CHAPTER 1

COMPANY RESIDENCE

All statutory references are to CTA 2009 unless otherwise stated.

1.1 Introduction

The question of a company's residence is important in that it will determine the extent to which it is within the charge to UK Corporation Tax.

UK resident companies are taxable on their **worldwide income.**

Non resident companies will be chargeable to UK corporation tax only if they are carrying on a trade in the UK through a **permanent establishment**. The profits chargeable to corporation tax will be trading income arising directly or indirectly from the permanent establishment (PE), together with income from property or rights held by or held for the PE and chargeable gains within s.10B TCGA 1992. We will look at the taxation of non resident companies in more detail later.

Special rules apply to companies known as Societas Europaea. We will look at these in a later chapter.

1.2 History

In the UK, the residence of companies was decided by case law until legislation was introduced by Finance Act 1988. Residence status for the purposes of a Double Tax Treaty (DTT) did not affect residence for UK tax purposes until Finance Act 1994.

We will look at each of the above and the rules that apply where a company is held to be dual resident.

1.3 Case Law

The test for determining a company's residence was set down in *De Beers Consolidated Mines v Howe.* It was stated in this case 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 company was established in South Africa and its main business was carried on there, however the controlling board of directors exercised its powers in the UK. The company was held to be resident in the UK.

A later case, *Bullock v Unit Construction Ltd (1959),* again involved companies operating in South Africa. The constitution of each company gave control to the board of directors who had to hold their meetings outside the UK. However, as a question of fact, it was found that real control was being exercised by the directors of the parent company in the UK, even though this was unconstitutional.

The cases of Untelrab Ltd v McGregor (Inspector of Taxes) ; Unigate Guernsey Ltd v McGregor (Inspector of Taxes) ; Unigate Overseas Ltd v McGregor (Inspector of Taxes) are interesting as they looked at the amount of influence a parent could have and stated that the burden of proof lay with HMRC.

In summary the facts were that: Untelrab Ltd (the subsidiary) was incorporated in Jersey in December 1979 for the specific purpose of receiving a sum of money which was to become due to its parent, Unigate, a company resident in the United Kingdom. The subsidiary's business consisted of receiving the money due to the parent, investing that amount on short-term bank deposits, and making loans to other companies in the Unigate group, usually at the parent's request.

Board meetings of the subsidiary were held two or three times a year in Bermuda attended by two out if its three directors at which investment policy was reviewed and requests for loans were considered. The minutes were signed in Bermuda and sent to the third director in Jersey, where the minute book was kept. The day-to-day management of the subsidiary was carried out in Bermuda. The parent's guidelines for the operation of overseas subsidiaries emphasised that, although advice could be given from the United Kingdom, no major decisions were to be taken there.

There was no occasion when a request for funds from the parent was refused and the revenue contended that this showed, prima facie, that control was exercised by the parent company in the UK. It was shown that no request was improper or unreasonable, but if it had been, it would have been refused. The subsidiary's directors would not have carried out directions from the parent if they considered that such instructions were to the subsidiary's detriment.

It was held that –

(1) The burden of proving residence lay on the Revenue. If they failed to establish that the company's residence was within their jurisdiction then the company ought not to be taxed.

(2) Although a board might do what it was told to do, it did not follow that the control and management lay with another, so long as the board exercised its discretion when coming to its decisions and would have refused to carry out an improper or unwise transaction. The subsidiary's board met in Bermuda and transacted the subsidiary's business there and would have refused to carry out any proposal which was improper or unreasonable. Although the subsidiary was complaisant to do the parent's will, it did function in giving effect to its parent's wishes and the parent did not usurp the control of the subsidiary. The

subsidiary's central management and control was in Bermuda and it was therefore resident there.

The decisions in these cases demonstrate that the question of central management and control is one of fact.

SP 1/90 sets out the Revenue's view quite clearly. They will look to the highest level of control - the place of central management and control is to be distinguished from the place where the main operations are carried on, although often they will be in the same place. There is no minimum level of activity required; control can be exercised passively as well as actively. Factors which influence a decision in one case may carry no weight in another case.

Where the **board of directors meet** will be important, however it is not necessarily conclusive. It will be significant only in so far as the meetings are the medium through which control is operated. It is possible for control to rest in the hands of one person, such as a chairman or a major shareholder.

The Revenue outlines the following approach:

(i) They will try to ascertain whether the directors actually exercise central management and control;

(ii) If they do, then they will seek to establish where it is exercised;

(iii) If they do not, then they will seek to establish who does exercise central management and control, and where.

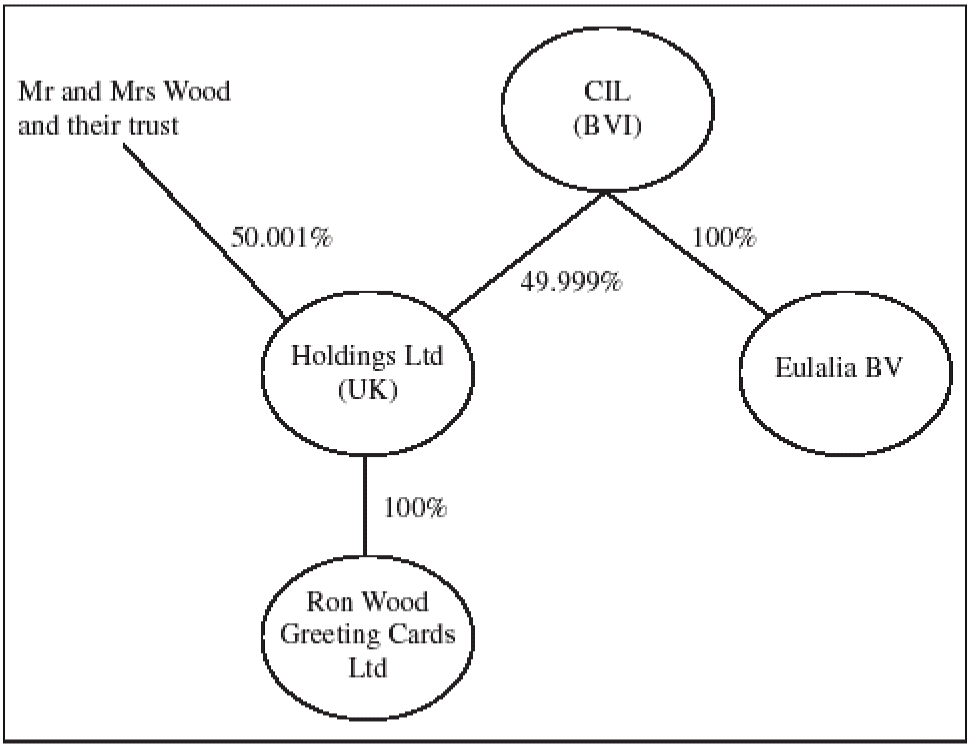
The Revenue recognises that the situation regarding subsidiary companies is not straightforward. A parent company will have some degree of influence over the actions of a subsidiary. It is necessary to distinguish between the parent exercising the normal powers of a majority shareholder in general meetings and the parent overriding the powers of the directors in the subsidiaries, as in the *Unit Construction* case. The Revenue will look at the amount of autonomy the subsidiaries have as regards decisions on marketing, investment, production and procurement.

Wood v Holden

A scheme was set up to reduce capital gains tax on the sale by the Wood family of Ron Wood Greeting Cards Ltd. The scheme was complex and involved a number of offshore companies and trusts. It is not necessary to explain how the scheme worked, as the court had to decide a single issue: the residence of one of the companies.

Eulalia Holdings BV was a dormant Dutch company pressed into service for the scheme. It was made a subsidiary of CIL, a British Virgin Island company. A Dutch trustee company (the AA Trust) was appointed director. Simplified, the structure was as set out in Figure 1.

Figure 1: Structure after Eulalia introduced



Eulalia did two things:

- it bought from its parent, CIL, its shareholding of just under 50% in Holdings Ltd; and
- three months later it sold that shareholding to the outside purchaser.

The shareholding was bought on 23 July 1996 for £23.7 million (with an upwards adjuster so that the price would equate broadly to just under the price to be received on the sale). The price was left outstanding as a loan.

The shareholding was sold on 21 October 1996 for £30.8 million, along with the other shareholdings totalling just over 50% owned by the Wood family.

For the scheme to work it was essential that Eulalia was tax-resident in The Netherlands. The Revenue argued that it was not. It said it was managed and controlled from the UK; the two transactions it entered into were choreographed from the UK by Mr Wood and his advisers.

The special commissioners found in favour of the Revenue. They had been struck by the lack of activity at director level during Eulalia's short active life. They said "We do not consider that the physical acts of signing resolutions or documents suffice for actual management. Nor does the mental process which precedes the physical acts."

However Park J observed that the decisions had nonetheless been made by the board. There was no evidence that they had acted mindlessly. They had certainly been influenced by what they understood to be the wishes of the Wood family,

Referring to an Australian case he distinguished between the advisers having wielded influence but not exercising control. Therefore Park J concluded that Eulalia was not resident.

1.4 Statute

Corporation Tax Act 2009, s. 14

A company incorporated in the UK will be regarded for the purposes of the Taxes Act as resident there.

1.5 Interaction of statute and Double Tax Treaties (DTTs)

Corporation Tax Act 2009, s. 18

S.14 CTA 2009 states that if a company is incorporated in the UK but a different place of residence is given by any rule of law, the company is not resident in that place for the purposes of the corporation taxes act.

Thus, a company incorporated in the UK will be resident in the UK even if the laws of the country where it operates its business deem it to be resident in that country. These companies are known as **dual resident** companies. In general, a company's overseas tax status is not relevant in determining its residence in the UK.

Without this rule a company could be non UK resident for the purposes of a DTT but UK resident for all other purposes.

S.18 CTA 2009 provides for companies held to be non UK resident under a DTT to be **non UK resident** for the purposes of the Corporation Tax Acts (exception in the case of the controlled foreign company provisions where such a company is still regarded as being UK resident – see s.747 (1B) ICTA)..

Most, but not all DTTs have a tie breaker clause that will determine the residence of a company. Thus s.18 will operate where there is a **tie breaker** clause in the treaty.

We will confine our studies to the tie breaker clause that is in the OECD model treaty. We will look at the OECD model DTT in a later chapter in more detail.

The tie breaker clause in the model treaty looks to the place of **effective management** of the company. Certain commentators argue that this is a test that takes place at a lower level i.e. where the business is effectively carried on. The Revenue used to hold the view that the place of "effective management" and "management and control" would be the same, they now accept that the head office will often be the place of "effective management", which can be in a different location to the place where "management and control" is exercised. However the Revenue still hold the view that it is very difficult to divorce the two, and as a result they think that the place of management and control and effective management will often coincide.

1.6 Dual resident companies

It is still possible for a company to be dual resident if the residence rules of the UK and another country are both satisfied.

In the past, dual resident companies have been used to gain a tax advantage in the UK, particularly in relation to **group relief** and thus the legislation contains **anti-avoidance** rules relating to dual resident companies.

The rules only apply to dual resident investment companies.

A dual resident company for these purposes is one that is resident in the UK and is also within the charge to tax under the laws of a territory outside the UK either:

- because it derives its status as a company from those laws; or
- because its place of management is in that territory; or
- because under those laws it is regarded for any other reason as resident in that territory.

A dual resident investment company is a dual resident company that is not a trading company throughout the accounting period, or one that is a trading company, but whose trade consists of acquiring and holding shares, securities or other investments in other companies or financial activities - for example the group banker or financial services company.

The restrictions for dual resident investment companies relate to the following:

(1) Group relief - no relief is available if the **surrendering** company is a dual resident investment company. ICTA 1988, s.404

(2) S.343 relief - the carry forward of losses on transfer of a trade does not apply to dual resident investment companies. ICTA 1988, s.343(2)

(3) Capital gains - no gain/no loss transfers do not apply if the disposal is to a dual resident investment company. The rules relating to a group being treated as one trade do not apply if the company acquiring the new asset is a dual resident investment company. TCGA 1992, s.171 (2)(d)

(4) Capital allowances - an election cannot be made for transfer at TWDV. CAA 2001, s.570(2)

1.7 Non Resident companies

Corporation Tax Act 2009, s.19 & s.21

Non resident companies are subject to UK corporation tax if they are **carrying on a trade** in the UK through a **permanent establishment (PE).** S.20 sets out how the profits of a PE are to be calculated.

A Company will have a PE in two circumstances

FA 2003, s. 148

a) it has **a fixed place of business** through which the business is wholly or partly carried on or

b) **an agent habitually carries on business activities as authorised for and on behalf of the company**

A fixed place of business is defined as including;

(i) A place of management;

(ii) a branch;

(iii) an office;

(iv) a factory;

(v) a workshop;

(vi) an installation or structure for the exploitation of natural resources;

(vii) a mine an oil or gas well a quarry or other place of extraction of natural resources;

(viii) a building site construction or installation project.

A company will not be regarded as having a PE if it carries on its business through an independent agent acting in the ordinary course of their business or if the activities are of a preparatory or auxiliary nature.

Activities will be of a preparatory or auxiliary nature if they relate to the use of facilities or maintenance of stock for the storage, display or delivery of goods; maintenance of goods for processing by another person; or the purchasing of goods or merchandise or collection of information for the company.

The UK legislation defines a PE in similar terms to the OECD model treaty which is reviewed generally in a later chapter. However, there are differences.

Note: A non-resident company will only be subject to corporation tax if carrying on a **trade** in the UK which is narrower than carrying on a business.

Corporation Tax Act 2009, s.5(2) & s.19(1)

Corporation Tax Act 2009, s.19(3)

1.8 PE charge to Corporation Tax

Where a **non resident company is trading through a PE in the UK** it will be chargeable to corporation tax on:

(a) trading income arising directly or indirectly through or from the PE;

(b) income from property or rights used by, held by or held for the PE; and

(c) chargeable gains arising within s.10B TCGA 1992 (see 1.9 below).

The legislation sets out that the PE will have attributed to it the profits it would have made if it were a distinct and separate enterprise engaged in the same, or similar, activities under the same, or similar, conditions dealing wholly independently with the non resident company. In applying this rule the PE will be assumed to: Corporation Tax Act 2009, s.21(1)

(a) have the same credit rating as the non resident company; and

(b) to have such equity and loan capital as it could reasonably be expected to have as an independent entity.

No deduction will be allowed for costs in excess of those that would be incurred on these assumptions. Corporation Tax Act 2009, S30

S.21 to 32 CTA 2009 set out further details relating to the deductions that can be claimed for allowable expenses. Basically the same rules will apply as for a UK resident company. In addition a deduction can be claimed for **executive and general administrative expenses whether incurred in the UK or elsewhere.** Corporation Tax Act 2009, s.29(2)

Transactions between the PE and the non resident company will be treated as taking place at **arm's length prices**. A deduction will be available for allowable expenses, whether or not the expenses are incurred or reimbursed by the PE, equal to the cost to the non resident company Corporation Tax Act 2009, s.22 Corporation Tax Act 2009, s.29(3)

Where the non resident company provides goods or services to the PE they will be treated as arm's length transactions under the separate enterprise basis if they are provided in the ordinary course of its business. Otherwise they will be treated as an expense of the non resident company incurred for the purposes of the PE. Corporation Tax Act 2009, s.23

No deduction is allowed for **royalties paid to other parts of the non resident company**, however contributions towards creating an IFA will be allowed. No deduction is allowed for interest payments to other parts of the non resident company unless it is incurred as part of a financial business carried on by the PE. Corporation Tax Act 2009, s.31/s.32

Dividends and other distributions from UK resident companies will not be charged to tax. If annual income or other annual payments are received after deduction of income tax, then so long as the income is subject to tax the same rules apply as to a resident company.

For a non resident company the **full rate of corporation tax is normally applied** regardless of the level of profits. However where the company is resident in a country that has a double tax treaty with the non discrimination clause (see later chapter), the small companies' rate and starting rate band can be claimed. Corporation tax self assessment applies.

1.9 PE chargeable gains

TCGA 1992, s.10B

As for resident companies, a PE will be charged to corporation tax on its chargeable gains.

In the case of a PE, chargeable gains will arise on the disposal of assets situated in the UK used for the purposes of the trade or the purposes of the PE, at or before the time the gain accrued. The disposal will only be taxable if the asset is used in a trade carried on through a PE in the UK at the time of disposal.

We can see that it would be easy to avoid the charge to tax by moving assets outside the UK. As a result there are rules to prevent this. Where a non resident company **ceases to trade through a PE a charge will arise.** The PE will be treated as having **sold and reacquired the chargeable assets at market value immediately before it ceased to trade.** If the PE **exports** a **chargeable asset** then a gain will be deemed to arise **immediately before the asset leaves the UK.**

TCGA 1992, s.25

Rollover relief can apply to a PE but not if the asset that is acquired is outside the charge to UK capital gains tax.

The no gain no loss rules of s.171 TCGA 1992 can apply where a non resident company transfers the whole or part of a PE to another company in the same 75% group. Note that where the transferee is also non resident the assets must stay within the charge to capital gains tax. Don't forget that similar rules apply to the transfer of intangible fixed assets.

1.10 Non Resident companies - Assessment, collection and recovery of CT

FA 2003, s.150

The rules relating to the assessment, collection and recovery of corporation tax for UK companies **apply to the UK representative of a non resident company as they would to a UK resident company**. A PE in the UK through which a trade is carried on **is the UK representative** of the non resident company. The PE will continue to be treated as the UK representative even after the trade has ceased and is treated as a distinct and separate person from the non resident company.

The non resident company will be bound by the acts of the UK representative as if they were its own in connection with the obligations and liabilities imposed on the representative.

FA 2003,s. 150(3)

However, the non resident company **will not be bound by mistakes** in information provided by the UK representative **unless** they arise from acts or omissions of the non resident company or to which it **consented or connived.**

FA 2003, s. 150(5)

The UK representative cannot be proceeded against for a criminal offence unless it committed the offence itself or consented or connived to it.

FA 2003,s. 150(6)

If corporation tax due by a non resident company is outstanding for more than six months, then other companies who were members of the same group or consortium as the non resident company, or members of a group where another company was a member of such a consortium, can be served a notice requiring them to pay the outstanding tax. FA 2000, Sch.28

The companies only have to be members of the same group etc at any time in the twelve month period before the start of the accounting period for which the outstanding tax is due.

For these purposes the 51% definition of group is used and for consortia the 75% definition for group relief is used. Where tax is recovered from a consortium member or another member of the same group as a consortium member, the amount cannot exceed the consortium member's share of the corporation tax outstanding. FA 2000, Sch 28 Para 2(3)

Any notice under these rules must be served within 3 years of the date on which the tax liability was finally determined. FA 2000, Sch 28 Para 4

1.11 Non Resident companies and income tax

FA 2003, s.150

Where a non resident company has income that is not subject to corporation tax, for example where it is not trading through a PE or has letting income from property in the UK, income tax will apply.

No further income tax is due where tax is deducted at source for loan relationship, dividends and certain miscellaneous income. Tax deducted at source includes tax paid or treated as paid or where there is an entitlement to a tax credit. This legislation was previously in place under s.128 FA 1995, but needed to be put into the context of PEs. S.128 remains for circumstances other than overseas companies. S.151 FA 2003 merely replicated s.128 FA 1995 once the concept of a branch or agency was replaced by a PE and applies to income arising in the UK, but which is not attributable to a PE through which a trade is carried on.