CASE NOTES

Keith M Gordon[1]

I *Agulian v Cyganik*[2] – The adhesiveness of a domicile of origin

The Court of Appeal recently reaffirmed the rule that a domicile of origin is not easily displaced. The case was not a tax case; instead it concerned a claim under the provisions of the Inheritance (Provision for Family and Dependants) Act 1975 by the fiancée of the deceased. Such a claim could not be entertained by the Courts unless the claimant first proved that the deceased (a Mr Nathanael) had died domiciled in England and Wales (section 1 of the Act).

Summary of facts

Mr Nathanael was born into a family in the Greek community in a village in northern Cyprus in 1939. His parents and grandparents had also been born in Cyprus. Following a broken engagement, Mr Nathanael fled the island at the age of 18. He came to England where he remained until 1972 when he went back to Cyprus

He returned to England following the Turkish invasion of Northern Cyprus in 1974. During his time in London he bought and ran a number of hotels. He started a relationship with a Polish woman in 1993 and it was suggested that the two had become engaged in 1999 and were due to marry at Easter 2003, but for Mr Nathanael's unexpected death a couple of months earlier.[3]

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2 [2006] EWCA Civ 129; [2006] WTLR 565

3 At the original trial, it was hotly disputed whether in fact Mr Nathanael intended to proceed with the marriage and the finding by the Deputy Judge that he did have such an intention was one of the grounds of appeal. However, the Court of Appeal held that the Deputy Judge had heard the conflicting oral evidence on this point and that the conclusion he reached was supported by ample evidence. Thus this part of the appeal was dismissed.

The High Court decision

When the case was heard at the High Court, the Deputy Judge held that Mr Nathanael's intention to remain "permanently or indefinitely" in England had been formed by the time he had become engaged in 1999. The Deputy Judge further noted that Mr Nathanael had strong links to Cyprus but "his own life revolved around his world in London". He added:

> "*For nearly 30 years [Mr Nathanael] could have lived in Cyprus had he chosen … But he stayed in London and made his life here, away from his family*."

The decision of the Court of Appeal

In the Court of Appeal, Mummery LJ held that the Deputy Judge had given the prospective marriage too much emphasis. In particular, the Deputy Judge had held that the engagement marked an end to Mr Nathanael's previous intention to return to Cyprus and indicated an intention to remain in England. Mummery LJ ruled that such a factor should not be determinative of the issue especially when a long-term presence in London, the establishment of his business interests and the birth of two children had all failed to displace his domicile of origin.

In addition, Mummery LJ held that the Deputy Judge had erred by failing to consider the post-engagement events in the context of Mr Nathanael's life as a whole. Whilst the test in that case was where was Mr Nathanael domiciled at the time of his death, such a determination could be made only by "[looking] back at the whole of the deceased's life, at what he had done with his life, at what life had done to him and at what were his inferred intentions".

Longmore LJ agreed. He emphasised the test that a Court had to apply when considering whether a domicile of origin had been abandoned. This can happen "only … by clear, cogent and compelling evidence that the relevant person intended to settle permanently and indefinitely in the alleged domicile of choice".

Longmore LJ also referred to two cases that had been used to support the arguments of the respondent (Ms Cyganik, the original claimant who had sought to argue that Mr Nathanael had died with an English domicile). In both of those cases, the cohabitation of a married couple was sufficient to give rise to a new domicile of choice.

The first such case was *Forbes v Forbes* (1854) Kay 341. In that case, it was held that General Forbes had acquired an English domicile by living with his wife and son in Chelsea after serving 35 years in India. In Longmore LJ's view, that case

did not help Ms Cyganik because General Forbes had previously acquired a domicile of choice in India[4] (rather than having a domicile of origin there) and, in the Judge's words, "It is easier to show a change from one domicile of choice to another domicile of choice than it is to show a change to a domicile of choice from a domicile of origin." Furthermore, the Judge held that there was a significant difference between an individual returning from India to live permanently with a family (wife and son) and Mr Nathanael's position consisting of a fiancée and no child of that relationship.

The second case was *Aitchison v Dixon* (1870) LR Eq 589. There a Scot (a Mr Allan) had, at the age of 40, become engaged to a wealthy English widow and, after living for a while in Scotland, moved to Buxton and then to Brighton. It was argued that Mr Allan had left Scotland only because of his dependency on his wife to care and to provide for him. However, the Vice Chancellor held that Mr Allan's dependency on his wife in fact reinforced the view that he had abandoned his domicile of origin. However, this case could also be distinguished from the present on the basis that Mr Nathanael was not anywhere near as dependent on Ms Cyganik as Mr Allan was on his wife.

Commentary

Although the rules of domicile have stemmed from a time when international travel was less easy than it is now, the Courts have retained their traditional approach. Mr Nathanael's continuing ties to his homeland were sufficient for the Court to overturn the finding at first instance that a domicile of choice had been established in England. Such a lesson should be noted by other expatriates in the UK who remain here for a long time. Mr Nathanael had, in the words of Mummery LJ, "continued to live the life of a Greek Cypriot, talking Greek, watching Cypriot television. Despite his British passport and his residence in London, he would have regarded himself very much as Cypriot rather than British."

However, care should be taken to ensure that such expatriates do not simply keep up the external links with the country of origin. If there is clear, cogent and compelling evidence that the relevant person has intended to settle permanently and indefinitely in a different country, that could be sufficient for a domicile of choice to be acquired in place of a domicile of origin. According to the authorities, it is not sufficient for an individual to have a vague intention of returning to his or her domicile of origin. In *Re Fuld (No. 3)* [1968] P 675 at 684G–685A, Scarman J held that if an individual settled in a new jurisdiction with an intention to return home when he/she had made his/her fortune or with a sentiment about dying in

4 General Forbes's domicile of origin was Scotland.

his/her homeland, the Courts could hold that a domicile of choice had replaced a domicile of origin.

Longmore LJ's final sentiment is also worth bearing in mind. The learned Judge made it clear that the outcome of the case was not one he was happy with. He explained that he felt it anachronistic that claims under the 1975 Act should depend on the deceased's domicile and suggested that section 1 of the Act be redrafted. Nevertheless, the Judge did not abandon legal principle in order to achieve what he might have thought a fairer result.

II *Wood and anor v Holden*[5] – Where a company is resident

The Court of Appeal recently confirmed that the exercise of control by a local board of directors would almost invariably mean that the company's central management and control is located where the directors meet.

Summary of facts

The background facts of the case are particularly complicated in that they deal with a scheme designed to avoid capital gains tax. However, ultimately, the case concerned two companies: one a 100% subsidiary of the other. The parent ("CIL") was registered in the British Virgin Islands and, it was accepted, was not resident in the UK. The subsidiary ("Eulalia") was incorporated in the Netherlands with a Dutch trust company as its corporate director.

The parent had transferred a shareholding at a gain to the subsidiary. Through a combination of sections 13 and 86 of, and Schedule 5 to, the Taxation of Chargeable Gains Act 1992, the gain arising was assessable on Mr and Mrs Wood, the appellant taxpayers. They submitted, however, that in fact no chargeable gain arose because of the provisions of section 14.[6] That applied if and only if both CIL and Eulalia were held to be non-resident in the UK.

Therefore, the role of the Courts was to determine the residence of Eulalia.[7]

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5 [2006] EWCA Civ 26; [2006] STC 443; [2006] BTC 208

6 Under section 14, the nil-gain nil-loss rules applying to intra-group transfers (section 171) are extended to non-resident groups.

7 Strictly, this was the role of the Special Commissioners and the role of the higher Courts was to review this decision. And in fact much of the judgment of the Court of Appeal concerned the scope of the role of an appellate Court. For the purposes of this article, however, it will be assumed that the Court's attention was simply focused on the residence of Eulalia.

The decision of the Court of Appeal

Park J had previously allowed Mr and Mrs Wood's appeal from the decision of the Special Commissioners on the basis that the company was resident in the Netherlands. The Court of Appeal upheld the decision of Park J in the High Court and dismissed the Revenue's appeal.

The common law test

The Court stressed that the residence of an overseas company should be determined in accordance with the *dictum* of Lord Loreburn LC in *De Beers Consolidated Mines Limited v Howe (Surveyor of Taxes)* [1906] AC 455 where he held at 458, following earlier authorities, 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 exception to this case can be typified by the facts of *Unit Construction Co. Limited v Bullock (Inspector of Taxes)* [1960] AC 351. There a UK parent of three East African subsidiaries usurped the authority of the subsidiaries' local boards of directors. Consequently, it was held that the real management and control of these companies was situated in London where the UK parent's board sat. It did not matter that the actions of the parent company were not authorised by the memoranda and articles of association of the subsidiary companies, As Lord Radcliffe said (at 370):"The articles prescribe what ought to be done, but they cannot create an actual state of control and management in Africa which does not exist in fact."

However, the relevance of the *Unit Construction* case was severely curtailed by the Courts in *Wood v Holden*. Park J described it as "very important" but nevertheless a decision that was "highly exceptional in terms of the result". In other words, whilst a local board's power might be usurped by undue influence coming from another party, that should be the exception.

Part of the Crown's argument was that the role of the Dutch board was limited to following the tax advice that had come out of the UK in order to effect the tax avoidance scheme and, therefore, the driving force behind the company was the source of the UK-based tax advice. However, the Courts held that there is a clear distinction between the provision of advice and the decision to follow that advice. First, there is no guarantee that the advice would be followed; secondly, the crucial part of the test is where the decision to follow the advice was made. That could be done only by the Dutch board and not by the UK advisers.

Furthermore, the Special Commissioners had, in the view of the higher Courts, erred in suggesting that the limited role of the Dutch board meant that their few acts of control and management of Eulalia did not count when determining where a company's central control and management lay. As Park J said, however:

> "*The test of a company's residence is still the central control and management test; it is not the law that that test is superseded by some different test if the business of a company is such that not a great deal is required for central control and management to be carried out*."

Consequently, Eulalia was held, on common law principles, to be resident in the Netherlands and not resident in the UK.

The test in double taxation conventions

As a result of the conclusions of the Courts in respect of the common law test of a company's residence, the Courts did not have to respond to Mr and Mrs Wood's second argument. That argument relied upon the application of the tie-breaker clauses in the UK-Netherlands Double Taxation Treaty under the provisions of section 249 of Finance Act 1994. However, the brief attention given to this issue by the High Court and the Court of Appeal merits a little further consideration.

Section 249 allows a company, which is held to be resident in the UK under domestic law, to have its residence determined in accordance with the provisions of the relevant double taxation agreement. It was accepted that Eulalia was resident under Dutch law. Therefore, if it was also held to be UK resident under UK law, its residence for the purposes of section 14 of the Taxation of Chargeable Gains Act 1992 would have to be determined under the tie-breaker provisions of the treaty.

The relevant tie-breaker clause provides that the company should be treated as "resident of the State in which its place of effective management is situated"[8].

Chadwick LJ held that, *on the facts of the particular case*, it was "very difficult to see how the two tests [i.e. the 'central control and management test' and the 'place of effective management test'] could lead to different answers".[9] However, it would appear implicit in the judge's remarks that the two tests are technically distinct.

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8 Article 4(3)

9 This echoes the decision of the Special Commissioners at paragraph 146: "*in the present context* there is no difference between central management and control and the place of effective management" [emphasis added].

The commentary on the OECD model double taxation agreement suggests that the two tests will almost always coincide.

> "*The place of effective management is the place where key management and commercial decisions that are necessary for the conduct of the entity's business are in substance made. The place of effective management will ordinarily be the place where the most senior person or persons (for example a board of directors) makes its decisions, the place where the actions to be taken by the entity as a whole are determined; however, no definitive rule can be given and all relevant facts and circumstances must be examined to determine the place of effective management. An entity may have more than one place of management, but it can have only one place of effective management at any one time.*"

However, the commentary does not attempt to provide an example of the exception to this rule.

In the High Court, Park J attempted to do so. He supposed that Eulalia was in fact resident in the UK under domestic law and then applied the place of effective management test to the company. He held that, even under this premise, the company's place of effective management was in the Netherlands.

He reached this conclusion by analysing the reasons which would require UK domestic law to treat Eulalia as resident in the UK. This would have had to have been because of the degree of influence over the company's affairs emanating from the UK being so great so as to mean that the central control and management of the company was based in the UK. Such an influence might have come from Mr (and possibly Mrs) Wood either from their home or office. Alternatively, that influence might have come from their accountant's office. In either case, Park J held that neither place could conceivably be a place of effective management of Eulalia.

Does this mean that the two tests are different? In my view, the answer is no. Alternatively, the answer is almost always no but the exceptions are hard to conceive (in the same way as the OECD commentary does not provide an example of a case where the place of effective management is *not* the place where the most senior person or persons make(s) its/their decisions). Whilst Park J assumed that the two tests were distinct, it is my view that this was simply in order to prove that the two tests actually gave the same result. In particular, Park J was relying upon the same distinction he used earlier between the provision of tax advice and the decision to carry it out.