Ask an expert

Treaty non-resident companies

Q My client, who is the managing director and controlling shareholder of a group of UK incorporated property holding companies, is about to leave the UK to take up permanent residence abroad. It is likely that future board meetings will take place outside the UK. What are the UK tax consequences if the companies are considered to be tax resident in more than one country?

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A A company which is resident in the UK is normally subject to corporation tax on the whole of its chargeable profits on a worldwide basis, subject to relief for double taxation.

A company is generally resident in the UK for the purpose of the Taxes Acts if it is incorporated in the UK or, if it is not UK incorporated, the central management and control of its business is in the UK.

The incorporation rule

The incorporation rule was introduced by FA 1988 and became effective from 15 March 1988. Before that date, the only rule for the determination of UK residence was that of the location of central management and control. Companies incorporated in the UK on or after 15 March 1988, provided they are not treaty non-resident (see below), will be automatically tax resident in the UK.

The case law rule

The decision in the leading case of *De Beers Consolidated Mines Ltd v Howe* (1906) 5 TC 198 (at 213) has led to the general rule that a company is centrally managed and controlled at the place where its board of directors meets, unless it can be established (as is sometimes the case) that the board of directors is not in fact the body through which the company is being managed. Where ultimate control of the company's business does not vest in the directors but is being exercised by some other person (for example, a controlling shareholder or the board of the parent company), the question of where the board of directors meets is of little consequence in determining where management and control is located. Neither is the place of meeting of significance if the directors in fact take decisions elsewhere and meet simply to 'rubber stamp' them.

In *Swedish Railway Company v Thompson* (1925) 9 TC 342, it was held that a company whose administrative control was divided between the UK and Sweden was resident in both jurisdictions. It was therefore taxable on the basis that it was resident in the UK (irrespective of the fact that it was also resident elsewhere).

Under CTA 2009 s 18, where a company is resident under the domestic laws of both the UK and another country and there is a double tax agreement (DTA) in place, if any company residence tie-breaker in the treaty would award residence to the other country, the company is called 'treaty non-resident' (TNR), and is treated as not resident for all UK tax purposes.

Most tie-breakers refer to the state in which the company's 'place of effective management' lies. However some non-standard tie-breakers depend on agreement between the competent authorities of the two states.

The commentary in article 4, paragraph 3 of the OECD Model Tax Convention (July 2008) defines the place of effective management as: 'the place where key management and commercial decisions that are necessary for the conduct of the entity's business as a whole are in substance made. All relevant facts and circumstances must be examined to determine the place of effective management. An entity may have more than one place of management, but it can only have one place of effective management at any one time.'

The consequences of becoming treaty non-resident

Immediately before ceasing to be UK resident, the company will be deemed to have disposed of and immediately reacquired all of its chargeable assets at their open market value. There is an exception from this 'exit charge' for assets the company continues to use in a trade carried on in the UK through a permanent establishment.

A trading company that ceases to be UK resident may cease to be within the charge to corporation tax in respect of its trade. This will have an impact as regards the company's trading losses, balancing charges or allowances on plant and machinery unless left in a UK trading branch, and stock treated as disposed of at the date of migration.

FA 2013 Sch 49 introduces deferred payment arrangements in relation to exit charges where residence is transferred to an EEA territory.

Companies with UK source income in the form of a rental stream will be within the charge to UK income tax at the basic rate (currently 20%), rather than being liable to corporation tax as they were when UK resident.

A company that satisfies the residence rules of two countries at the same time, perhaps in the hope that a group may obtain relief for a loss twice by the surrender of group relief in both countries, is subject to certain restrictions on its ability to surrender group relief (CTA 2010 s 109) and may also be subject to capital allowances and rollover relief restrictions, under the rules applicable to dual resident investing companies.

Action to be taken

It may be necessary to determine the location of the companies' central management and control and their place of effective management, if different. Factors to take into account will include: the role of directors as stated in the company's memorandum and articles of association, the location of board and shareholder meetings, the residence status of directors, the expertise and experience of the directors to control the business, the influence of any shadow directors, the frequency of board meetings, documentary evidence of discussions and decisions made, and the location of management and control functions, including the control of bank accounts for major transactions. ■

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