Location, location, location

Large Corporate Management of taxes

01 July 2019

Bill Dodwell provides an update on a recent case affecting corporate residence

Corporate residence has traditionally not been a fertile ground for HMRC. The basic test – central management and control – can be recited by almost all corporate tax practitioners, since it's been with us for over 100 years. The leading case – *De Beers Consolidated Mines* – is one of the few tax cases known by most.

The recent case of *Development Securities plc and others v HMRC* highlights the issues HMRC faces when it seeks to challenge the corporate residence of subsidiary companies. The Upper Tribunal overturned the decision of the First-tier Tribunal in favour of HMRC. The case concerned tax arrangements advised on by PwC in 2004, designed to give the Development Securities group effective tax relief for capital losses, as well as indexation. At the time, indexation wasn't permitted to augment a loss, which some might argue was an economically incoherent policy. However, it was the law.

PwC advised that Development Securities set up several Jersey subsidiaries. The idea was that they should be tax resident in Jersey for just over a month, before moving to the UK. Whilst in Jersey, they were due to acquire the properties at an amount equivalent to original cost to the group, plus indexation, financed by Development Securities. This was an obvious over-value. The plan was to trigger the capital loss on the properties once UK-resident, so that the purchase price to the companies, which effectively included indexation, formed the new base cost and a larger loss would arise.

HMRC had abandoned any argument based around the *Ramsay* doctrine, so the arrangements succeeded if indeed the Jersey companies were resident there when needed.

The judges spent some time considering the judgement of Mr Justice Park in *Wood v Holden*, when he considered the role played in modern international finance and commerce by companies with limited functions and possibly limited duration. Advisers often refer to such companies as special purpose vehicles – but they remain companies with all the legal responsibilities of those of longer duration.

'…special purpose vehicles…are principals, not merely nominees or agents, in whatever roles they are established to undertake. They usually have board meetings in the jurisdictions in which they are believed to be resident, but the meetings may not be frequent or lengthy. The reason why is that in many cases the things which such companies do, though important, tend not to involve much positive outward activity. Such companies do not need frequent and lengthy board meetings.'

The judges noted that: 'The mere fact that a 100% owned subsidiary carries out the purpose for which it was set up, in accordance with the intentions, desires and even instructions of its parent does not mean that central management and control vests in the parent', adding that it is essential to distinguish between influence over the subsidiary and control of the subsidiary.

Interestingly, the First Tier Tribunal had added a sentence of its own to a quotation it included from the judgement in De Beers. No doubt the taxpayers objected to the erroneous sentence and the Tribunal then sought to remove it, under rules allowing for the correction of errors. This didn't impress the Upper Tribunal, which concluded that the First Tier was not entitled to make the correction – and that the additional sentence did not reflect the correct approach in all cases. The additional wording was ‘You reach that conclusion [on central management and control] based on a scrutiny of the course of business over the relevant period, informed by what has taken place immediately prior to incorporation.’

In this case, the Upper Tribunal agreed that it was appropriate to consider what took place before incorporation, since the scheme was planned before the Jersey companies were formed.

The Jersey companies had three Jersey-resident professional directors. The fourth director was UK-resident and was the company secretary of Development Securities. There were five Board meetings on different days between 10 June and 20 July.

The Upper Tribunal dismissed the idea that the mere fact that the directors had a specific task entrusted to them by their parent, after which they were to resign, says anything about where central management and control vested. The judges considered how the Jersey directors had approached their duties, noting that the first meeting had lasted five hours, with a lunch break, and that several substantive points had been raised with legal advisers. It was accepted that the three Jersey directors had played substantive roles as directors, although the UK-resident had not.

In the end, the Tribunal concluded that all the evidence pointed to the companies being resident in Jersey for the relevant period. They concluded: ‘The essential error committed by the FTT was to focus on the uncommerciality of the transactions to the individual Jersey Companies without having regard to the actual duties the directors owed to those companies. These duties, as we have noted, in this case principally involved consideration of the shareholders’ interests…’

The message from this case – and many others – is that the bar for corporate residence is not high. Thoughtful application of the case law principles in each case should support overseas residence where desired.