

Bridging the Atlantic Series

February 2014



Tax residency of offshore vehicles

UK Tax residence

A company that is tax resident in the UK will be chargeable to corporation tax on all of its worldwide profits and gains at a rate of 23% (this rate will be reduced to 21% from 1 April 2014 and falling to 20% from 1 April 2015). A company that is not tax resident in the UK will only be liable to corporation tax if it carries on a trade in the UK through a permanent establishment. A non-resident company may also be liable to UK income tax on non-trading income.

Tax residence is therefore important as it determines the scope of the charge to corporation tax. The tax residence of companies is one area where it is easy for companies inadvertently to fall on the wrong side of the line.

HMRC (the UK's taxation authority) has had some success in establishing that offshore companies were UK tax resident. In 2009, the First Tier Tax Tribunal heard the case of *Laerstate B.V.*, concerning the tax residency of an offshore company. The Tribunal found that an offshore company was, in fact, UK tax resident and its profits taxable in the UK.

In response to HMRC's success, the government set out its intention to investigate companies claiming to be offshore when Dave Hartnett, then Permanent Secretary for Tax at HMRC, said, "Some companies claim to have changed their residence and left the UK. Investigation and litigation in the UK will establish that." We are now seeing increased scrutiny by HMRC into the tax residency of offshore vehicles.

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Berwin Leighton Paisner

Central management and control

Under UK tax law, a company is tax resident in the UK if it is either:

- (a) incorporated in the UK (with certain exceptions); or
- (b) the central management and control of its business is in the UK.

There is no statutory definition of central management and control, so it is necessary to rely on case law, as interpreted by HMRC guidance. The case law rule for determining the place of central management and control is authoritatively expressed in Lord Loreburn's speech in *De Beers Consolidated Mines Ltd v Howe* [1906] AC 455:

"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." (emphasis added)

The case law concept of central management and control in the UK is, in broad terms, directed at the highest level of control of the business of a company. When evaluating the location of central management and control of a company incorporated outside the UK, therefore, it is necessary to look for the location of the highest level of decision making of the company and then compare this to the location of the day-to-day management of the business.

As general policy decisions on the conduct of a company's business are normally taken at board level, case law places particular emphasis upon the meetings of the directors in determining who exercises central management and control.

Permanent establishments

A company not resident in the UK is nevertheless within the charge to UK corporation tax if it carries on a trade in the UK through a permanent establishment. A company has a permanent establishment in the UK where:

- (a) the company has a fixed place of business in the UK through which the business of that company is wholly or partially carried on; or
- (b) an agent acting on behalf of the company has, and habitually exercises, their authority to do business on behalf of that company.

Where a company has a permanent establishment in the UK that company will be subject to UK corporation tax on its profits to the extent those profits are attributable to the company's UK permanent establishment.

How will HMRC assess a company's tax residence?

If there are any doubts about residence, HMRC have stated they will adopt the following approach:

- (a) first, ascertain who, in fact, exercises central management and control, and at which level;
- (b) second, seek to establish the jurisdiction where such management and control is exercised; and
- (c) third, if the board do not exercise management and control, ascertain who does and where.

What must a company do to ensure it maintains the correct tax residence?

(a) Key decision making

- The directors must make all major decisions in relation to the central management and control of the company and such decisions must be made in the company's jurisdiction.
- All major and strategic decisions must be made at meetings of the directors held in the company's jurisdiction and not at meetings held previously or elsewhere on the basis that they will subsequently be approved or "rubber stamped" at the board's meeting.
- The directors must review and comment on all key documentation (and must be given sufficient time to do so) and must demonstrate a genuine understanding of the transactions being undertaken by the company.

(b) The Directors

- All directors should ideally be resident in the company's jurisdiction for tax purposes.
- All directors must have, and continue to have, sufficient knowledge of the company's structure and strategy, in order to be able to make informed decisions in relation to its business.

- All directors must have the appropriate qualifications and requisite experience so as to execute the role of director credibly in making informed decisions about the business of the company.
- All directors must be able to demonstrate that they are adequately remunerated for their services.

(c) Notification of meetings of directors

- A full agenda for each meeting of the directors and any other relevant documentation must be presented to each director well in advance of the meeting, to allow each director to formulate their own thoughts and opinions on items proposed for discussion.
- Meetings of the directors must be held as and when required in order for the company to conduct its business and, in any event, at least quarterly.

(d) Attendance at meetings of directors

- Meetings of the directors should be held in the company's jurisdiction in all circumstances and contemporaneous evidence (such as travel documentation) should be retained as evidence of this (where relevant).
- Meetings should not (preferably) be held by telephone, video-conferencing, electronic conferencing or any other similar means. If a director has to attend a meeting via telephone, they should still be located in the company's jurisdiction at that time.
- If (subject to the Articles of Association) directors can appoint proxies to attend meetings on their behalf, the proxies must fulfill the same requirements (e.g. as to residence) as the appointing director.

(e) Conduct of meetings of shareholders

- Meetings must be substantial and include detailed discussions relating to the recommendations of any directors (acting at all times in the interest of the shareholders).
- Full and accurate minutes must be prepared promptly after the meeting, circulated to all shareholders and kept at the company's registered office in the company's jurisdiction.

(f) Location of statutory books

- All statutory books, register of shareholders and other constitutional documents of the company must be kept in the company's jurisdiction, together with all accounting records, original documents, minute books and other corporate records

(g) Contractual arrangements

- All contracts or other documentation binding on the company must be reviewed by the directors and executed in the company's jurisdiction.

- All supplies made to the company must be issued and invoiced to it and payments should be made to the company in its jurisdiction.

The following table suggests a working protocol for an offshore company (in this case, a Delaware LLC) which invests in UK real estate assets. This is, ultimately, a question of fact.

| THE DIRECTOR (S) | | BOARD MEETINGS |
|---|---|---|
| ✓ MUST: | * MUST NOT: | ✓ MUST: |
| <ul style="list-style-type: none"> • be actively involved in decision making and make all strategic and high level decisions of the company in meetings of the director(s) held in Delaware; • review, comment on and control entry into and termination of key agreements; • at all times act in the best interests of the shareholders; • be resident in Delaware; • have sufficient experience and qualifications to manage the company; • devise and approve the investment strategy / business plan of the company; • formally appoint the company's advisors and approve delegation of tasks; • have sufficient knowledge of the company's business; and • be adequately remunerated for their services. | <ul style="list-style-type: none"> • act on the instructions of another party; • let any other party fetter the directors' ability to manage the company; • "rubber stamp" decisions made elsewhere (e.g. by its advisors); • make strategic decisions without a meeting of the directors; • execute contracts, entered into by the company, in any jurisdiction other than Delaware; or • become resident or tax resident in any jurisdiction other than Delaware. | <ul style="list-style-type: none"> • only take place in Delaware; • be held with (preferably) all of the directors physically present (or, if this is not possible a director may attend by telephone provided all attendees are located in Delaware); • be held each time a strategic decision is made / material agreement entered into; • be held to agree the scope of the delegation of any operational tasks; • be substantial with full minutes; and • be held on sufficient notice to allow the directors' time to prepare. |
| ADMINISTRATION | | |
| The company MUST: | The company MUST NOT: | |
| <ul style="list-style-type: none"> • keep all statutory books and corporate documentation in its registered office in Delaware; • hold shareholders' meetings in Delaware and nowhere else; and • ensure its supplies are issued and invoiced to it in Delaware. | <ul style="list-style-type: none"> • establish a permanent establishment (i.e. an office, branch or other fixed place of business) in any jurisdiction other than Delaware; or • open any bank accounts in any jurisdiction other than Delaware. | |

Getting in touch

If you would like to talk through your project or discuss solutions to your legal needs, please get in touch.

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