CASE NOTE

SMALLWOOD V. REVENUE & CUSTOMS COMMISSIONERS[1]

by Milton Grundy

This is a decision about a "round-the-world" scheme: a trustee resident in Mauritius – a jurisdiction having a tax treaty with the United Kingdom – replaced one resident in Jersey – a jurisdiction which does not; it then realised a capital gain and was itself replaced by a UK-resident trustee before the end of the tax year. It was claimed that the capital gain could not be taxed, because it was made by a resident of a treaty country and was accordingly exempt under the treaty. There could be no denying that this was a blatant tax avoidance scheme, and it is no surprise that the Special Commissioners (Brice/Avery Jones) found in favour of the Revenue. What is surprising, however, is the route by which they came to their conclusion.

The route is not altogether easy to follow. The argument is easier to understand if you know how it is going to end. The conclusion is that the Mauritius trust company was a resident of the United Kingdom and not a resident of Mauritius – within the treaty definition in both cases, and that therefore the capital gain in question was not made by an alienator which was a resident of Mauritius and accordingly did not enjoy the exemption provided by Article 13. The stepping-stone to this conclusion is the finding that the residence of the Mauritius trust company required to be determined by application of the tie-breaker clause. We need first to look at the reasons for that finding.

The Commissioners appear to have accepted that the company was a "resident of Mauritius". It would also be a "resident of the United Kingdom" if it were liable to UK tax because of its residence in the United Kingdom. The Commissioners say that, by virtue of residing in the United Kingdom during the last part of the year, the trustees were liable to tax in the tax year. This is rather an odd statement, because only one of the three consecutive trustees was actually resident in the United Kingdom. But perhaps by "the trustees", the Commissioners intend to refer to the "single and continuing body of persons" (as it was then described) treated as existing by s.69 of TCGA 1992, and they may have considered that, just as a real person who is resident in the United Kingdom for part of a tax year is resident for the whole, so a deemed person who is resident for part of the year is resident for the whole. It may be that the next step in the argument is to say that if the deemed trustee is resident, then the entities which were the actual trustees for the time being, and not resident in the United Kingdom, are to be treated, in that capacity – and in that capacity only – as resident, and liable to tax accordingly on any gain realised during their respective periods of trusteeship. It would follow that the Mauritius trust company, being treated as regards its capacity as trustee of this settlement as resident *in* the United Kingdom and liable to UK tax accordingly, falls to be regarded as a resident *of* the United Kingdom under the treaty.

To apply the tie-breaker clause, the Commissioners had to consider the concept of the "place of effective management" – the *POEM*, as they put it, and they concluded that "the real top management decisions, or the realistic, positive management decisions of the trust" had been taken in the United Kingdom. Whether or not this finding is supported by the evidence may be an issue on appeal (and it is understood that the case is going to appeal), but the phrase itself points to the conclusion that, if I may respectfully say so, the Commissioners were at this point asking themselves the wrong question. A trust does not make decisions, nor

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does it “alienate” assets. It may be treated as a body of persons for capital gains tax, but I need hardly say that it is in fact no such thing: it is a bundle of obligations owed by the trustee for the time being. The trustee – in this case, the Mauritius trust company – is the person which makes the decisions, and the trustee is the “alienator” within Article 13. The question the Commissioners should have addressed is, “What is the POEM of this trust company?” It seems to me that the POEM of a company carrying on business as trustee is ascertained in exactly the same way as the POEM of a company carrying on the business of constructing airfields. You do not ask how a particular job is managed; you look at the company’s business as a whole, and you look at where the directors reached their decisions. It so happened, in this case, that the decision to sell the trust investments was taken at board level, but, as anyone who has attended board meetings of a trust company will know from experience, such decisions are not necessarily – or even usually – taken at board level, and if they are, they have to take their place among matters of considerably more importance to the management company – the appointment of a new CEO, the review of KYC procedures, a consideration of current marketing strategy, the opening of a new branch, and so on. Whether the Commissioners heard any if so what evidence on this question does not appear from the decision, but it seems unlikely that if the Commissioners had thought that this was the right question, they would have given a similar answer.

This decision highlights a particular hazard of which trustees may not always be aware. If a resident of a country outside the United Kingdom accepts the sole trusteeship of any settlement (whether or not having any connection with the United Kingdom), and a protector or someone else has power to remove him and replace him with a UK-resident trustee before the end of the tax year, he may find himself with a liability to UK taxation for that year, and may not have retained – or have been able to retain – trust assets sufficient to meet that liability.