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Upper Tribunal Rules in Favour of Taxpayer in Tax Residence Case

Tax Talks on **June 19, 2019**

Development Securities plc and others v HMRC [2019] UKUT 169 (TCC)

The Original Judgment

As we reported in our August 2017 UK Tax Round-Up [https://www.proskauer.com/newsletter/uk-tax-round-up-august-2017], the UK's First Tier Tribunal ("FTT") found against the taxpayer in the *Development Securities* case, and ruled that certain Jersey-incorporated companies were, in fact, UK tax resident through central management and control.

By way of reminder, Development Securities plc ("DS") – a UK company – had incorporated a number of Jersey subsidiaries intended to be Jersey tax resident as part of its implementation of a scheme which was intended to increase available capital losses on UK real estate. The facts showed that all the board of directors had a Jersey-resident majority of directors (three were Jersey-resident and one was UK-resident), the board meetings all took place in Jersey and decisions were actually taken at those board meetings.

However, the FTT pointed to the uncommercial nature of the transactions from the perspective of the Jersey subsidiaries themselves (which could only be justified in the context of the tax benefit to the DS group as a whole) and that Jersey corporate law meant that the Jersey subsidiaries could only enter into the uncommercial transactions with the approval of their UK-resident parent company.

Consequently, the FTT had held that central management and control of the Jersey companies had been undertaken by the UK DS parent and, in taking on their director appointments, the Jersey directors were simply agreeing to implement what the UK DS parent company had already decided to do.

The Upper Tribunal Decision

The Upper Tribunal (“UT”) has overturned that decision in a judgment published this month. The UT ruled that central management and control was exercised in Jersey and not the UK.

The UT found that the relevant assets were indeed acquired at an overvalue, but the overpayment by the Jersey companies was not funded by them. So the FTT’s decision that the transactions were “uncommercial” for the Jersey companies was doubtful.

The UT analyzed Jersey company law in some depth, looking at how the directors were obliged to act in the best interests of the (Jersey) company. Jersey company law requires the company to consider the interests of shareholders, employees and creditors. In this case, given that the Jersey Companies had no employees and the transactions that the Jersey Companies were to enter into, pursuant to the scheme, did not prejudice creditors, the UT decided that the primary consideration can only have been the interest of the shareholder (DS). The UT reported that the directors gave detailed consideration to the appropriateness of the scheme – including the apparently uncommercial nature of the options and the acquisition by the Jersey companies of the relevant assets – and concluded that the transactions were in the best interests of the shareholder and therefore in the best interests of the Jersey companies.

It is very clear from the judgment that, just because the transactions were uncommercial, they were not automatically to be treated as contrary to the best interests of the Jersey companies

Although the UT agreed that the UK resident director had acted as a puppet or “rubber stamp”, the FTT had not made a similar finding regarding the Jersey directors. The evidence pointed strongly to the Jersey directors properly applying their minds to the transactions. The UT noted that one board meeting lasted five hours; and that the Jersey directors sough clarification on a number of points including the potential stamp duty liability arising; and also noticed and raised with advisers an inconsistency between the terms of the option and the drafting of the option notice.

HMRC tried to argue that the FTT had excluded from consideration material factor(s) going to the question of central management and control because they had occurred outside a board meeting. The UT rejected that argument and said that the FTT had, correctly, focused on the board meetings, but clearly also took account of matters occurring outside these meetings: for example, actions by the group more generally and events pre-dating the incorporation of the Jersey companies.

Analysis

This is a welcome decision in favour of the taxpayer. It demonstrates again the importance of running offshore companies properly. The evidence as to what happened in the Jersey board meetings proved critical here. The board minutes showed that the three Jersey-based directors had met in Jersey, and had spent some considerable time analyzing and discussing the terms of the deals over several board meetings. It was important to the UT's decision that the board minutes demonstrated that the directors had asked meaningful questions about the transaction and had called for explanations where necessary. Well-prepared contemporaneous minutes of such meetings are vital.

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