The Offshore Taxation Review

THE *BRICOM* DECISION

A Reply to Dr John Avery Jones from Robert Venables QC.

In my article on *Bricom Holdings Ltd v IRC* in Volume 6 Issue 3 of this *Review*, I referred to what I termed a "show stopper" argument which in my view might have been successfully adduced on behalf of the taxpayer. In that case, the Revenue sought, under the Controlled Foreign Companies legislation, to tax Bricom, a UK incorporated and resident company, in respect of interest received by a Netherlands incorporated and resident subsidiary ("the CFC") which would not have been taxable in the hands of the subsidiary on account of article 11 of the United Kingdom-Netherlands double taxation convention of 7th November 1980 ("the Convention").

I argued that what is apportioned is a controlled foreign company's chargeable profits, namely the amount of the total profits of the company on which, on the assumptions in Taxes Act 1988 Schedule 24, after allowing for any deductions available against those profits, corporation tax would be chargeable. Schedule 24 paragraph 1(1) provides that the foreign company is to be assumed to be resident in the United Kingdom. Paragraph 1(2) makes it clear that nothing in sub-paragraph (1) requires it to be assumed that there is any change in the place or places at which the company carries on its activities. Paragraph 4(1) provides that, subject to two immaterial exceptions, where any relief under the Corporation Tax Acts is dependent upon the making of a claim or election, the company shall be assumed to have made that claim or election which would give the maximum amount of relief and to have made the claim or election within any time limit applicable to it.

Although, I argued, the CFC was to be assumed to be resident in the United Kingdom, that was not inconsistent with its being also resident in the Netherlands. We are expressly told by Schedule 24, paragraph 1(2) that the mere assumption of residence in the United Kingdom does not require any further assumption that there is any change in the place or places at which the company carries on its activities. The company is thus assumed to be dual resident. Under the Convention, it is therefore deemed for the purpose of the treaty to be a resident of the Netherlands: see article 4(3) "Where by reason of the provisions of paragraph (1) a person other

than an individual is a resident of both States, then it shall be deemed to be resident of the State in which its place of effective management is situated."[1]

As a resident of the Netherlands for the purposes of the Convention, the CFC would, even if resident in the United Kingdom as a matter of United Kingdom municipal law, have been entitled to claim relief from corporation tax on interest derived and beneficially owned by it. Schedule 24 paragraph 4(1) requires one to assume that it would have made a timeous claim for such relief. In that case, the interest would have fallen out of account in calculating its chargeable profits. Hence, the interest could not be apportioned to Bricom.

In Volume 7 Issue 1, there was published a letter from Dr John F Avery Jones, one of the learned Special Commissioners who made the decision, pointing out a "technical defect" in my argument:

> "The technical defect in the argument is that, although a CFC is assumed to be resident [in the United Kingdom], it is not liable to tax in the UK by reason of domicile, residence, place of management or any other criterion of a similar nature (article 4(1) of the treaty). It is liable to tax by virtue of control by UK residents, which is not of a similar nature to the one specified. Accordingly one never reaches the dual residence position."

With respect to Dr Avery Jones, I am quite unable to see the force of his point that there is a technical defect in my argument. It is no part of my argument that the CFC in question should *in fact* be liable to the tax in the UK, whether by reason of domicile, residence, place of management, any other criterion of a similar nature or otherwise.[2] In order to calculate what sum is payable by the UK resident company to which an amount of profits of the CFC is apportioned, one must ascertain the "chargeable profits" of the CFC: section 747(4)(a). Section 747(6) makes it clear that the chargeable profits of a CFC for an accounting period is the amount which, on the assumption set out in Schedule 24, *would be* the amount of the total profits for that company for that period on which, after allowing any deductions available against those profits, corporation tax would be chargeable. Schedule 24 sets out the assumptions. Paragraph 1(1) provides that the CFC should be assumed to be resident in the United Kingdom. Now I have enormous difficulty in seeing how, on the assumption that it is resident in the United Kingdom, it would not "under the laws of [the United Kingdom]... [be]

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1 The whole of article 4 is set out in the Appendix to this Reply.

2 If it were material, I would respectfully also challenge Dr Avery Jones' statement that it "is liable to tax by virtue of control by UK residents". On a strictly technical view, the CFC legislation does not purport to charge *it* to tax at.

liable to tax therein by reason of [its]...residence...", so that it would be a "resident of the United Kingdom" for the purposes of the Convention.

It has been suggested to me that Dr Avery Jones is in fact relying on the opening words of article 4(3) of the Convention:

> "(3) Where by reason of the provisions of paragraph (1) a person other than an individual is a resident of both States ...."

In the context of the *Bricom* case, it is said, the CFC was a resident of the Netherlands "by reason of the provisions of paragraph (1)" but was a resident of the United Kingdom not by that reason but by a different reason altogether.

In my view, this argument fails too. One is asking what UK tax the CFC would suffer on the (counter-factual) assumption that it is resident in the United Kingdom. On the assumption that it is resident in the United Kingdom it would be liable to tax in the United Kingdom by virtue of its residence and would thus be a "resident of the United Kingdom" within the meaning of article 4(1). It would also be a "resident of the Netherlands" within the meaning of article 4(1), because it would in fact be liable to Netherlands tax by virtue of its residence there. It would thus, by reason of the provisions of article 4(1), be a resident of both States, so that the tie-breaker would come into play.

In my respectful view, each argument retains an appearance of credibility only so long as one confuses what is *in fact* the case with the *hypothetical* state of affairs which the statute bids us to assume in order to calculate the CFC's "chargeable profits".

Even if for some reason I am wrong as regards either or both of these two arguments, the validity of my basic point is in my view not in the least affected. For even if, on the statutory assumptions, the CFC is not a resident of the United Kingdom for United Kingdom tax purposes nor a "resident of the United Kingdom" within the meaning of article 4(1) of the Convention, yet it is clearly resident in the Netherlands. The result is just the same, namely that it is a "resident of the Netherlands" for the purposes of article 4(1). The position is simply that one arrives at this conclusion more quickly, without having to apply the tie-breaker clause, article 4(3).

APPENDIX

Article 4 of the Convention - Residence

(1) For the purposes of this Convention, the term "resident of one of the States" means any person who, under the laws of that State, is liable to tax therein by reason of his domicile, residence, place of management or any other criterion of a similar nature. But this term does not include any person who is liable to tax in that State in respect only of income from sources in that State.

(2) Where by reason of the provisions of paragraph (1) an individual is a resident of both States, then his status shall be determined as follows:

(a) he shall be deemed to be a resident of the State in which he has a permanent home available to him; if he has a permanent home available to him in both States, he shall be deemed to be a resident of the State with which his personal and economic relations are closer (centre of vital interests);

(b) if the State in which he has his centre of vital interests cannot be determined, or if he has not a permanent home available to him in either State, he shall be deemed to be a resident of the State in which he has an habitual abode;

(c) if he has an habitual abode in both States or in neither of them, he shall be deemed to be a resident of the State of which he is a national;

(d) if he is a national of both States or of neither of them, the competent authorities of the States shall settle the question by mutual agreement.

(3) Where by reason of the provisions of paragraph (1) a person other than an individual is a resident of both States, then it shall be deemed to be a resident of the State in which its place of effective management is situated.