RESIDENCE OF COMPANIES: THE REAL MANAGEMENT AND CONTROL TEST

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1 Corporate Residence in UK Tax Law

If a company is incorporated in the United Kingdom, it is prima facie resident there. Even if it is not incorporated in the United Kingdom, it will still be prima facie resident there if central management and control of its business is carried on there. Both these tests, however, are subject to a rule, introduced by Finance Act 1994, under which it will be deemed not to be resident in the United Kingdom if it is so treated for the purposes of a double taxation treaty entered into by the United Kingdom.[2]

The test of central management and control of the business of a company is easily misunderstood. It has, in my view, been so understood in three recent criminal trials for tax fraud.[3] In this article, I attempt to set the record straight.

2 The Classic Statement of the Central Management and Control Test

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2 Finance Act 1994 section 249, which introduced this rule is discussed by me in an article 'Residence of Companies: the New United Kingdom Rules' in *The Offshore Tax Planning Review* Volume 5, Issue 3, at page 163.

3 The first was *R v Charlton*, reported in the Court of Appeal (Criminal Division) at [1996] STC 1418, on which an article of mine *"Unsafe and Unsatisfactory": R v Charlton* was published in Volume 7 Issue 1 of this *Review*. The second was *R v Chipping, Da Costa and Dimsey* (unreported). Mr Dimsey has been given leave to appeal to the Court of Appeal and I am instructed, together with the Junior Counsel who defended him at the trial, to appear on his behalf. The third was *R v Allen* (reported, at [1997] STC 1141, only a judicial review point prior to the trial proper). I also advised Mr Allen at one stage, albeit on a basis which turned out to be unremunerated. I understand that his conviction too is under appeal. I, of course, say nothing about the *Dimsey* or *Allen* cases, and mention them simply to declare my interest.

The "common law" test of where a company is resident is where the central management and control of its business abides. See *De Beers Consolidated Mines, Limited v Howe (Surveyor of Taxes)* (1906) 5 TC 198 per the Lord Chancellor at page 213: "a company resides, for purposes of Income Tax, where its real business is carried on ... and the real business is carried on where the central management and control actually abides." This is a very technical and artificial test, deceptively expressed in what appears to be everyday language and thus easily misunderstood by the uninitiated.

3 Other Similar Tests

3.1 The Tests

This test of corporate residence must be distinguished from other tests:

(a) of who has control of the company; and

(b) of where the business of the company is carried on; and

(c) of where the profits of the company are earned.

In essence:

the shareholders control the company;

the directors of the company sitting as a board exercise central management and control over the business of the company, which is resident where the board habitually meets and decides matters of high policy; and

where the actual business is carried on and/or the profits are earned is immaterial to the residence of the company (or who controls it).

3.2 An Illustration

By way of illustration: suppose City Co PLC, an English incorporated and resident company which carries on a merchant banking business in London, acquires the entire share capital of Jersey Co Ltd, incorporated under the laws of Jersey, to act as a financial dealing/investment company. It appoints Jersey resident directors who are made well aware of the parent's wishes that it should deal only in, say, Russian quoted securities. The Jersey directors meet only in Jersey. Acting on the advice of the parent, they appoint a manager in London to carry on the dealing on their behalf. The manager could be the parent or another company in the same group. All the activities

of the business are carried on in London. All the decisions as to what to buy and sell, when and at what price are taken there by the manager, acting within the scope of its authority as determined by the directors. The manager sends reports to the Jersey directors, who meet, perhaps only once a year, to consider the reports and accounts and to make the basic policy decisions, e.g. as to whether the business should be continued and as to whether another manager should be appointed. The directors can listen to advice from the parent and can ascertain its wishes. They can follow that advice completely. They may be well aware that if they make a decision which displeases the parent, they may be removed from office. Nevertheless, they are still exercising central management and control of the business of the company and the company is resident only in Jersey.

It makes no difference that it is in London that the general meetings of the company are held, at which the accounts are approved, dividends voted, directors appointed/ reappointed/dismissed, and share issues and any alterations to the company's constitution are decided.

It is irrelevant that the company is controlled by City Co PLC from London. It is irrelevant that the actual business of the company is carried on in London and that the profits are in fact all earned there.

4 Control of a Company

4.1 The Tests

There is a "common law" test and various statutory tests, which build on the common law test. In this article, I discuss only the common law test. The statutory tests, of which the most important are those contained in Taxes Act 1988 sections 416 and 840, are compendiously discussed in my *Control of Companies*, in preparation. Finance Act 1998 has added yet a further test of "control", for the purposes of the new transfer pricing provisions. The interaction of this test with the section 416 and section 840 tests is discussed in an article of mine in the *Corporate Taxation Review* Volume 1, Issue 4.

4.2 The Common Law Test

A company is controlled by the one or more persons who have the ultimate power to ensure that the affairs of the company are conducted in accordance with their wishes. In the case of a limited liability company which is owned by shareholders, it is typically they who collectively have this power, which they exercise by resolutions adopted at general meetings of the company.

A classic statement is to be found in *British-American Tobacco Co Limited v IRC*,[4] especially per Viscount Simon, pages 66-68, especially at page 67 after second break:

> "The word "interest" ... is a word of wide connotation, and I think the conception of "controlling interest" may well cover the relationship of one company towards another, the requisite majority of whose shares are, as regard their voting power, subject, whether directly or indirectly, to the will and ordering of the first mentioned company ... I find it impossible to adopt the view that a person who (by having the requisite voting power in a company subject to his will and ordering) can make the ultimate decision as to where and how the business of the company shall be carried on, and who thus has in fact control of the company's affairs, is a person of whom it can be said that he had not in this connection got a controlling interest in the company.
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> "... [Rowlatt J in *B W Noble Limited v IRC*[5]] said that the phrase ["controlling interest"] had a well known meaning and referred to the situation of a man "whose shareholding in the company is such that he is the shareholder who is more powerful than all the other shareholders put together in General Meeting." So here, the owners of the majority of the voting power in a company are the persons who in [are] in effective control of its affairs and fortunes."

Another leading case is *J Bibby & Sons Limited v IRC*[6], where Lord Russell said, at page 179: ""controlling interest" ... is ... concerned with the extent to which [individuals] have vested in them the power of controlling by votes the decisions which will bind the company in the shape of resolutions passed by the shareholders in general meeting." Lord MacMillan said, at page 181 second paragraph: "The control of a company resides in the voting power of its shareholders." Lord Porter said, at page 183 first paragraph: "... by the expression "a company the directors whereof have a controlling interest therein" is meant a company in which the directors by means of their shareholding are able to direct the affairs of the company according to their will." Lord Simonds said, at page 184: "What, my lords constitutes a controlling interest in a company? It is the power by the exercise of voting rights to carry the resolution at a general meeting of the company."

4.3 Control of Company v Control of Business of Company

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4 (1942) 29 TC 49 (HL).

5 (1926) 12 TC 911.

6 (1945) 29 TC 167 (HL).

Control of a company is not in law the control of its business in applying the residence test. This was made clear by an early case, *Stanley (Surveyor of Taxes) v The Gramophone and Typewriter & Co Limited.*[7] Even though the defendant, a UK resident company, was the sole shareholder of a German company, the profits of the latter were not taxable in the UK. As the Master of the Rolls said, at page 383: "I have no doubt that the English Company in a popular sense, by its ownership of the shares and by the person of those who conduct affairs in Germany, has an effective control over the German business. That, to my mind, is not the question."

The subtle distinction is that while the sole shareholder has control of the company because he has the ultimate power, by appointing new directors, to secure that the affairs of the company are conducted in accordance with his will, yet it is the directors who have the immediate power, however precarious, of control of the business of the company at the highest policy level and it is where that power resides and is exercised that determines the residence of the company.

5 The "Where is 'The Real Business' Carried on?" Test

The residence test of central management and control of a company's business is sometimes confused with the test of where its "real business" is carried on, in the sense of where the profits are in reality earned. The following are illustrations of cases where a company was held to be resident in the United Kingdom notwithstanding that the location of the "real business" as that expression would be understood be a juryman, i.e. the place where the profits were earned, was outside of the United Kingdom:

> *The Cesena Sulphur Company Limited v Nicholson* (1876) 1 TC 88: business of sulphur miners and manufacturers carried on at Cesena, Italy
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> *The Calcutta Jute Mills Company, Limited v Nicholson* (1876)1 TC 83: business of spinning jute in Calcutta
>
> *Denver Hotel Company Limited v Andrews* (1895) 3 TC 355: hotel business in Denver, Colorado
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> *San Paulo (Brazilian) Railway Company, Limited v Carter* (1895) 3 TC 344 and 407 (HL): railway business carried on in Brazil
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> *De Beers Consolidated Mines, Limited v Howe (Surveyor of Taxes)* (1906) 5 TC 198 (HL): exploitation of diamond mines at Kimberley, South Africa

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7 (1908) 5 TC 358 CA.

The Egyptian Hotels, Limited v Mitchell (1915) 6 TC 154 and 540 (HL): a hotel business carried on in Egypt

The American Thread Company v Joyce (Surveyor of Taxes) (HL) (1913) 6 TC 1 and 163: company owned cotton mills in the United States for the manufacture of cotton thread, none of which was sold in the United Kingdom. Per Sir Robert Finlay KC, for the company: "All the current business of the Company is done in America. Where would any man of business say that the business of this Company is carried on? It is carried on in America, where the mills are, where the ordinary meetings of the directors take place, and where the executive committee conducts the business between the weekly meetings of the directors, and reports."

6 Conclusion

These tests involve some very fine distinctions indeed. They are difficult enough for a Chancery judge to understand. They must be well nigh impossible for a common jury, unless it is minutely directed.