RESIDENCE AND ZERO RATE OF TAX JURISDICTIONS

by Laurent Sykes

The question often comes up as to whether a company resident in a so called zero/ten rate jurisdiction (Isle of Man, Jersey and Guernsey) is able to benefit from the relief conferred by a double taxation agreement entered into with the UK. (Whether these tax systems will remain as they are is of course currently the subject of debate following recent announcements. These suggest that thought is being given, by at least some of the jurisdictions, to a 10% rate to replace the 0% rate.)

To take the example of Jersey (and it is important to consider each country's tax system carefully), income tax is imposed by the Income Tax (Jersey) Law 1961. The author understands[1] that, under this Act, tax is charged under Schedule A and Schedule D. Schedule A is the head of charge for rents and other profits from Jersey land (s.51). Schedule D by contrast is the head of charge for Jersey source income received by non-residents[2] as well as the worldwide income of Jersey residents (other than that charged under Schedule A) (s.61 and s.62). From 2009, a company which is either resident in Jersey or which has a Jersey permanent establishment has been charged to tax under Schedule D at a rate of 0% (s.123C). Tax is otherwise charged at 20%. Special rates apply to financial services companies and utilities. In order to be a "resident of Jersey" and therefore to benefit from the treaty with the UK, a company must:

(a) Not "be resident in the UK for the purposes of UK tax" (i.e. the treaty does not cater for dual residents), and

(b) "Be resident in Jersey for the purposes of Jersey tax". For these purposes a company is to be regarded as resident in Jersey if its business is managed and controlled in Jersey.

It will be seen from the above brief description of the Jersey tax system that, on the face of it, the significance of being a Jersey resident is much diminished by the zero rate of tax applicable to Schedule D, given in particular that Schedule A applies to residents and non-residents equally. However it has some residual significance:

(a) As regards Schedule D, a Jersey non-resident which does not have a permanent establishment in Jersey does not in fact benefit from the 0% rate (s.123C).

(b) As regards Schedule A, residence is relevant to withholding obligations. Para 3 of Schedule 3A of the Act provides for instance for a prima facie withholding obligation to be placed on agents receiving rents on behalf of a non-resident.

The 1961 Act states that "a company incorporated outside Jersey shall be regarded as resident in Jersey if its business is managed and controlled in Jersey" (s.123 of the 1961 Act).

The case that a company whose business is managed and controlled in Jersey is entitled to the benefits of the relevant treaty seems to be a fairly robust one, notwithstanding the zero rate of tax applicable to Schedule D. A company whose business is managed and controlled in Jersey would, it is considered, be resident in Jersey for purposes of Jersey tax – which are real purposes. The position may be different if the definition of residence followed the OECD Model residence definition. This would require it to be liable to tax by reason of domicile, residence, place of management or similar criteria and this is specifically stated to exclude a person who is liable to tax in respect only of income from sources in that State or capital situated therein (see Article 4(1) of the OECD Model). It is difficult to see how a company charged at a rate of 0% is liable to tax at all, and as regards Schedule A, this applies to residents and non-residents equally. However that is not what the definition of residence in the Jersey/UK treaty asks. The position can be bolstered as a practical matter by the relevant company deriving Jersey-source rents, which would be received without withholding.

Note:

(a) If the definition of residence is satisfied, there does not appear to be any overriding principle of treaty interpretation which would cause treaty benefits to be disapplied simply because the result would be non-taxation. See for instance *Estate of Michael Hausmann v R* (Tax Court of Canada)[3] and

Lamesa Holdings v Commissioner (Federal Court of Australia (Full Court))[4].

(b) Although s.788(1) ICTA 1988 describes double taxation agreements as arrangements "with a view to affording relief from double taxation", there is no domestic principle that double taxation must occur absent the treaty. (Indeed s.788(8) provides that "arrangements to which effect is given under this section may include provisions... as to income or chargeable gains which is or are not subject to double taxation, and the preceding provisions of this section shall have effect accordingly". This is reflected in s.3(2) of the Taxation (International and Other Provisions) Bill.)

(c) There is perhaps a question as to whether the income tax imposed by the 1961 Act (as modified by the introduction of the zero tax regime) is a tax which is within the scope of the double tax treaty. "For the purposes of 'Jersey tax' " means "for the purposes of the income tax" and "any other taxes of a substantially similar character" (Article 1 of the treaty). However it is considered that the income tax imposed by the 1961 Act continues to be the same tax, income tax. The fact that the rate of tax on Schedule D income has been reduced for residents and non-residents with a permanent

> establishment does not in the author's view, on balance, result in the income tax no longer being the same (or substantially similar to its predecessor).

It is understood that HMRC have not to date taken the zero rate of tax point to deny treaty benefits although they are aware of it. It may be that future developments in the relevant jurisdictions render the point moot going forward.

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[1] The author thanks Nathan Powell of Ogier, Jersey for his assistance in confirming the relevant aspects of the Jersey tax code.

[2] By concession non-residents will not be assessed in respect of Jersey bank interest.

[3] (1998) 4 CTC 2232 (Canada): "[20] One thing however is quite clear and it is that the premise upon which the assessment was based, that if Belgium did not tax the payments they must be taxable in Canada, is plainly wrong…[29] I have concluded that the pension payments received by the late Mr Hausmann…are social security pensions and similar allowances and are taxable only in Belgium. The fact that Belgium chose not to tax them in this case is irrelevant."

[4] (1997) 36 ATR 589 (Australia): "It happens to be the case, because of unilateral relief granted by the law of the Netherlands, that no tax will be payable in the Netherlands. That of itself cannot affect the interpretation of the Agreement. If the relevant mining property had happened to be in the Netherlands so that the issue was between taxation there on the one hand and taxation in Australia on the other, the situation would have been one where tax would clearly have been payable on the alienation of the shares in Australia without the benefit of any exemption. Yet the Agreement must operate uniformly, whether the realty is in the Netherlands or in Australia."