

THOUGHTS ON CORPORATE RESIDENCE

by David Goldberg

According to Google's on line etymology dictionary, the phrase "get real" originated, in American college slang, in the 1960s – which was, of course, the era of hippie culture and flower power.

Apparently, the apogee of usage of this phrase was reached in 1987, since when it has been in relative decline as a matter of popular speech, being largely replaced by the, perhaps more useful, exhortation to wake up and smell the coffee.

In the world of tax, however, the requirement to get real has been growing since about 2003, when Ribeiro PJ told us, in his judgment in the *Arrowtown* case, that it was necessary, in tax cases, to apply the statute, construed purposively, to the facts viewed realistically.

A difficulty with this sort of elegant formulation is that the words "viewed realistically" are clearly meant to add something to the words "the facts".

Are the facts one thing when just viewed, and another when viewed realistically; and, if so, what is the difference?

I ask the question because the word "real" quite often crops up in Special Commissioners' decisions on residence, although higher courts on appeal seem to avoid it and go along with the proposition that what happens is what happens and does not change if you ask what really happened.

I shall try, a bit later, to see if I can demonstrate what I mean about how the Special Commissioners seem to treat what really happened as different from what happened, by reference to the recently decided cases about residence.

However, before I do that, I should make some general points about corporate residence.

As every reader will know, any company incorporated in the United Kingdom since 1988 is automatically resident here for tax purposes, unless it can show that its place of effective management is in a country with which we have a relevant double tax treaty – see FA 1994 s.249.

And any company which is not incorporated here (or which was incorporated here before 1988 and which has been resident outside the United Kingdom since then) will be resident here if the central management and control of the company abides here, so that its real business is carried on here.

That is the well known common law test laid down by Lord Loreburn in 1906 in the *De Beers* case.

Now no doubt all sorts of tests could have been chosen for residence, but incorporation and central management and control seem just as good to me as any other test of residence: indeed, in the case of a body corporate, it seems quite hard to think of another more sensible test of residence.

In what follows, I shall speak essentially about companies not incorporated in the United Kingdom, though I shall also make some comments relevant to UK-incorporated companies seeking to say that they are Treaty non-resident.

I should begin by making four points about the company law or treaty test of residence.

First, the central management and control test relates to the business of the company and not to the company itself.

The enquiry is not into where the company is controlled, but into where the business of the company is controlled.

Thus we do not look to see where the shareholders of a company meet: we look to see where the controlling mind of the company's business is to be found.

Now a point quite often overlooked here is that, in looking for the place of the controlling mind, something – not everything, but something – will turn on what the company's constitution says.

The case law shows that the usual thing to do when looking to find the place of central management and control is to look to where the directors meet.

I accept, of course, that there are *dicta* in some of the cases that you do not just look to see where the board meets to determine residence, but I assert that, in general, the authorities show that the first thing to do in deciding residence is to see where the board meets and that that will determine residence in the absence of some other feature.

I shall come in a moment to discuss what that other feature might be.

However, before I do that I should say that it will only be right to look to where the board meets if the company's constitution gives the directors of the company the power to manage its business (which it usually does do, but may not), and the directors are actually acting as directors and have not been usurped.

The case law makes a huge distinction between cases where the directors act, albeit

only slightly, and cases where control has been wrenched away from them and they do not act.

Thus the case law shows that , in a case where the constitution of the company in question gives power to the directors to manage its affairs, central management and control is to be found where the board of directors meets, unless the functions of the board have been usurped.

Case law around the common law world is unanimous on this point, perhaps surprisingly unanimous; and the test is applied not just in tax cases, but in other areas of law too.

Accordingly, the feature which makes it wrong to look to the place where the board meets to find the place of residence – and the only feature which makes it wrong to do that – is usurpation.

Without usurpation, the decisions in the cases show that the place of residence is the place the board meets and, accordingly, I do not entirely agree with those who say that location of formal board meetings is not determinative of tax residence.

In my view, it is, on the authorities, determinative of tax residence, unless it can somehow be said that the functions of the board have been usurped.

I understand people have said that the location of the directors' meetings is not determinative.

The *dicta* in the cases give some encouragement for that view, by referring to the place of actual management.

However, there is an important point to make here about the way in which judges decide cases, about what I might call the case law experience.

It is a commonplace of many areas of the law that judges, in certain parts of their judgments, make very high-flown comments: in the field of judicial review, for example, there are passages which make you believe that the courts will give a distressed litigant the waters of the moon.

It is, nonetheless, necessary not only to look at these high-flown passages, but also to what actually happens when the case is decided.

Never mind what the judge says: what does he actually do, what does he decide?

It is only the decision which is binding authority, not the commentary.

It is true that in residence cases, the judges emphasise that we are looking for the real place of control.

But the really important point to note – the thing which, like coca cola, is the *real thing* – is that the judges have always decided that a company is resident where its board of directors meets and that that is the place of real control with only one exception, the exception being a quite extraordinary case in which the directors had stood aside, had abandoned their role so that their position had been usurped.

It is only when you can find that feature that residence is not where the board meets; and experience, not all of it bitter, has taught me that, in using case law, it is essential to look to what is decided and not to the promises made in the commentary which are virtually never fulfilled in the actual decisions.

Moreover, case law in the higher courts is unanimous about the need to distinguish between the exercise of control on the one hand and the exercise of influence on the other: control makes a company resident; influence does not.

Furthermore, the exercise of influence over a board does not amount to a usurpation of its functions: on the contrary, the board usually has to act to implement the influence and it is that acting which is the exercise of central management and control, not the influence leading to that action.

I have limited what I have just said about case law to decisions of the higher courts because, as I shall show shortly, the Special Commissioners here seem somewhat wedded to the proposition that influence is important; a proposition for which (leaving aside the Special Commissioners themselves) there is no case law authority at all anywhere in the common law world.

However, again leaving the Special Commissioners aside for the moment, the general proposition can be safely stated: control of the kind which makes a company resident is found where the directors of the company meet, so long as they are meeting and acting in a way no matter how formal.

A recurring theme of what I want to say is that, for something to be actual management or control or to be the real place of control, it must be something that is, somewhere where management or control is.

Finding something to be real and then describing it as management does not make it control.

The position is likely to be different if the company's constitution does not give the directors of the company power to manage its business; but this point has not yet actually arisen for decision, no doubt because advisers are, on the whole, sensible enough to

ensure that it does not arise.

The second point to make is that the case law does recognise the possibility of a company being resident in two or more places at once.

Although the concept is central management and control, the centre is apparently capable of being geographically diverse.

Recent case law has tended to shy away from this idea, but the possibility of multiple residence should not be overlooked.

Good planning, of which more later, will ensure that the possibility of multiple residences does not arise.

The third point is that, as I have mentioned, sometimes, where a treaty is relevant, we need to find the “place of effective management” of a company.

I should have thought it completely obvious that the phrase “effective management” refers to a wholly different concept from that to which the phrase “central management and control” refers.

Central management and control consists in the giving of directions and effective management is not control, but putting the decisions of central management into effect.

It turns out, however, that even English language versions of DTCs contain French words and that “effective” is one of them and should, accordingly, be pronounced “effectif” – which means something different from effective.

At any rate, current authority and commentary both now strongly equate the concepts of effective management and central management and control.

Another point here is that you do not really want to be in this position.

The fourth point I should make before turning to the recent cases is that litigation about corporate residence is really no different from litigation about anything else, though it is a bit unusual in tax terms, because it is unusually fact-centric: there is no issue here as to what the statute means; the case is all about finding the place where central management and control is to be found.

One point to note here is that, in terms of tax litigation, cases about residence might be one-shot cases, in the sense that, if the Special Commissioners make unhelpful findings of fact, an appeal from them, which is, of course, only on a point of law, may be quite difficult.

In fact-centric litigation, there is often a danger of the wood getting lost in the trees (that happened, appropriately enough, in the *Holden* case) and because that is so it is necessary for the advocate to ensure that the enquiry made by the court is focussed on the proper question.

As I have said, the proper question is about central management and control, and it is, “Where did the acts of central management and control take place?”

We are looking for management and control, not hopes, dreams and wishes.

The failure properly to distinguish between management and control on the one hand and hopes, dreams and wishes on the other has, in recent cases, led the Special Commissioners into error; and anybody litigating about corporate residence needs to make sure that the court understands that hopes, dreams and wishes do not decisions make.

The Special Commissioners do not presently seem to have a firm grip on that point; and, indeed, the way they have been coping with hopes, dreams and wishes and treating them as management and control is what led me to begin this talk with some musings about the requirement to get real.

As we shall see, the Commissioners, in an endeavour to make resident in the United Kingdom certain entities the residence of which is in doubt, have been trying to develop a concept of effective or real management in relation to things which are not management at all.

Indeed, it was the endeavour of the Special Commissioners to develop that sort of point which led them into error in *Wood v Holden*.

The question in that case was about a company called Eulalia, which had directors in Amsterdam.

It was the subsidiary of another foreign company, CIL, which, in turn, was owned by a foreign trust, the beneficiaries of which were in the United Kingdom.

It was accepted that the other company, CIL, and the trust were non-resident but, even so, the Special Commissioners held that they were not satisfied that Eulalia was non-resident.

That was an odd conclusion, related to the burden of proof, which is on the taxpayer in a tax appeal: it was not a finding that Eulalia was resident in the United Kingdom, and it was, accordingly, a somewhat fence-sitting decision.

In reaching that conclusion, the Special Commissioners made a number of errors.

First, they failed to recognise that all sorts of people – shareholders perhaps, beneficiaries of trusts holding shares perhaps – can huff and puff about what they want done, but nothing can actually happen in the corporate sphere unless the people who actually run the company do something: in a typical case, unless the directors make a company do something, nothing can happen.

That seems to me to be a rather telling point: influence does not make – has no power to make – things happen.

Secondly, the Special Commissioners failed to recognise that, if the people who actually run the company – the directors – do make the company act, what they do must be an effective decision, must be an act of central management and control.

What happened, of course, in *Wood v Holden* was that the Special Commissioners saw a tax plan thought up in the United Kingdom and implemented because Mr Wood, who lived here, wanted it to be implemented.

So they seem to have adopted the slogan with which I began – get real – and said the real control of the relevant company was here in the United Kingdom.

But so called “real control” can only be central management and control if you can make the company actually do something, can only be central management and control if you can actually control the business of the company.

On the facts of *Wood v Holden*, there were many, many people in the United Kingdom exercising influence over what happened in Holland, but none of them could make anything happen there: the only people who could do that were the directors of Eulalia, and so they were the only people with any form of control over what Eulalia did.

There is a difference between just deciding on the one hand and deciding coupled with the ability to do, on the other.

I realised the difference most strongly on Black Whatever-day-of-the-week-it-was.

I had decided, just before, to sell all my shares, not that I had many, but the decision to sell them availed me nothing when the markets tumbled. I had not actually sold them.

In order to have central management and control of a company in a particular place, it is necessary for there to be, in that place, decisions taken by persons who can put them or cause them to be put into effect.

In *Wood v Holden*, there was no place in the United Kingdom where that was being done: the only place where that could happen was in the Netherlands; and the Courts so held.

The Special Commissioners did not realise that, because they confused influence with control and, happily for the taxpayers, made an important mistake in their reasoning here.

In particular, they said, in that case, that the only acts of management took place in Amsterdam; and they then implied that the acts of management taken there were not effective acts.

They then went on to imply that effective control was in the United Kingdom, but did not say that precisely.

They did not, in that case, themselves use the language of reality, but rather that of “effective control” and, as I say, they implied it was in the United Kingdom.

They did not ask themselves how influence could be effective control if there was no way of forcing it into effect and so, as is often the case, in a search for reality found only an illusion they believed in.

The mistake in their reasoning – the contradiction between the finding that all the acts of management were in Amsterdam and the holding that residence in Holland had not been established – enabled us to say that there was an error of law here and so to get the decision reversed.

The High Court and the Court of Appeal both decisively rejected the idea that actions taken by a board could be ignored because they were formal actions or because they were not fully informed actions.

The Court of Appeal in particular made it clear that, if the board of a company acted, its actions and nobody else’s were the acts of control, and the Company was resident where it acted and nowhere else: the only exception was usurpation. Sir Christopher Staughton in particular was scathing about the use of the word “real” to ignore or disguise the effect of what happened: the actuality remained the actuality even if something else was said to be real.

I should, however, repeat that questions of residence do, usually, in the end turn on findings of fact, and the scope for reversing a decision of the Commissioners is quite limited: that point, by the way, is true not only of cases of corporate residence, but also of individual residence.

The taxpayers were very lucky in *Wood v Holden*, because the reasoning of the Special Commissioners was distinctly odd: once they had found that the only acts of management were in Amsterdam, the only logical possible conclusion – the only conclusion that was correct in law – was that the company was resident there.

I might also add here that it is sometimes said by the Commissioners that the question in a tax appeal about residence is not where the company was resident, but whether it was resident in the United Kingdom.

That is, of course, in a certain sense true, because the tax question will usually be dependent on residence here, and, since dual residence is at least a theoretical possibility, the relevant issue is usually whether residence here has been established.

However, the older case law, which is, of course, decided in the House of Lords, clearly contemplates that a company can have a residence in a particular place which is not in the United Kingdom, and it must, inevitably, be helpful in a case where a claim of non-residence is being pursued, to point to a place outside the United Kingdom where the company is resident.

News Datacom is an interesting case.

The putative taxpayer was a Hong Kong incorporated company, which had held a board meeting in the United Kingdom, a thing which is not to be recommended if you are seeking to say that the company is not UK resident.

However, the Special Commissioners in that case (who were different from those in *Wood v Holden* and from those in the next case I shall consider) incisively recognised that not everything done by directors constitutes central management and control; and found that what had happened in the United Kingdom did not, in that particular case, make the company resident here, because it represented mere administration and not control.

That was an important point, not previously expressly recognised in our case law, and so the case represents a material advance in the thinking about corporate residence.

However, as I have indicated, it is not a good idea to hold any board meetings in the United Kingdom at all.

The most recent case about residence is *Smallwood*. The decision of the Commissioners was reversed by the High Court (which Philip Baker discusses elsewhere in this issue), but here I want to look simply at the way the facts were found by the Commissioners.

This was a case about the residence of a trust, not about a company and there are, I think, important differences, not least that the constitutional documents are different.

The question in the case was where the place of effective management of the trust was in a period when the trustee itself was in Mauritius and there was influence flowing from the United Kingdom: in that period, the trustee sold certain shares at an enormous

gain.

There was no doubt that people in the United Kingdom wanted the shares sold; and equally no doubt that people in the United Kingdom had decided that they should be sold.

There was also no doubt, however, that the only person with the right to sell the shares was the trustee in Mauritius.

The question which arose under the terms of the UK/Mauritius DTC (so that no question of purely domestic law arose) was whether the gain which arose on the disposal of the shares was exempt from capital gains tax in the United Kingdom.

The Commissioners found that the degree of influence emanating from the United Kingdom was such as to constitute effective management of the Trust here; and it is, perhaps, relevant to note that one of the Commissioners was Dr Brice who did not sit in the *News Datacom* case but who did sit in *Wood v Holden* case at first instance; and that, in this case, the Commissioners again attempt to get real, referring this time to “real control”.

I can well understand how the Special Commissioners felt that the influence flowing from the United Kingdom was effective.

I have more difficulty in seeing how the effective influence was management of the trust: before you can have effective management, you must have management, and I cannot see any actual management of the trust in the United Kingdom in the relevant period; calling what happened in the United Kingdom “real” management does not actually make what happened here management.

What happened in *Smallwood* involved the carrying out of a relatively unattractive tax avoidance scheme of the too good to be true kind, and the residence issue (because it relates to a trust and not a company) does not benefit from the fact (as the residence issue in *Wood v Holden* did) that the decision of the Court could impact on wholly commercial arrangements which had no tax avoidance aspects whatever.

I am not sure that the case should be of too much concern in the corporate context.

In particular, the Court of Appeal in *Wood v Holden*, has made it absolutely clear that, if a non-UK incorporated company has directors acting outside the United Kingdom, their actions cannot be ignored and influence emanating from the United Kingdom will not make the company resident here.

I am not sure that the Special Commissioners who decided *Smallwood* fully recognise that point.

Let me now turn to some practical points.

If you want to make a company non-resident, these are the rules to observe if you want to avoid the opportunity of contributing to the Law Reports at the highest level:

- (i) hold at least six board meetings a year; (I say this because anyone receiving this advice might hold three or four which is enough to make me feel comfortable, but if I said three or four, they might only hold one, which would not make me feel comfortable.)
- (ii) keep full minutes which show the directors exercising central management and control;
- (iii) hold the meetings in a fixed place or at least usually in a fixed place. This is a practical point, not a legal one: if there is a peripatetic board, meeting at different places outside the United Kingdom, the company will still be non-resident; but it is easier, if a challenge to residence arises, to be able to say “this company is resident in X” rather than “this company is not resident in any particular place and, in particular, is not resident in the UK”.

In law, it does not matter where a directors’ meeting is held, so long as it is not in the United Kingdom: it can be on a ship or a plane outside the United Kingdom, and the relevant company will still be non-resident.

Again, however, the practical issue of proving non-residence needs to be borne in mind.

Do not hold any board meetings in the United Kingdom.

Do not have a quorum of directors resident in the United Kingdom (to avoid accidental meetings) and, similarly, do not have a quorum present temporarily in the United Kingdom and deciding things.

- (iv) do not allow directors to participate in directors’ meetings by telephone or video conferencing facilities or by using e-mail from within the United Kingdom.

There is no law on this and the probability is that, so long as the majority of the board are outside the United Kingdom, this is all right.

But the chief thing you do by trying this is to give yourself the opportunity to be a leading case, which is an opportunity which should be avoided if possible.

Similarly, where directors' resolutions are passed in writing, don't sign them here;

- (v) there is, however, no harm in thinking about things in the bath here: thinking is not doing and doing is needed before there can be any management and control;
- (vi) if the board wants things done in the United Kingdom it needs to delegate the functions to be performed here to people here and then supervise what they do at their regular board meetings: the acts of delegation and supervision are then the acts of central management and control, and what is done here is of a lower order, in the administrative category.

Overall, the general message in this: if you want a foreign incorporated company to be non-resident, you need an active board which meets and takes decisions.

If that is inconvenient to highly important board members, they need to remember that tax mitigation requires some effort and that nothing which comes easy is worth having. Or at any rate that is my view of reality.