The Offshore Tax Planning Review

RESIDENCE OF COMPANIES: THE NEW UNITED KINGDOM RULES

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1 Overview

There have been introduced some subtle but important changes to the rules for determining whether for United Kingdom fiscal purposes a company is resident in the United Kingdom. This can affect the tax position of not only the company itself, but of a trust of which it is the trustee or one of the trustees, of other companies or individuals connected with it and of persons who receive dividends or interest from it.

If it is incorporated in the United Kingdom, it is *prima facie* resident here: see 2. Even if it is not incorporated in the United Kingdom, it will still be *prima facie* resident here if central management and control of its business is carried on here: see 3. Both these tests, however, are subject to a new 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: see 4.

2 Company incorporated in the United Kingdom

A company incorporated in the United Kingdom is, for most United Kingdom fiscal purposes,[2] *prima facie* resident here and not resident elsewhere. This rule was introduced by Finance Act 1988,[3] which provided transitional relief for certain companies for a five-year period which has now expired. There are also

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[2] More accurately, for the purposes of "the Taxes Acts", as defined by Taxes Management Act 1970 s.118(1). This is a wider definition than that of "the Tax Acts" contained in Income and Corporation Taxes Act 1988 s.831(2) and covers capital gains tax as well as income tax and corporation tax.

[3] s.66 and Sch 7.

exceptions for companies which emigrated from the United Kingdom with Treasury consent.[4]

3 Central Management and Control of Business of Company

A company not incorporated in the UK, is resident "where its real business is carried on ... and the real business is carried on where the central management and control actually abides".[5] Provided a company has a sufficiently large number of directors and central management and control of the business of the company is in fact exercised only by the directors meeting as a body and such meetings occur only outside the UK, then the company cannot be UK resident under this rule, notwithstanding that one or more of the directors may be UK resident. Of course, if the reality of the situation is that central management and control of the business of the company is, whether lawfully or not, delegated to, say, one director who in fact exercises central management and control in the UK, then the company will be resident in the UK for UK tax purposes, notwithstanding that it may also be resident in some other jurisdiction.[6] The same is true if the delegation is to a non-director, such as a controlling shareholder or the settlor or beneficiary of a trust which owns the company.

What is crucial is management and control of the business of the company, which will normally be exercised by its board of directors, and not control of the company itself, which will normally be reposed in the shareholders who are able by their votes to secure the passing of a resolution in a general meeting of the company.[7]

4 Dual Resident Companies: Finance Act 1994 s.249

4.1 The Basic Rule

Finance Act 1994 s.249 introduced an important new rule which overrides the previous two rules when it applies. If a company is regarded[8] by any double

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4 See, generally, Revenue SP 1/90.

5 This is classic the statement per Lord Loreburn in *De Beers Consolidated Mines v Howe* 5 TC 198.

6 See *Bullock v The Unit Construction Co. Ltd* (1959) 38 TC 712.

7 For a recent example of a case involving the latter, see *Steele v European Vinyls* [1995] STC 31.

8 Or would be so regarded if it made a claim for relief.

taxation relief arrangements[9] as resident in a territory outside the United Kingdom and not resident in the United Kingdom, then it will be so regarded for all the purposes of the Taxes Acts. In practice, this will happen only where the company is regarded under the municipal law of each of the parties to the arrangement as being resident in its jurisdiction, but, under a "tie-breaker" clause contained in the treaty, it is regarded for the purpose of the treaty as resident only in the jurisdiction of the Contracting State other than the United Kingdom.

4.2 Double Taxation Arrangement of Limited Scope

Once a company is regarded as non-United Kingdom resident for the purposes of *any* double taxation arrangement, no matter how limited those purposes are, then s.249 applies for all the purposes of corporation tax, income tax and capital gains tax. Even a double taxation arrangement which deals only with international transport would suffice.

4.3 Any One Double Taxation Arrangement Sufficient

Another curious feature is that provided the company in question is regarded as not resident in the United Kingdom under *any one* treaty, then it will be regarded as not so resident for all purposes.

4.4 Indirect Effect on other Double Taxation arrangements

Thus, if a company is regarded as resident in Contracting State A by virtue of a double taxation arrangement between the United Kingdom and Contracting State A, it will be regarded as not resident in the United Kingdom for all purposes, including other double taxation arrangements entered into by the United Kingdom. If under a double taxation arrangement between the United Kingdom and Contracting State B, the company would otherwise be regarded as a resident of the United Kingdom, it will no longer rank as such because it will be prevented by the combined effect of s.249 and the other double taxation arrangement from being a person liable to tax in the United Kingdom by virtue of its residence. An otherwise dual (or multiple) resident company could thus be denied double taxation relief as a result of s.249.

Conversely, there is nothing to stop the company being regarded under a double taxation arrangement between the United Kingdom and Contracting State B as a resident of Contracting State B. If, as the result of a double taxation arrangement with Contracting State A, s.249 treats the company as not resident in the United Kingdom, it will deem it simply to be "resident outside the United Kingdom", but not in any particular jurisdiction. There is thus nothing inconsistent with the

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9 i.e., a treaty or other arrangement which has effect by virtue of Income and Corporation Taxes Act 1988 s.788.

company being treated after the enactment of s.249, just as much as before, as resident in Contracting State A for the purposes of the double taxation arrangement between the United Kingdom and Contracting State A and as resident in Contracting State B for the purposes of the double taxation arrangement between the United Kingdom and Contracting State B.

Where s.249 is brought into play by virtue of a double taxation arrangement between the United Kingdom and Contracting State A, it may have the indirect effect of *causing* the company to be treated as resident in Contracting State B for the purposes of a double taxation arrangement between the United Kingdom and Contracting State B. For if s.249 had not applied and if the company were treated as resident for tax purposes by both the United Kingdom and Contracting State B, the tie-breaker clause may have resulted in the company being treated as resident in the United Kingdom for the purposes of the arrangement. Now that s.249 applies, the company will be treated as resident in Contracting State B, so that it will be able to take advantage of the double taxation arrangement to shield it from liability to United Kingdom taxes.

4.5 Branch or Agency and Permanent Establishment

Section 249 has no effect on liability to tax based on the existence of a "branch or agency" or permanent establishment in the United Kingdom. A branch or agency can cause a non-United Kingdom resident to be liable to or exempt from taxing on United Kingdom source income.[10] It is a moot point whether a company can be its own "branch or agency".[11] A permanent establishment can cause a non-United Kingdom resident company to be liable to corporation tax rather than income tax or can deprive a non-United Kingdom resident of an immunity otherwise conferred by a double taxation arrangement. The concept of a permanent establishment clearly does not involve any person other than the company being involved.

4.6 Planning

In essence, the result of the new rule is that provided one can find one jurisdiction in the world which has a double taxation arrangement with the United Kingdom, no matter how limited, under which the company is treated as resident in that jurisdiction, then the company will be treated as non-United Kingdom resident for all purposes even if it is United Kingdom incorporated and central management and control of its business abides here. Moreover, if the company can do enough to qualify as a resident of a third jurisdiction which has entered into an

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[10] The rules have been rewritten by Finance Act 1995 Part III.

[11] Repugnant as such a concept is to common sense, the draughtsman of the UK representative legislation contained in Finance Act 1995 apparently thought that it could!

appropriately worded double taxation arrangement with the United Kingdom, then it can be further sheltered from liability to United Kingdom taxes.

4.7 Non-United Kingdom Resident Trusts

In the context of non-resident trusts, it might be desired to appoint as trustee a corporation which would in fact administer the trust in the United Kingdom but would be treated as non-United Kingdom resident by s.249, perhaps because it had some trifling income of its own in some jurisdiction where it was admitted to be resident for the purposes of a double taxation treaty between that jurisdiction and the United Kingdom. In that way, one could achieve all the advantages of a non-UK resident trust while having it openly administered in the United Kingdom by, say, the settlor. While this strategy would in general work for income tax purposes, one must remember that the trust will still normally be resident in the United Kingdom for capital gains tax purposes if the general administration of the trust is ordinarily carried on here.[12] Although a company to which s.249 applies could thus be useful, it will not allow the trust to be completely run from the United Kingdom.

4.8 Tax Havens Local to the United Kingdom

Ideally, one would like to find a double taxation arrangement with a territory which imposed little taxation of its own. It is well know that Guernsey, Jersey and the Isle of Man have double taxation arrangements with the United Kingdom. The fact that they are very limited in scope would not matter, provided that a dual resident company were under the relevant arrangement treated as a resident of the island in question. Unfortunately, all of the arrangements are peculiar in that none of them has any tie-breaker clause. Indeed, a person who is dual resident does not count as a resident of either the United Kingdom or the relevant island for the purposes of the arrangement!

5 Summary

The full effects of Finance Act 1994 are almost certainly somewhat different from those in the contemplation of the draughtsman.

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[12] See Taxation of Chargeable Gains Act 1992 s.69(1), discussed in my *Non-Resident Trusts, 6th edition*, published by Key Haven Autumn 1995, at 11.3.2.1. For an exception, see *ibidem* 11.3.2.2.