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# NEWHAVEN TRUST COMPANY (CHANNEL ISLANDS) LIMITED

## COMPANY RESIDENCE – A QUESTION OF MIND OVER MANAGEMENT?

**S**ome of the more interesting discussions I have held in the past year have revolved around where mind, management and central control of a company actually resides.

Like many things in life, the answer to the substantive question used to be far simpler than it is today. On first principles, non-UK incorporated companies with non-UK resident directors exercising unfettered control of a company's affairs from overseas have limited UK tax exposures. Specifically, a company not resident in the UK is within the charge to corporation tax if, and only if, it carries on a trade in the UK through a permanent establishment (S.149(1) Finance Act 2003). On the face of it, income from UK situs assets also falls within the realms of one form of taxation or another.

Whilst other tests are relevant, generally a body corporate is a tax resident of the place where mind and management resides and central control is exercised. Historically few looked further than the residence of the directors and the address on the board minutes to determine this.

So what has changed to cause this issue to move up the agenda and to make the position more complicated? The answer is probably two-fold. The first is the political prominence now given to initiatives aimed at combating domestic tax leakage. No matter if you look at Europe, the Americas or Australasia, you find countries with sophisticated and developed anti-avoidance regimes, aimed at minimising legitimate tax planning opportunities and ensuring that individuals and legal entities alike make their fair tax contribution in their country of residence and/or citizenship. Tax compliance is very much the name of the game.

Secondly, and certainly in the UK, significant investment

in people, systems and infrastructure has resulted in Revenue agencies possessing far greater ability and determination to conduct effective enquiries. Increased global transparency and information flows fuel this process.

Cases are now emerging which provide both insight into the prevailing regimes and food for thought for clients and their advisors. One such is that of *Wood v Holden*. Essentially this case concerned the effectiveness of a complex UK tax mitigation scheme. It is also of interest because of the examination of the role played by professional fiduciaries situated outside of the UK who were charged with providing administration and management services to overseas companies which themselves were vital cogs in the tax planning wheel.

In greatly simplified terms the background to *Wood v Holden* is as follows. A number of trusts were set up (and run out of Switzerland) which, in turn, owned a BVI Company also administered from Switzerland. Via a UK company, the BVI entity owned just under 50% of a chain of shops which were to be sold. The scheme was designed to mitigate Capital Gains Tax on the sale.

Because of a change of law during the sale process the BVI company sold its shares in the UK company to a new Dutch company ("Dco") established for the purpose. The idea was to take advantage of the available double tax treaty between the UK and the Netherlands. Dco was "managed" by a Dutch fiduciary services firm which "supplied" Directors. Dco took detailed advice from accountants and lawyers in the UK before entering into a series of agreements.

In determining tax liabilities following the transaction the Inland Revenue took the view that Dco had its central mind and management in the UK and was accordingly resident in the UK. The Inland Revenue issued tax assessments totalling £12 million.

The matter went to appeal before the Special Commissioners before ultimately escalating to the High Court.

At least for the purposes of this article, it is not the detailed merits of the case that interest me but more the factors that the Special Commissioners and the High Court took into account in reaching their respective verdicts. As examples, and in support of the Inland Revenue, the Special Commissioners noted:-

The Directors of Dco were not always kept up to date with the status of negotiations.

- Advice to the Directors was, in some areas, incomplete.
- There was a lack of written evidence to confirm that the Directors had really considered and reviewed documentation.
- The fees payable to the fiduciary company were only £1,300 suggesting that not much work had been done in managing Dco (the implication presumably being that clients who pay peanuts get what they deserve!).
- In reality Dco just did what the client wanted as expressed by the UK lawyers, accountants and other advisors.

The judgement of the Special Commissioners also included the following commentary:-

“We do not consider the mere physical act of signing resolutions or documents suffice for actual management. Nor does the mental process which precedes the physical act. What is needed is an effective decision as to whether or not the resolution should be passed and the documents signed or executed and such decisions require some minimum information ....merely going through the motions of passing or making resolutions and signing documents does not suffice”.

In the High Court it was indicated that the Special Commissioners were correct in viewing as irrelevant the mere physical act of signing documents. The High Court, however, took the view that the thoughts, the processes and the actions which took place before the signing were vitally important and relevant in establishing the place of central management and control of Dco. By close examination of many elements, the High Court effectively built up a picture to detract from allegations that Dco was a “sham” and decided that elements of substantive management and control genuinely took place in the Netherlands.

In fact, the High Court appeal in Wood v Holden resulted in at least a partial victory for the taxpayer but in so doing, it has left some important markers. The first consideration is how many people wish to spend years of worry and many thousands of pounds if their “case comes up” and in the hope of getting a good outcome.

It is time to look beyond the letter of the law and to the sentiment of it. The answer to the question of where mind, management and central control of a company actually resides can now only be determined by detailed analysis of the substantive reality (and not the smoke screen) of who understood what, who did what and why. It is equally clear that the likelihood of the Revenue going to the trouble of conducting that analysis is much higher than it was before.

I think we will see many more cases along the lines of Wood v Holden. I also think that clients, their advisors and professional fiduciary companies alike would be well advised to take on board the lessons that the case provides.

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