

## The Offshore Tax Planning Review

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### APPENDIX C

#### STATEMENT OF PRACTICE SP 15/91 of 29th November 1991

##### **Treatment of investment managers and their overseas clients**

1. This statement sets out the Inland Revenue's view on:
  - (a) the extent to which trading in the UK by a non-resident client affects the protection from assessment in the name of the investment manager (TMA 1970 s.78(2));
  - (b) the factors to be taken into account in determining whether active management of a portfolio on behalf of a non-resident client constitutes the exercise of a trade in the UK by that client; and
  - (c) the meaning of "investment transactions" in TMA 1970 s.78(3) as amended by FA 1991 s.81 to show that it includes many transactions which are normal in the course of portfolio management.

Unless otherwise stated all subsequent statutory references are to TMA 1970.

##### **Background**

2. Under domestic law, a non-resident is liable to income tax on annual profits or gains arising "from any property whatever in the United Kingdom or from any trade, profession or vocation exercised within the United Kingdom" (TA 1988 s.18(1)(a)(iii)). A corporation tax charge is imposed in broadly similar terms on non-resident companies trading here through a branch or agency (TA 1988 s.11). In effect therefore non-residents are in principle liable to tax on income from UK sources,

although liability may be affected by a double taxation agreement. Non-residents are not liable to tax on capital gains other than those from the disposal of assets in the UK which broadly relate to a UK trading branch or agency (TCGA 1992 s.10 and TA 1988 s.11(2)(b)).

3. TMA 1970 s.78 provides that, subject to certain exceptions, a person not resident in the UK is assessable and chargeable to income tax in the name of any branch or agency acting for that person whether or not the branch or agency is in receipt of the profits or gains. The same approach is applied to corporation tax (TMA 1970 s.85).
4. No charge to tax is raised in the name of an agent on profits or gains arising from investment transactions carried out by him or her for the non-resident provided that -
  - (d) the agent concerned is carrying on a business of providing investment management services to several clients including the non-resident in question; and
  - (e) the investment transactions were carried out by the agent in the ordinary course of his or her business; and
  - (f) remuneration received by the agent from the client is at not less than the normal rate (see para 5 below); and
  - (g) if such profits or gains are chargeable to tax as profits or income of the non-resident person from carrying on a trade in the UK through a branch or agency, the agent carrying out the investment transaction is also the agency through which the trade is carried on (see para 9 below).

Where an agent provides investment management services as part only of a business, (a) to (d) above apply to that part as if it were a separate business.

5. In considering whether the agent is remunerated at not less than a normal rate (see para 4(c) above), 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.
6. A non-resident who does not, for whatever reason, enjoy the protection of TMA 1970 s.78(2) is not necessarily liable to UK tax on all the income and gains realised through the investment manager. The non-resident may be exempt from tax on capital gains (see para 2 above) or may be entitled

to the specific exemption from tax for non-residents given on income from some UK securities. The non-resident may also be able to claim exemption under a double taxation agreement as it is possible that the investment manager will not be a permanent establishment of the non-resident. But exemption under an agreement will depend on both the facts and the terms of the agreement.

### **Connected persons**

7. Protection from assessment in the name of the investment manager is not available to connected persons (see TMA 1970 s.78(5)).
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 -
  - (h) 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 1970 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;
  - (i) 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
    - (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,

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

### **Trading**

9. The effect of TMA 1970 s.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.
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 FA 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).

#### **Investment transactions**

15. TMA 1970 s.78(3) as amended by FA 1991 s.81 sets out the meaning of the term "investment transactions". These are defined as including "...futures contracts, options contracts or securities of any description not mentioned in this paragraph..". 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. 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.
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)).

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, for the purposes of TMA 1970 s.78(2) the results of 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.