MACFARLANES

CORPORATE RESIDENCE - “CENTRAL MANAGEMENT AND CONTROL”

INTRODUCTION

This note gives a very brief introductory overview of the UK tax law relating to corporate residence. It discusses the factors relevant to ensuring that a company incorporated outside the UK does not become UK resident. We have separately compiled a headline list of dos and don’ts for companies for whom this is an issue.

Both areas are complex and fact-specific and detailed advice should be sought in any particular situation. This note does not consider the liability to UK tax of a non-resident company with UK activities or investments or when UK activities might constitute a permanent establishment in the UK, which may also create a liability to UK tax. It also does not cover the “effective management” test found in the tie breaker clause of the OECD Model Tax Convention, which would be relevant in determining residence where a company is UK resident under the UK rules and also resident in another jurisdiction, with which the UK has a double tax treaty (which follows the OECD Model Tax Convention), under the rules of that jurisdiction.

PART ONE – LEGAL PRINCIPLES

Tests of residence

Under domestic UK rules, a company incorporated in the UK is resident in the UK.

For companies incorporated outside the UK, residence is essentially a question of fact.

- A non-UK company is resident in the UK for tax purposes if its “central management and control” is in the UK.
- This is the place where decisions about the strategic policy and direction of a company are taken: these decisions can generally be distinguished from decisions of a more day-to-day, operational nature.

The burden of establishing that an offshore company is UK resident, and within the charge to tax by virtue of its UK residence, lies with the UK revenue authority, HMRC. HMRC’s approach is set out in a Statement of Practice. Their objective is to ascertain (a) who exercises central management and control and (b) where, by:

- ascertaining whether the directors in fact exercise central management and control; then
- determining where the directors exercise this control (not necessarily where board meetings are held); or
- where directors do not exercise control, establishing where and by whom it is exercised.

Hence, where HMRC are seeking to show that a company is within the UK tax net, they usually argue either that:

- the directors exercise control in the UK – not through offshore board meetings; or
- someone other than the directors exercises control from within the UK.

Note that normally central management and control is not:

- the exercise of powers vested in the shareholders in general meeting (for example, the appointment of directors of the company);
- day to day management of a company’s business (since this is the implementation of the policy and decisions of those who ultimately control the company) – this generally has a more administrative flavour; or
- the actual carrying on of a company’s business.

PART TWO – ENSURING NON-UK RESIDENCE

To avoid being tax resident in the UK, a non-UK company must conduct its affairs in a manner such that it can show that its key strategic decisions are taken outside the UK. Whilst each case is tested on its individual facts, the following features should help preserve non-UK residence.

Board meetings: location

HMRC attach great importance to the place where the board holds its meetings.

Accordingly, no meetings of the board should take place in the UK.

Directors should never join a meeting by telephone or video conference from the UK.

It is helpful if a company is unambiguously resident in another jurisdiction (although as a technical matter it is only necessary to show that the central management does not reside in the UK).

It is best practice, therefore, to avoid a peripatetic board, since that makes it harder to demonstrate clear residence in any one location: most, if not all, of the company’s board meetings should be held in a single jurisdiction.

Board meetings: frequency
Board meetings should be sufficiently frequent to enable the directors to exercise control over the strategic affairs of the company.

Depending on the level of activity in the company, we would recommend a minimum of six board meetings in each year with each board meeting taking no more than two months after the last one.

Records and administrative matters
Full and accurate minutes of each board meeting should be taken.

- These should comprehensively note the time and place of the meeting and who was present.

- What was resolved and the reasons for such resolution should be recorded in as much detail as possible: where full discussion has taken place, it is important that such discussion is fully minuted, noting questions raised and any alterations to proposals made by the directors, to provide evidence of the board's independence. Debate on a decision is important evidence that the directors applied their minds to the relevant questions. Establishing a pattern of decision making is also important. The key point is that these minutes are likely to be more comprehensive than is perhaps the norm.

Copies of any notices, agendas and other documentation circulated to directors should be retained at the company's registered office.

Minutes should be prepared as soon as possible following a meeting and be reviewed and signed, preferably offshore and by an offshore resident director: a contemporary record of proceedings has more evidential force. Ultimately, in the case of any challenge from HMRC, this documentation forms a crucial part of the evidence as to where the central management and control of the company resides.

Decisions of the board should not be made by written resolutions as these can suggest "rubber stamping" or that the matters to which the resolution relates were decided in the UK.

Neither should any strategic decisions be made from a personal computer or mobile device while in the UK.

Documents relating to any key decisions should be executed outside the UK by a member or members of the board. There should be a suitable company infrastructure (an office and personnel) in the jurisdiction in which it is intended that the company be resident. The company secretary should be resident in that other jurisdiction and accounting records, corporate records and other significant original documents should be maintained outside the UK. All finance documents should be executed outside the UK. Funds paid to the company should be received in an overseas bank account and all invoices issued to or by the company should show the company's address outside the UK.

It is helpful to include provisions in the constitution of the company to give effect to these guidelines but, as noted above, residence is assessed as a question of fact. A provision in the articles stating that no board meeting can take place in the UK would not prevent the company being UK resident if in fact meetings did take place there, even if that were ultra vires.

Directors: residence
The board of directors must not be controlled by UK resident directors.

- We recommend that the directors should be individuals and that the majority of the board should be non-UK resident.

- Where a majority of directors is based in the UK, HMRC may argue that, notwithstanding that board meetings are properly held outside the UK, decisions could be taken by the UK directors in the UK, in advance of the meeting, and the non-UK directors overruled.

It is also important to ensure that UK resident directors cannot alone form a quorum or pass resolutions. Where appropriate, this can be achieved by splitting the directors into separate classes and requiring approval from each class, countering the argument above.

Directors: expertise
A board must consist of directors with sufficient knowledge, experience, and expertise to manage the strategic affairs of the company. It is important that this experience is not concentrated in the UK resident directors.

The overseas directors should be appropriately qualified and experienced in the relevant sector to enable them to consider (rather than merely follow) proposals and reach a reasonable conclusion. It is important to consider the calibre of the overseas directors: where the board consists of a minority of "strong" UK directors with a majority of non-resident (perhaps professional) directors with less experience and qualifications, HMRC may argue that the UK directors are able to influence the rest of the board, who merely acquiesce to the decisions taken by UK directors and "rubber stamp" the decisions made in the UK.

Delegation – the "éminence grise" effect

No key, strategic decisions should be made outside a formal meeting of the directors. Directors (whether or not they are UK resident) should not consider or act on any matters relating to the general policy of the company's business or management while they are in the UK.

Where discretionary powers have been delegated to any person (including a director), that power should only relate to day-to-day affairs and should not include the power to make key decisions. Powers should be confined within parameters set by the board and regular critical review should be undertaken.

Where a material contract is being considered, meetings relating to that contract should not be held in the UK. No one should be given authority to finalise the agreement at a meeting in the UK and the contract itself should be executed outside the UK.

Usurpation

Constitutional starting position: In most (but not all) cases, those who have the legal authority to exercise central management and control are those who in fact exercise it. The question of who has the legal authority to exercise central management and control is generally provided for in the constitutional documents establishing the company. Central management and control is normally vested as a matter of law in the company's board of directors and is exercised by means of resolutions passed at properly constituted and substantive (not merely formal) board meetings.

Primacy of the facts: However, the question of who actually exercises central management and control of a company is determined by reference to the facts and not just the legal entitlement.

It follows that if a UK resident director runs the affairs of the company from the UK to the exclusion of the company's board of directors (whether or not such usurping of the rights and duties of the board is in contravention of the company's constitution), then the company is resident in the UK for UK tax purposes. The company should not have UK resident directors if those directors are likely to the "guiding force" behind the company.

Parent/autonomy: Similarly, there is a risk that a parent company may exert significant influence over an overseas subsidiary. HMRC recognise that the exercise of powers available to a shareholder in general meetings (appointments to the board, changes to financial structure etc.) do not on their own affect the residence of the subsidiary. It is, however, important to avoid the parent being deemed to have usurped the functions of the subsidiary board, and thereby to exercise central management and control over the subsidiary's business.

HMRC look to the degree of autonomy of the subsidiary board in conducting the business of the company, including the extent to which the directors take decisions on their own authority as to investment, production, marketing and procurement, without reference to the parent. It is the management and control of the subsidiary's business, rather than the location of shareholder control, that determines residence.

3rd parties: Similar questions of influence can arise in relation to advisers, be they professionals retained by a shareholder or, in the case of investment funds, an investment manager straying into decisions properly the responsibility of the board of a general partner.

Similar considerations apply to the presence of observers or other non-directors at board meetings. Inviting a particular person to present to the board on a particular subject on an ad hoc basis does not present concerns. However, where an individual is a regular attendee of meetings covering a range of subjects, HMRC may argue that he is in fact taking part in central management and control and, if that person is based in the UK, this may point to decisions being taken in the UK.

Rubber-stamping: In all cases where proposals, suggestions or other advice is being submitted to the company's board by a person or entity who is resident or otherwise present in the UK, the directors should examine them critically and adhere to a proper decision making process. It is important that the board meeting at which such proposals etc. are considered cannot be seen as a sham or as merely "rubber stamping" decisions which have been taken in the UK. The independence and expertise of the overseas board, together manner of communication between the parties, is crucial here.

Key decisions

What are regarded as “key” decisions of the company depends on the nature of the company in question but might include, inter alia, decisions relating to:

- the acquisition or disposal of substantial assets (including shares in subsidiaries);
- significant items of capital expenditure;
- approval of budgets;
- major operational decisions;
- decisions relating to any key aspect of operational, financial or personnel policy (strategic policies subject to which the day-to-day management of the company is carried out);
- decisions on the engagement or dismissal of directors and other senior personnel;
- approval or execution of material contracts;
- significant borrowings;
- any major reorganisation of group companies;
- any extension or restriction of the company’s scope of activity or setting, reviewing and altering the investment criteria or strategy for an investment fund;
- the appointment of investment advisers to an investment fund; and
- determining accounting principles and nominating auditors.

CONTACT DETAILS
If you would like further information or specific advice please contact:

EDWARD REED
PARTNER
PRIVATE CLIENT
DD: +44 (0)20 7849 2568
edward.reed@macfarlanes.com

OLIVER COURT
PARTNER
PRIVATE CLIENT
DD: +44 (0)20 7849 2783
oliver.court@macfarlanes.com

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MACFARLANES LLP
20 CURSITOR STREET LONDON EC4A 1LT
T: +44 (0)20 7831 9222 F: +44 (0)20 7831 9607 DX 138 Chancery Lane www.macfarlanes.com