment vehicles whether open or closed ended.) If the main business of a non-resident company is a trade outside the financial area or an investment holding business, the activities in the UK would normally amount to trading only if they constituted or were part of a separate financial trade. But if, exceptionally, activities which are an integral part of the profit earning activities of a non-financial trade are carried out through a UK investment manager (for example, hedging on the London terminal markets by a non-resident dealer in physical commodities) then that might amount to trading here. The view to be taken on a particular case must depend on all the facts of that case.
13. The buying and selling of shares, bonds and money market instruments such as bills, certificates of deposit, floating rate notes and commercial paper held for investment is not normally regarded as constituting a trade even when a policy of active management of the portfolio is followed. Where futures and options are concerned, the statement of practice SP14/91 (Tax treatment of transactions in financial futures and options) will be applied to non-resident clients who are collective investment vehicles (whether open or closed ended), pension funds and other

bodies which either do not trade or whose principal trade is outside the financial area.

14. If the non-resident carries on a financial trade outside the UK, the transactions carried out through the investment manager are likely to amount to trading in the UK. That is so whether there is a discretionary agreement or whether the manager acts on the instructions of the client. The criteria for deciding whether a financial company is an investment company or a trading company are the same as those which apply to a resident client. Some considerations are mentioned in paras 12 and 13 above. But if the transactions in the UK do amount to or are part of a trade the protection of TMA 1970 s.78(2) is available unless the non-resident is connected with the investment manager (see paras 7 and 8 above) or the transactions are part of a trade in the UK which is not confined to the investment management agency (see para 9 above)."

The Revenue consider that section 78(2) does cover trading transactions unless they are part of a wider trade, e.g., insurance business.

That more than one agent within section 78(2) is used does not *of itself* cause the exemption to be lost.

When does portfolio management become trading?

### 3.2.8.3 Statement of Practice 15/91

#### 3.2.8.3.1 Forward Contracts and Transactions in Commercial Paper and Warrants

The Revenue stated in SP 15/91 para 15:

"For the purposes of TMA 1970 s.78(3) the Revenue accepts that futures contracts include forward contracts, and that transactions in commercial paper and warrants are covered by the words quoted."

#### 3.2.8.3.2 Spot Transactions

The Revenue stated in SP 15/91 para 15:

"Generally, spot transactions are not within the terms of this definition but may, subject to the facts of a particular case, fall within its terms where eg such a transaction is used to close out a forward transaction."

Is the exception really an exception, as there will be no profit in such a case?

Commodities actually held are not covered. Nor are Currencies actually held covered in terms. On the other hand, securities denominated in a foreign currency or foreign currency deposits which earn interest are.

#### 3.2.3.8.3 Land Transactions

It is stated in SP 15/91 para 16:

"Transactions in futures contracts and options contracts relating to land are not investment transactions with TMA 1970 s.78(3)(a). Dealings in land continue to be regarded as outside the definition of investment transactions; futures and options contracts involving indices of land prices could fall within the terms of this exclusion, but will however qualify as investment transactions if carried out on a recognised futures exchange (see TMA 1970 s.78(3)(b))."

For a recognised futures exchange, see TCGA 1992 s.288(6) - for the moment LIFFE.

#### 3.2.3.8.4 Currency Transactions

It is stated in SP 15/91 para 17:

"Transactions in currencies which are carried out on a recognised futures exchange are investment transactions within TMA 1970 s.78(3)(b). In addition, forward foreign exchange contracts will be accepted as constituting futures contracts for the purposes of TMA 1970 s.78(3)(a) (see para 15 above).

More generally, currency transactions may be taken into account as part of the "profits or gains arising from investment transactions" where those currency transactions are used to eliminate or reduce the risk in respect of transactions in securities which are within TMA 1970 s.78(3)(a). The profits or gains from such currency transactions may then be regarded as arising from the underlying investment transactions against the risk from which the currency transactions have been conducted."

Must these not always be futures contracts or options contracts?

#### 3.2.4 Connected Persons

Taxes Management Act 1970 section 78 further provides:

"(5) Subsection (2) above does not apply if the non-resident person and the agent are connected with each other, within the terms of section 839 of the principal Act<sup>11</sup>."

The test is that contained in Taxes Act 1988 section 839.

SP 15/91 para 8 provides:

"8. The question of whether a non-resident person and investment manager are connected with each other for this purpose is one which can only be determined on a review of the relationship which exists between them in fact as well as in law. But in making this determination -

- (a) where the establishment of a connected person's relationship depends on the question of whether a person falls to be regarded as having control of a company's affairs within the terms of TA 1988 s.416(2), it is not considered that a person's ability (whether de facto or de jure) to appoint the majority of the board of directors will itself constitute control of the company's affairs - unless, that is, the board exercises powers which would normally be exercised by the shareholders at a general meeting;"

SP 15/91 para 8 (a) refers to Taxes Act 1988 section 839(5)-(7) which imports the section 416 test of control. Great care is needed in relying on this. In summary there is no liability if

- "(b) where a non-resident person is appointed to act as investment manager in respect of an investment portfolio of a non-resident third party and -
  - (i) in turn the non-resident manager itself appoints its UK affiliate to manage the investment of all or part of the portfolio;
  - (ii) it is not part of the overseas affiliate's trade to make money from these investments for itself (which is a question of fact to be determined in the particular circumstances of each case); and

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<sup>11</sup> Income and Corporation Taxes Act 1988.

- (iii) the relevant business does no more than pass through the hands of the overseas affiliate so that the UK manager is effectively acting in its affiliate's shoes and for the same reward,

Taxes Management Act 1970 section 78(1) will be applied as between the UK manager and the overseas third party - looking through the overseas affiliate - with the consequences that section 78 (2) could apply unaffected by s.78(5)".

It is stated in Revenue Interpretation 29:<sup>12</sup>

"The reference to "these investments" is to the investment portfolio under management. A manager's remuneration may be fixed as a performance fee linked to how well the managed funds perform....

The holding [by overseas managers of units for themselves in a fund which they also act as investment managers] will have no direct relevance to the application of para 8(b)(ii)."

In applying para 8(b)(iii) the Revenue are concerned not so much with whether the reward received by the UK manager for services is at a market rate but rather whether by reference to the arrangements as a whole it matches the reward received by the overseas affiliate from the non-resident third party for that business which is being passed through to the UK. Where not all the services contracted to be performed for the non-resident third party by the overseas manager are passed through to the UK, it is only that part of the investment management services which does pass through which is "relevant business" within para 8(b)(iii) and subject to the test in that paragraph.

Note: a connected person may still qualify for exemption under section 82: see 3.3.

Under the new rules, the requirement that the agent is not a connected person is replaced by a requirement that he acts in an independent capacity.<sup>13</sup>

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<sup>12</sup> The Interpretation is set out more fully in Appendix D to this article.

<sup>13</sup> See 4.5.3.3.



3.3 Taxes Management Act 1970 section 82 provides:

"(1) Nothing in this Part of this Act<sup>14</sup> shall render a non-resident person chargeable in the name of a broker or in the name of an agent not being an authorised person carrying on the regular agency of the non-resident person, in respect of profits or gains arising from sales or transactions carried out through such a broker or agent:

Provided that where sales or transactions are carried out on behalf of a non-resident person through a broker in the ordinary course of his business as such and the broker -

- (a) is a person carrying on bona fide the business of a broker in the United Kingdom, and
- (b) receives in respect of the business of the non-resident person which is transacted through him remuneration at a rate not less than that customary in the class of business in question, then, notwithstanding that the broker is a person who acts regularly for the non-resident person as such broker, the non-resident person shall not be chargeable in the name of that broker in respect of profits or gains arising from those sales or transactions.

In this subsection, "broker" includes a general commission agent."

The meaning of "broker" is discussed by Megarry J in *Fleming v London Produce Co Limited* 44 TC 582.

Thus there is no liability if

- either* (a) the agent is not an authorised person carrying on the regular agency of the non-resident person
- or* (b) the agent is a bona fide UK broker fully remunerated.

3.4 Comparison between Exceptions

The broker exception not limited to particular types of investment. In particular, it includes land.

The broker exception can apply to connected persons.

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<sup>14</sup> Part VIII, Charges on Non-Residents, being sections 78-85.

### 3.5 Non-Taxability of Principal

ESC B40 is in full force up to 5th April 1995.<sup>15</sup> It provides:

"TMA 1970 ss.78(1) and 79 each provide for assessments to be made on a non-resident person in the name of a branch or agent. TA 1988 s.59 can also apply with the same effect where a branch or agent receives or is entitled to income chargeable to income tax. The Taxes Acts additionally allow for a non-resident to be assessed directly, whether or not there is a branch or agent in whose name the non-resident can be assessed.

However, where in a case otherwise within TMA 1970 s.78(1) the agent is specifically protected from assessment by the terms of s.78(2) (investment managers) or s.82(1) (brokers and general commission agents), the Revenue neither assesses the non-resident directly nor exercises the option of assessing the agent under TMA 1970 s.79 or TA 1988 s.59.

This concession does not apply -

- (a) to any income of the non-resident falling within the terms of extra-statutory concession B13 and to which that concession is applied; or
- (b) if the employment of the agent in the UK is outside or goes beyond the normal use by non-residents of UK investment managers, brokers and other agents within TMA 1970 ss.78(2), 82(1); or
- (c) if the non-resident has some other presence or representative in the UK which carries on activities related to the transactions conducted through the agent, unless that other representative is also protected from assessment by TMA 1970 s.72(2) or s.82(1)."

To take advantage of the ESC is it necessary that there should have been a *prima facie* liability under section 78 removed by one of the two exceptions. Formerly, I considered that this may simply have been an oversight on the part of the Revenue in drafting the ESC and that they might in practice have extended the benefit of it to a person who was not even *prima facie* taxable in the name of an agent. Yet the drafting of the corresponding new statutory provisions, Finance Act 1995 section 127(1)(b) and (c) and section 128(2)(d)<sup>16</sup> is quite unequivocal.

<sup>15</sup> See the previous article at 3.6.

<sup>16</sup> See 4.5.

## **4 Post 5th April 1996**

### **4.1 UK Representatives of Non-Residents**

As from 6th April 1996, Taxes Management Act sections 78-85 are repealed.<sup>17</sup> They are replaced by Finance Act 1995 sections 126-127 and Sch 23 which impose burdens on "the UK representative of a person who is not resident in the United Kingdom ("the non-resident"): section 126(1). Much - too much - of the old law remains in substance unrepealed. Broadly speaking, the UK representative is made severally liable with the non-resident as regards all his fiscal obligations connected with the taxation of any amounts in relation to which he is the UK representative of the non-resident: Sch 23 para 1(1). Only a "branch or agency" in the United Kingdom through which the non-resident carries on a trade profession or vocation can be the non-resident's UK representative.

A person cannot be a UK representative:

if he does not carry on the regular agency of the non-resident

if he falls within the broker exception

if he falls within the investment manager exception

where the non-resident is a member of Lloyd's, he is the members' agent or the managing agent of the syndicate in question.<sup>18</sup>

### **4.2 The Basic Provision**

Finance Act 1995 section 126 provides:

"(1) Schedule 23 to this Act shall have effect for imposing obligations and liabilities in relation to income tax, corporation tax and capital gains tax on a branch or agency which, under this section, is the UK representative of a person who is not resident in the United Kingdom ("the non-resident").

### **4.3 Who is a UK representative?**

#### **4.3.1 The Basic Statutory Test**

Finance Act 1995 section 126(2) provides:

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<sup>17</sup> See Finance Act 1995 Schedule 29 Part (15) NON-RESIDENTS.

<sup>18</sup> See section 127(1).

- "(2) Subject to the following provisions of this section and to section 127 below, a branch of agency in the United Kingdom through which the non-resident carries on (whether solely or in partnership) any trade, profession or vocation shall, for the purposes of this section and Schedule 23 to this Act, be the non-resident's UK representative in relation to the following amounts ..."

#### 4.3.2 "Branch or Agency"

This term has the same meaning as in the Taxes Management Act 1970.<sup>19</sup> The Taxes Management Act definition, which is contained in section 126(1) and has effect unless the context otherwise requires, provides that:

"'branch or agency' means any factorship, agency, receivership, branch or management, and 'branch or agent' is to be construed accordingly."

This term has never fitted well into the context of Part VIII (Charges on non-residents). It was always implicit in Chapter VIII that a branch or agent must be a legal person, even if a branch or agency is not. For the purposes of the new rules, if a UK representative is to have obligations and liabilities, it must have legal personality, i.e., it must be a natural person or a corporation.

The draughtsman of the new provisions seems to have overlooked this elementary legal point. He states, for example, at section 126(4):

"For the purposes of this section and Schedule 23 to this Act, the non-resident's UK representative in relation to any amount shall be treated, where he would not otherwise be so treated, as if he were a separate and distinct person from the non-resident."

Yet if the two are the same, Schedule 23 does nothing. It simply imposes a joint liability on the UK representative as well as on the non-resident. Yet if the two are the same, that does not take the matter any further.

The matter may be of relevance in the context of the new rules for limiting the tax payable by non-residents.

Under Taxes Management Act 1970 Part VIII, where a trade is carried on in the United Kingdom through a branch or agency, it would not have availed the proprietor to argue that there was no branch or agent in the sense of a natural or legal person capable of assessment. For that would not have relieved him from his obligation to pay tax. Nor could he bring himself within Extra-Statutory

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<sup>19</sup> See Finance Act 1995 section 126(8).

Concession B40, as that would involve his being *prima facie* assessable in the name of a branch or agent but the branch or agent then being relieved from liability to be assessed by virtue of the investment manager or broker exception.

Under the new rules, much will turn on the circumstances. As regards income from a United Kingdom trade, it will never<sup>20</sup> be in the interest of the non-resident to argue that there is no branch or agency. For the existence of such a branch or agency can only relieve him from tax. As regards income connected with the trade, but not itself trading income, it may be, if the non-resident is an individual or the trustees of a trust, as in that case he may be entitled to a cap on his income tax liability.<sup>21</sup>

#### 4.3.2 "in the United Kingdom"

There is nothing to prevent one non-resident being the UK representative of another non-resident, provided the former has at least a sufficient United Kingdom presence to be carrying on there as agent the trade of his principal. Thus, for example, a corporation resident outside the UK but with a United Kingdom office could be the UK representative of another non-resident.

A branch or agency which is not situate inside the United Kingdom, even one which trades in the United Kingdom on behalf of its principal, will not be a UK representative. By contrast, it is not essential that the trade, or that part of the trade carried on through the branch or agent, be carried on in the United Kingdom. If it is not, the trading profits will not be within the charge to tax, yet other income could be. See below.

#### 4.3.3 "through which the non-resident carries on ... any trade, profession or vocation"

Under Part VIII, there is no limitation as to the functions of the agent or the type of income in respect of which he may be assessable. Under the new rules, it is essential that the non-resident be carrying on a trade, profession or vocation through the branch or agency in the United Kingdom.

Once a branch or agency qualifies as a UK representative, however, he can be assessed on certain income trading income.

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<sup>20</sup> The position would be different if he were protected by a double taxation arrangement from tax on trading profits not referable to a *permanent establishment* in the United Kingdom.

<sup>21</sup> See Finance Act 1995 section 128, discussed in the previous article at 3.3.

#### 4.4 In respect of what income and gains is a UK representative liable?

A UK representative is as such liable only in respect of four categories of specified "amounts": section 126(2). These are:

- "(a) the amount of any such income from the trade, profession or vocation as arises, directly or indirectly, through or from that branch or agency"

Income from a trade carried on by a non-resident is assessable to United Kingdom tax only if the trade is carried on in the United Kingdom. Para (a) does not extend the charge.

The UK representative is not liable in respect of income from the trade which, although having a United Kingdom source, does not arise through or from him. There may be such income, and that income either may or may not arise through or from another UK representative.

Can the word "such" be given any meaning? I do not see how it can. Did the draughtsman perhaps mean "any income from such trade, profession or vocation"?

- "(b) the amount of any income from property or rights which are used by, or held by or for, that branch or agency"

Hence the UK representative will also be liable for tax on non-trading income which is connected with the branch or agency. It is not enough that the income is connected with the trade. Again, this does not extend the scope of the tax. If, for example, the agency owns foreign bonds, interest on which has a non-United Kingdom source, it will not be taxable.

- "(c) amounts which, by reference to that branch or agency, are chargeable to capital gains tax under section 10 of the Taxation of Chargeable Gains Act 1992 (non-residents) or fall under that section to be included in the chargeable profits of the non-resident"<sup>22</sup>
- "(d) in a case where the non-resident is an overseas life insurance company, any other amounts which by virtue of paragraph 3 of Schedule 19AC to the Taxes Act 1988 fall by reference to that branch or agency to be included in the company's chargeable profits for the purposes of corporation tax."

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<sup>22</sup> See my *Capital Gains Tax Planning for Non-UK Residents* published by Key Haven Publications PLC.

## 4.5 Persons not treated as UK Representatives

### 4.5.1 Summary

Finance Act 1995 section 127(1) provides some important exceptions for:

- (a) a person who does not act in relation to the transactions in the course of carrying on a regular agency for the non-resident;
- (b) protected transactions carried out through a broker;
- (c) protected transactions carried out through an investment manager; and
- (d) the members' agent or managing agent of a non-resident who is a member of Lloyd's as respects income and gains arising from his underwriting business.

### 4.5.2 Broker Exception

This is a re-wording of Taxes Management Act section 82(1), contained in section 127(1)(b) and (2). The only new requirement is the curiously worded section 127(2)(d):

- "(d) the non-resident does not fall (apart from this paragraph) to be treated as having the broker as his UK representative in relation to any income or other amounts not included in the taxable sums but chargeable to tax for the same chargeable period."

In other words, if the broker is the UK representative of the non-resident in relation to *any* income at all, then the broker exception is disallowed in respect of *all* income in respect of which he is (otherwise) a UK representative. This seems unduly harsh.

Do the words "(apart from this paragraph)" have any effect? I do not see that they do.

### 4.5.3 Investment Manager Exception

#### 4.5.3.1 General

This is a re-wording of Taxes Management Act section 78(2), (3), (3A) and (5), with some changes of substance. The new requirements are contained in section 127(3)-(18).

#### 4.5.3.2 Number of Clients

It is no longer necessary that the investment manager have a number of clients.

#### 4.5.3.3 Independent Capacity

The investment manager must have acted in an "independent capacity": see section 127(3)(c). He will not be regarded as having so acted unless, "having regard to its legal, financial and commercial characteristics, the relationship between" him and the non-resident "is a relationship between persons carrying on independent business that deal with each other at arms' length": see section 127(18).

In my view, the parties need not actually be at arms' length: they must merely act as if they were.

#### 4.5.3.4 Not UK representative in Relation to Other Income

There is a similar condition<sup>23</sup> to the new one imposed on brokers: see 4.5.2.

#### 4.5.3.5 Beneficial Entitlement to Relevant Excluded Income

##### 4.5.3.5.1 The Basic Rule<sup>24</sup>

There must be a "qualifying period" in relation to which "it has been or is the intention of the manager and the persons connected with him" that the non-resident's "relevant excluded income" should, as to at least 80%, consist of amounts to which neither the manager nor any such person has a "beneficial entitlement".<sup>25</sup>

##### 4.5.3.5.2 Let-Out for Non-Negligent Failures to Realise Intention

There is a let-out where the failure to fulfil the intention "is attributable (directly or indirectly) to matters outside the control of the manager and persons connected with him ... and does not result from a failure by any of them to take such steps as may be reasonable for mitigating the effect of those matters in relation to the fulfilment of that intention."

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<sup>23</sup> Contained in section 127(3)(f).

<sup>24</sup> These conditions are contained in section 199(4)-(11), incorporated by section 127(3)(d).

<sup>25</sup> Section 127(4)(a).



#### 4.5.3.5.3 Qualifying Period

References to a "qualifying period" in relation to a transaction are references to any period consisting in or including the chargeable period for which the taxable sums are chargeable to tax, being, in a case where it is not that chargeable period, a period of not more than five years comprising two or more complete chargeable periods: section 127(7).

#### 4.5.3.5.4 "Relevant Excluded Income"

The "relevant excluded income" of a non-resident is such of the profits and gains of the non-resident as derive from transactions carried out by the investment manager and are treated as "excluded income" for the purposes of section 128 or section 129.<sup>26</sup> For "excluded income", see the previous article at 3.4. Broadly speaking, it is income in respect of which, under the new rules, a non-resident will neither be liable to any tax beyond that withheld at source nor assessable in the name of a UK representative.

#### 4.5.3.5.5 Excluded Income to which a Person has a "Beneficial Entitlement"

This term is defined only in circular terms. What is clear is that "beneficial entitlement" cannot bear its ordinary English law meaning.

We are told that:

"For the purposes of this section any reference to an amount of relevant excluded income to which a person has a beneficial entitlement is a reference to so much of any amount to which he has or may acquire a beneficial entitlement by virtue of -

- (a) any interest of his (whether or not an interest giving a right to immediate payment or a share in the profits or gains) in property in which the whole or any part of that income is represented, or
- (b) any interest of his in or other rights in relation to the non-resident,

as is or would be attributable to that income."<sup>27</sup>

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<sup>26</sup> See section 127(5).

<sup>27</sup> See section 127(6).

My guess is that the concern is not with the investment manager's commission, as that will be brought into charge to tax, but his indirect interest as a shareholder, unit-holder or beneficiary in or of the non-resident. If so, it is appallingly drafted.

#### 4.5.3.5.6 Partial Relief

The investment manager exception is still available to the extent that the investment manager (or a person connected with him) does not have any beneficial entitlement to the non-resident's income: see section 127(8).

#### 4.5.3.5.7 Collective Investment Schemes

Where amounts arise or accrue to the non-resident as a "participant" in a "collective investment scheme",<sup>28</sup> one applies a special test to determine whether the "no beneficial entitlement" condition is satisfied as respects a transaction carried out for the purposes of the scheme (in so far as it is a transaction in respect of which any such amounts arise or accrue to him).<sup>29</sup>

One hypothesises firstly that the transactions in fact carried out for the purposes of the scheme are carried out on behalf of a company constituted for the purposes of the scheme and resident outside the United Kingdom.<sup>30</sup>

One further hypothesises that the participants do not have any rights in respect of the amounts arising or accruing in respect of those transactions other than the rights which, if they held shares in the hypothetical company, would be their rights as shareholders.<sup>31</sup>

One then asks whether the assumed company would, in relation to the chargeable period in which the taxable sums are chargeable to tax, be regarded for tax purposes as a company carrying on a trade in the United Kingdom.

If it would not, then the "no beneficial entitlement" condition is deemed to be satisfied as regards transactions carried out for the purposes of the scheme.<sup>32</sup>

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<sup>28</sup> "Collective investment scheme" has the same meaning as in Financial Services Act 1986 section 73 and "participant" in relation to such a scheme is to be construed in accordance with section 75 of that Act: see Finance Act 1995 section 127(17).

<sup>29</sup> Section 127(9).

<sup>30</sup> Section 127(10)(a).

<sup>31</sup> Section 127(10)(b).

<sup>32</sup> Section 127(10).

If it would, then one applies the basic "no beneficial entitlement" test<sup>33</sup> in relation to the income of the assumed company and not of the non-resident principal, subject to one variation: the "relevant excluded income" of the company is the aggregate of the amounts which would be chargeable to tax on that company as profits derived from the transactions carried on by the manager and assumed to be carried out on the company's behalf.<sup>34</sup>

Collective investment schemes tend to involve either companies or unit trusts. In the case of a company, no real hypothesising will normally be needed. One will ask whether the company is itself carrying on a trade in the United Kingdom. If it is, it will not matter that it will not be liable to United Kingdom income tax or corporation tax in respect of trading profits because of double taxation arrangement relief.

In the case of a unit trust, it is not conceptually difficult to deem it to be a company and the rights of the unit holders to be shares.<sup>35</sup>

"Transactions carried out for the purposes of the scheme" must, if the provision is to be workable, be confined to the management of the property subject to the arrangements and not extend to dealings with participants with their interests in the scheme.

Presumably, "profits" means profits taxable as income.

What was the draughtsman aiming at? Was he trying to protect the manager of the collective investment scheme? Yet the manager would not normally be the United Kingdom representative of a non-resident who happened to own shares or units in the scheme. Even if the scheme were a company which was trading, that would not make its shareholders traders. Conceivably, one could have a trading unit trust, in which case it might *just* be said that the unit holders were carrying on a trade in partnership (as required by section 126). It is also just conceivable that the non-resident held his units as trading stock, in which case he would be carrying on a trade solely, but it is difficult to imagine the manager of the scheme being a branch or agency of that trade.

Was the draughtsman trying to protect an investment adviser who purchased and/or held and/or sold units in a collective investment scheme on behalf of a non-resident principal? If the assumed company is not trading in the United Kingdom, then one assumes that the no beneficial entitlement test is satisfied as regards transactions

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<sup>33</sup> Contained in section 127(4)-(8) inclusive.

<sup>34</sup> See section 127(11).

<sup>35</sup> In the case of an authorised unit trust, this fiction is routinely employed for the purposes of the Tax Acts: see Taxes Act 1988 section 468(1).

carried out for the purposes of the scheme. But the investment adviser will not be carrying out such transactions: only the manager of the scheme will.

If the assumed company is trading in the United Kingdom, then one apparently is looking to the proportion of the taxable profits of the scheme vehicle to which the investment manager has a beneficial entitlement. That seems a completely arbitrary test.

#### 4.5.3.6 Investment Transactions

The definition of "investment transactions" is changed only slightly. For "transactions on a recognised futures exchange" there is substituted "transactions consisting in the buying or selling of any foreign currency". The Treasury is given power by regulations to designate other transactions.

#### 4.5.3.7 Remuneration at Customary Rate

It is a further requirement that the remuneration which the manager received for the provision to the non-resident of the investment management services in question was at a rate which was not less than that which would have been customary for that class of business.<sup>36</sup> This mirrors Taxes Management Act 1970 section 78(2)(c), except that "would have" has been substituted for "is". Why?

#### 4.5.3.8 Connected Persons

The requirement that the investment manager and non-resident must not be connected with each other is not reproduced.

### 4.6 Schedule A

Taxes Act 1988 section 43<sup>37</sup> is replaced by Finance Act 1995 section 40, inserting a new section 42A in the Taxes Act 1988. The new section 42A empowers the Board to make regulations "for the charging, assessment, collection and recovery on or from prescribed persons ... of prescribed amounts in respect of the tax which is or may become chargeable under Schedule A on the income of any person who has his usual place of abode outside the United Kingdom ('the non-resident')."

It is unfortunate that section 42A still uses the concept of "any person who has his usual place of abode outside the United Kingdom". This could include some persons who are resident in the United Kingdom for income tax purposes. It might conceivably exclude some persons who are not. While it may be tolerably

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<sup>36</sup> See section 127(5)(e).

<sup>37</sup> See 3.1.

clear where an individual has his usual place of abode, the same cannot necessarily be said of a company. In the case of groups of persons who are the personal representatives of the same person or the trustees of the same trust and who themselves have places of abode in different countries, it is not at all clear how the provision would work. Finance Act 1989 section 110 and section 111 lay down rules for determining the *residence* of trustees and personal representatives respectively. Yet these do not affect any question of usual place of abode. Surely, it would have been far simpler for the draughtsman of section 42A to refer in terms to a person who was not resident in the United Kingdom for income tax purposes.

In order for a person to be caught by section 42A, it is essential that he is either a person by whom any sums are payable to the non-resident as fall, or would fall to be treated as receipts of a Schedule A business carried on by the non-resident or, alternatively, a person who acts on behalf of the non-resident in connection with the management or administration of any such business. Thus, a person potentially caught by section 42A could be in an unenviable position. A tenant who pays a rent of £10 a year to a non-resident might be liable for income tax on the whole of his Schedule A income! Managing agents of a let property might also be liable even though they did not receive the rent. It is to be hoped that in practice the potential rigours of the sections will be avoided by the regulations which will in due course be made avoiding any unjust charge to tax.

## **5 Conclusion**

Most of the new law is now on the statute book, even if it will, by and large, not come into force until 6th April 1996. The resolution of some problems, especially in the case of agents liable for tax under Schedule A, will turn on the detailed regulations which will be made before that date.

On the whole, the initiative is to be welcomed. The Revenue have certainly taken several steps in the right direction. While there has been a considerable tidying up of the law, especially in relation to agents, it has not gone far enough. The new provisions themselves are very difficult to construe and contain many problems of interpretation. Perhaps the most serious criticism is that the Revenue have focused far too much on the position of investment managers and brokers and not asked themselves the fundamental question when a non-United Kingdom resident person ought to be liable to UK tax in respect of operations conducted in or income arising from source within the United Kingdom. The impression one gains is that there has been a very powerful investment manager and broker lobby which has focused the attention of the Revenue on certain points to the exclusion of others.