

SOME OBSERVATIONS ON THE RESIDENCE OF CORPORATE TRUSTEES

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Introduction

The legal test to determine the residence of trustees was harmonised by FA 2006 with effect from April 2007. However, the legislation was so poorly conceived and badly drafted that practitioners are still beset with uncertainty on the limits of the test. In this article, I shall deal with a few issues arising from the new statutory test and HMRC's Final Guidance.

The Legislation

The starting point for income tax is at para 474 ITA 2007. That provides:

“(1) For the purposes of the Income Tax Acts (except where the context otherwise requires), the trustees of a settlement are together treated as if they were a single person (distinct from the persons who are the trustees of the settlement from time to time).”

Section 475 ITA 2007 then provides:

“(1) This section applies for income tax purposes and explains how to work out, in relation to the trustees of a settlement—

- (a) whether or not the single person mentioned in section 474(1) is UK resident, and
 - (b) whether or not that person is ordinarily UK resident.
- (2) If at a time either condition A or condition B is met, then at that time the single person is both UK resident and ordinarily UK resident.
- (3) If at a time neither condition A nor condition B is met, then at that time the single person is both non-UK resident and not ordinarily UK resident.
- (4) Condition A is met at a time if, at that time, all the persons who are trustees of the settlement are UK resident.
- (5) Condition B is met at a time if at that time—
- (a) at least one person who is a trustee of the settlement is UK resident and at least one such person is non-UK resident, and
 - (b) a settlor in relation to the settlement meets condition C (see section 476).
- (6) **If at a time a person (“T”) who is a trustee of the settlement acts as trustee in the course of a business which T carries on in the United Kingdom through a branch, agency or permanent establishment there, then for the purposes of subsections (4) and (5) assume that T is UK resident at that time.** (my emphasis)

The CGT provision is in s69 TCGA 1992 and is not in identical terms but is materially similar:

“(1) For the purposes of this Act the trustees of a settlement shall, unless the context otherwise requires, together be treated as if they were a single person (distinct from the persons who are trustees of the settlement from time to time).

(2) The deemed person referred to in subsection (1) shall be treated for the purposes of this Act as resident and ordinarily resident in the United Kingdom at any time when a condition in subsection (2A) or (2B) is satisfied.

(2A) Condition 1 is that all the trustees are resident in the United Kingdom.

(2B) Condition 2 is that—

- (a) at least one trustee is resident in the United Kingdom,
- (b) at least one is not resident in the United Kingdom, and
- (c) a settlor in relation to the settlement was resident, ordinarily resident or domiciled in the United Kingdom at a time which is a relevant time in relation to him.

(2C) In subsection (2B)(c) “relevant time” in relation to a settlor—

- (a) means, where the settlement arose on the settlor's death (whether by will, intestacy or otherwise), the time immediately before his death, and
- (b) in any other case, means a time when the settlor made the settlement (or was treated for the purposes of this Act as making the settlement);

and, in the case of a transfer of property from Settlement 1 to Settlement 2 in relation to which section 68B applies, “relevant time” in relation to a settlor of the transferred property in respect of Settlement 2 includes any time which, immediately before the time of the disposal by the **trustees** of Settlement 1, was a relevant time in relation to that settlor in respect of Settlement 1.

(2D) A trustee who is not resident in the United Kingdom shall be treated for the purposes of subsections (2A) and (2B) as if he were resident in the United Kingdom at any time when he acts as trustee in the course of a business which he carries on in the United Kingdom through a branch, agency or permanent establishment there.

(2E) If the deemed person referred to in subsection (1) is not treated for the purposes of this Act as resident and ordinarily resident in the United Kingdom, then for the purposes of this Act it shall be treated as neither resident nor ordinarily resident in the United Kingdom.]” (my emphasis)

So, for a trust of which the settlor is UK domiciled, resident or ordinarily resident, it is necessary, if the “deemed person” is to be non-resident, to ensure that no person who is a trustee is UK resident. What does this mean in practice? For corporate trustees, it means that

the corporate trustee must not be UK resident on basic principles. In other words, assuming that it is foreign incorporated, the company's place of central management and control must be outside the UK. In effect, the place where the decisions of top level and strategic importance in relation to the business of the company are taken must be outside the UK. Nothing in the recent case of *Laerstate* changes that basic rule.

Once the corporate trustees have satisfied the first test of actual non-residence, they must next satisfy the test of deemed non-residence set out at s475(6) ITA 2007 and s69(2D) TCGA 1992. In other words, the corporate trustee must make sure that it does not:

- act as trustee,
- in the course of
 - i. a business which he/ it carries on
 - ii. in the United Kingdom,
- through a branch, agency or permanent establishment there.

In relation to (a), it is important to determine in the first place whether the person is acting in his capacity as trustee. If he is not, the deeming provision does not apply.

Re (b)(i), what is required is that the trustee must be carrying on a "business" of acting as trustee. What does this mean? It is well settled that "business" is a wider concept than "trade" (*American Leaf Blending* [1978] 3 All ER 1185). It is generally taken to mean an activity conscientiously pursued rather than a pastime (see *CEC v Lord Fisher* [1981] 2 All ER 147).

A question sometimes asked is whether a trustee of just one trust can be carrying on a "business"? We have the authority of *American Leaf Blending* which states that what may not be a business if carried on by an individual may well amount to a business when carried on by a company: in Lord Diplock's words at p1189:

"in the case of a company incorporated for the purpose of making profits for its shareholders any gainful use to which it puts any of its assets prima facie amounts to the carrying on of a business."

So, a corporate trustee which is trustee of only one trust but is properly remunerated for it is likely to be carrying on a business.

What the legislation also requires is that the trustee must be carrying on his business – note the use of the term "which he carries on". So an individual acting as trustee not in the course of his own business but in the course of his principal's business does not satisfy this requirement. This issue is likely only to be relevant in the context of individual trustees where the question may arise whether they are acting on their own behalfs or whether they are simply named representatives of their employer.

Re (b)(ii) above, what is required is that the business of the trustee must be carried on in the UK. In other words, the acts of being a trustee must be conducted in the UK.

Re (c) – this is the requirement that the business of trustee must be carried on in the UK “through a branch, agency or permanent establishment in the UK”.

The strict words of the legislation appear to stipulate that all three parts apply to both individual trustees and corporate trustees. However, this uncertainty has been removed by HMRC Guidance para 5 which states that the “branch” and “agency” parts apply to non-corporate trustees and the “permanent establishment” part applies to corporate trustees.

Turning to the meaning of “permanent establishment”, we find that there is no specific definition set out in this part of the legislation. As a result, the general definition of PE that applies for the purposes of the Income Tax Acts applies here. This definition is set out in s148(3) FA 2003. It provides that:

“(1) For the purposes of the Tax Acts a company has a permanent establishment in a territory if, and only if—

- (a) it has a fixed place of business there through which the business of the company is wholly or partly carried on, or**
- (b) an agent acting on behalf of the company has and habitually exercises there authority to do business on behalf of the company.**

This general definition is subject to the following provisions.

(2) For this purpose a “fixed place of business” includes (without prejudice to the generality of that expression)—

- (a) a place of management;**
- (b) a branch;**
- (c) an office;**
- (d) a factory;
- (e) a workshop;
- (f) an installation or structure for the exploration of natural resources;
- (g) a mine, an oil or gas well, a quarry or any other place of extraction of natural resources;
- (h) a building site or construction or installation project.

(3) A company is not regarded as having a permanent establishment in a territory by reason of the fact that it carries on business there through an agent of independent status acting in the ordinary course of his business.

(4) A company is not regarded as having a permanent establishment in a territory by reason of the fact that—

- (a) a fixed place of business is maintained there for the purpose of carrying on activities for the company, or**

- (b) an agent carries on activities there for and on behalf of the company,

if, in relation to the business of the company as a whole, the activities carried on are only of a preparatory or auxiliary character.

(5) For this purpose “activities of a preparatory or auxiliary character” include (without prejudice to the generality of that expression)—

- (a) the use of facilities for the purpose of storage, display or delivery of goods or merchandise belonging to the company;
- (b) the maintenance of a stock of goods or merchandise belonging to the company for the purpose of storage, display or delivery;
- (c) the maintenance of a stock of goods or merchandise belonging to the company for the purpose of processing by another person;
- (d) purchasing goods or merchandise, or collecting information, for the company.” (my emphasis)

It is clear therefore that there are two *separate* and alternative types of permanent establishment: first, the fixed place of business PE; and, second, the agency PE. It is important, as is well-known, to ensure that a non-resident corporate trustee has neither kind of PE. I shall deal with each in turn.

Fixed Place of business PE: This term includes:

- (a) a place of management;
- (b) a branch;
- (c) an office;
- (d) a factory;
- (e) a workshop. (s148(2) FA 2003).

The term, fixed place of business PE, is defined further in the OECD Commentary and in the HMRC Guidance. Put briefly, a fixed place of business PE exists where there is:

1. A physical location,
2. Which is fixed in time,
3. And is more than temporary,
4. Which is at the disposal of the enterprise (i.e. the corporate trustee),
5. Which is not used solely for preparatory or auxiliary activities,
6. through which the business of the enterprise (i.e. the corporate trustee) is wholly or partly carried on.

Focusing on point 1 (“a physical location”), para 4 of the OECD Commentary makes clear that a place of business may exist where no premises are available or required for carrying on the business of the enterprise and it simply has a certain amount of space at its disposal. This space may be within the premises of another enterprise, for example where the foreign enterprise has at its constant disposal certain premises or part thereof owned by another enterprise.

Further, it is irrelevant to the question of whether a particular location is the fixed place of business of a foreign enterprise whether the location is rented or loaned or simply available in some other way. Additionally, there need be no formal legal right to occupy the premises so that illegal occupation could also create a PE.

Point 2 above (“which is fixed in time”) recognises the importance of the word “fixed” in the term “fixed place of business”. Para 5 of the Commentary makes the following points:

- There must be a link between the place of business and a specific geographical point: if the place of business is itinerant then it cannot be regarded as “fixed”.
- However, where activities are moved between different physical locations, this may not avoid the “fixed” requirement if the location within which the place of business is moved forms a coherent commercial and geographical whole.

Point 3 above (“and is more than temporary”) also focuses on the term “fixed” and recognises that it carries with it the concept of some degree of permanence. – in other words something that is more than purely temporary.

Turning to point 4 (“at the disposal of the enterprise”), it is necessary that the physical location is available to the enterprise. The Commentary states that mere presence in a place does not mean that that place is at the enterprise’s disposal. What is required is that the enterprise is able to use it as of right – it does not need to ask permission every time for its use and is not limited by time constraints concerning how long it can use that premises.

Point 5 (“not preparatory or auxiliary activities”) recognises that the carrying on of preparatory or auxiliary activities does not render the place from which they are carried on a fixed place of business PE (echoing s148(4) FA 2003). What are preparatory or auxiliary activities will vary from one enterprise to the next. In relation to trustees activities they raise interesting issues –

- i. is meeting beneficiaries a preparatory or auxiliary activity?
- ii. Is reading minutes a preparatory or auxiliary activity?

HMRC Guidance indicates what HMRC consider to be “core” trustee activities. But the Guidance is not exhaustive. The “core” activities are set out in para 10 which states:

“A trustee is the person who has a legal duty to manage the assets of that trust in the best interests of the beneficiary or beneficiaries. The trustee manages, employs and disposes of the trust assets in accordance with both the terms of the trust and the duties and responsibilities which the law places upon trustees. The core activities of a trustee would therefore be regarded *as including*:

10.1 the general administration of the trusts

10.2 the over-arching investment strategy.

10.3 monitoring the performance of those investments.

10.4 decisions on how trust income will be dealt with and whether distributions should be made.”

Point 6 above focuses on the fact that it is the business of the enterprise that must be carried on in the place of business in the UK i.e. it is the corporate trustee’s business that must be carried on in the UK place of business and not the business of the UK place of business itself.

An Agency PE: Put briefly, an agency PE exists where there is a dependent agent. This term does not appear in the legislation but is used in contra-distinction to the term “agent of independent status”. A dependent agent exists where the agent:

- Has authority to do business on behalf of the corporate trustee; and
- Habitually exercises this authority.

It should be noted that s148 FA 2003 uses the term “authority to do business” which is narrower than the term used in the OECD Model Convention which refers to “authority to conclude contracts”. Consequently, care must be taken by the non-resident corporate trustee to ensure that no-one in the UK has authority to bind the corporate trustee or to carry on any core activity in the UK.

An employee of the corporate trustee is regarded as its agent (*Puddu v Doleman* [1995] STC (SCD) 236) and so if that employee has and habitually exercises his authority to carry out core activities in the UK, this will create an agency PE.

It must be noted that the dependent agent must have authority to do business which relates to the business proper of the corporate trustee i.e. it must relate to the core activities. If the authority relates merely to internal operations of the corporate trustee, that will not create an agency PE. Internal operations could include engaging employees of the corporate trustee or drawing up accounts of the corporate trustee rather than, say, accounts of the trusts in respect of which the corporate trustee acts as trustee.

However no agency PE will be created if the agent is an independent agent. Broadly speaking, an independent agent is someone who is:

- Independent of the corporate trustee; and
- Acts in the ordinary course of his business when acting on behalf of the corporate trustee.

Para 37 of the OECD Commentary explains that the putative independent agent will need to be both legally and economically independent of the enterprise i.e. the corporate trustee. As explained below, ownership of an entity by the corporate trustee does not of itself make that subsidiary an agent of the corporate trustee. (para 38.1).

Quite apart from being independent economically and legally, the putative independent agent must also act in the ordinary course of his business when he acts for the corporate

trustee. In other words, he must act in much the same way and on the same terms for the corporate trustee as he acts for his other clients.

Finally, HMRC Final Guidance para 3 deals with agency PE and places great emphasis on the existence of arm's length terms: where they exist there is no dependent agent.

Two Practical Issues

These principles are relatively easy to state but can prove somewhat difficult to apply in practice. For example, let us consider the one-off decision making in the UK. It may have been thought that a single decision taken in the UK was not capable of jeopardising the residence status of the trust. However, in the light of the HMRC Final Guidance, in particular Example 2b, one-off meetings with beneficiaries at which trust matters are discussed in such a way as to bind the corporate trustee or where decisions are taken should be avoided.

Example 2b suggests that even a single core activity (i.e. trustee decision) made in the UK may be relevant. However, in example 2b, the corporate trustee has a fixed place of business in the UK at which the meeting in the example takes place.

It is unclear whether, if there were no fixed place of business in the UK, HMRC would claim that there was a PE where a single trustee decision was taken in the UK. My concern is that although there may be no fixed place of business PE there be an agency PE because a director or other representative of the corporate trustee had exercised his authority to do business in the UK in such a way as to bind the corporate trustee

Another practical difficulty centres around the existence of UK resident directors of the corporate trustee. We know that an employee or director of an entity may be a dependent agent of that entity (*Puddu v Doleman* & HMRC Guidance para 4):

1. If he carries out in the UK the business of the entity;
2. And that business is not preparatory or auxiliary.

Therefore, in my view, UK resident directors of the Corporate trustee should make sure that they only carry out, at most, preparatory or auxiliary activities in the UK. These, in my view, include:

1. reading trust documents (whether on email or hard copy) before trustee meetings;
2. preparing documents containing matters for discussion at trustee meetings;
3. taking phone calls relating to the mechanics of setting up trustee meetings (but with no discussion of the substantive issues) e.g. dates and venues for meetings or travel arrangements.

Conclusion

There are myriad other practical issues arising directly from the deemed trustee residence provisions. It is understood that the representative professional bodies are actively seeking further clarification from HMRC on these issues. What would be infinitely

preferable to receiving further HMRC Guidance or Briefings is a well thought through re-write of the offending provisions so that their meaning, scope and effect are clearer.