Tax residency of Jersey companies

Insights - 23/05/2024

This briefing covers both (i) the general position under Jersey legislation and a consideration of the previous case law relating to management and control of Jersey companies and (ii) an evaluation of a UK tax case involving three Jersey companies which is relevant to local service providers.

Current regime

The principal Jersey tax statute is the Income Tax (Jersey) Law 1961 (**the Income Tax Law**) which determines the rate of Jersey income tax payable by Jersey companies.

A company will be Jersey tax resident for the purposes of the Income Tax Law if it is incorporated in Jersey or, if incorporated elsewhere, its business is managed and controlled in Jersey. The general rate of tax is 0% (subject to some local exceptions).

Notwithstanding the general rule that Jersey incorporated companies are treated as Jersey tax resident, the Income Tax Law states that a Jersey incorporated company will be entitled to be regarded as exclusively tax resident elsewhere if its business is managed and controlled in a jurisdiction other than Jersey, it is tax resident in that jurisdiction and the highest rate of corporate income tax in that jurisdiction is 10% or higher.

For Jersey and English purposes tax residency is broadly determined by reference to where an entity's central management and control abides, being the location where the high-level strategic decisions of the company are made. The principles of management and control in Jersey are the same as those in the UK so English case law is very relevant. However, as set out below, there are other considerations to bear in mind and factors which influence where management and control is deemed to be located.

General tax residency guidelines

Wood v Holden [2006] EWCA Civ 26

The English law case of Wood v Holden confirmed that all board meetings should be held and all decisions and resolutions should be made in Jersey to ensure that a Jersey entity's tax residency remains in Jersey as a matter of English tax law.

Laerstate BV v HMRC [2009] UKFTT 209

In the English case of Laerstate, the First Tier Tribunal (**FTT**) held that a company's residency cannot be established merely on the basis of the location of board meetings. The FTT found that a company should be resident in the place that it had been doing all its real business, including contract negotiations and obtaining its advice. In Laerstate the FTT found that this was within the UK, which made the company tax resident in the UK. The following guidelines were raised:

- When determining central management and control, the FTT will apply a general overview of how a company is run, and in particular look at the course of trading and business of a company (more relevant to trading companies than holding companies which have no operations overseas)
- All board meetings should be held and all documents signed outside the UK, and attendance by telephone from within the UK should also be avoided (travel documentation should be kept to evidence attendance at meetings and where documentation is signed)
- UK resident directors (or directors conducting business from within the UK) should not conduct themselves in such a way that may lead third parties to assume that they are authorised to negotiate on behalf of and bind the company (i.e. any duties carried out on behalf of the company, such as the negotiation of documents, should be delegated by the board at a meeting, and the execution of all documentation should remain subject to the board's approval)

Recent developments

Development Securities plc and others v HMRC [2020] EWCA Civ 1705

Background

Development Securities (No.9) Ltd (**DSL**) set up three Jersey subsidiaries to participate in a tax planning arrangement on the recommendation of a major accounting firm. The Jersey companies were to acquire certain assets at more than their market value via the use of call options which could be exercised once certain conditions were met. This structure was intended to increase the capital losses that were available to the DSL group whilst protecting against allegations that the transactions were preordained.

At face value the acquisitions did not make commercial sense for the Jersey subsidiaries. However, they did make commercial sense for DSL on the basis that any capital loss (when set off against any capital gain) could be deducted from the group's tax liabilities, reducing the amount DSL would have to pay in corporation tax.

To allow the Jersey subsidiaries – special purpose vehicles (**SPVs**) incorporated solely to participate in the scheme – to purchase the assets at an uneconomically high value, the parent made a capital contribution to the subsidiaries. For the scheme to be effective, the SPVs had to be Jersey tax resident at the time the acquisitions took place. Once the structure had been implemented the Jersey directors resigned and the SPVs became UK tax resident. In theory each such tax migration would avoid any stamp duty or corporation tax accruing and reduce the overall level of tax each company would have to pay as a result of the capital losses.

The FTT case

HMRC rejected the scheme, arguing that the Jersey subsidiaries had always been tax resident in the UK since their central management and control took place there, rather than in Jersey, despite their directors being Jersey-based. DSL appealed to the FTT, which took HMRC's side, agreeing that the Jersey subsidiaries were centrally managed and controlled in the UK, where their sole shareholder was based. It followed that, in the FTT's view, the companies were UK tax resident at the time they took the decision to acquire certain assets for a price well in excess of their fair market value.

Subsequent appeals

DSL appealed the FTT's decision and the Upper-Tier Tax Tribunal (the **UT**) accepted the appeal in 2019. The UT concluded that the Jersey directors had acted properly in taking into account the interests of its sole shareholder when deciding to enter into the disputed transactions. The SPVs had no employees and the transactions did not prejudice creditors. The UT added that given the keenness of the parent company to enter into the transactions, it would take a 'factor of some significance' – such as the scheme being illegal (which it was not) – to overturn the desire of a sole shareholder.

Following the ruling from the UT, HMRC appealed the case to the England and Wales Court of Appeal (the **CA**). In December 2020, the CA upheld the appeal on technical grounds, ruling that the UT had mischaracterised the reasons for the initial FTT decision. The primary reason for the FTT ruling in favour of HMRC had, in the CA's view, been that the Jersey director of the SPVs had followed the 'instructions' of their parent to enter into the transaction 'without any engagement with the substantive decision'.

It should be noted that Development Securities is a case with very specific facts, relating to a complex tax scheme rather than the day-to-day management of a business. Even in that context one of the CA judges, Lord Justice Nugee, had 'very significant reservations' regarding the FTT's decision, which he felt was without precedent in finding that a Jersey board of directors who 'had actually met, had understood what they were being asked to do, had understood why they were being asked to do it, had decided it was lawful, had reviewed for itself the transactional documents, [and] had been found not to have acted mindlessly' had nonetheless been found not be exercising central management and control from Jersey. As DSL had not appealed this element of the FTT's decision, the CA was not able to overturn the FTT's findings on this point. In contrast, we note that the decision in Wood v Holden, discussed above, was endorsed by each of the FTT, the UT and the CA and sets a clear test for what a Jersey company should do from an English tax law perspective to ensure that it remains tax resident in Jersey.

The Supreme Court declined to hear a further appeal from DSL in late 2021, and in doing so passed up the opportunity of providing clearer guidance on tax residency. It is yet to be seen whether a future case may offer more clarity.

Lessons to be learned

The Development Securities case again flags the importance of normal safeguards Jersey service providers and advisers are used to ensuring are in place, including a proper composition of a non-UK company's board of directors, protecting the genuine autonomy of that board, and ensuring that all decisions in relation to the business strategy and activities of the company are taken at meetings of the board outside the UK. However, albeit that it is an extreme case, it goes further in highlighting several other considerations:

- Regard must be had to the use of terminology in board meeting minutes and other correspondence (e.g. "recommendations" rather than "instructions"). Central management and control can be influenced or negated if there are dominant shareholders or shadow directors
- The absence of any corporate benefit will make it easier for HMRC to challenge the location of management and control. Consideration should be given to whether there is a commercial (as opposed to tax) rationale for entering into a transaction (and such rationale should be discussed and recorded in full in board meeting minutes). Such discussion and recording of rationale will provide a better audit trail for the future. Note that an article 74 corporate benefit 'whitewash' under the Companies (Jersey) Law 1991 where there is no benefit will not assist in the context of UK tax and residency
- If the benefits of a transaction are tax benefits, advice on the benefits and the risks should be obtained by the relevant company
- HMRC will consider all company records, emails and correspondence in forensic detail and although correspondence with lawyers may be privileged, other correspondence and advice, including tax advice, will be available for inspection by HMRC

- HMRC may begin to look more closely at company residence in other situations
- An unforeseen impact may arise where an exit is being considered by a shareholder via a sale of the company and the purchaser or the insurer providing warranty and indemnity insurance may well scrutinise records in more detail than may have been the case before. Due diligence in relation to Jersey companies which have participated in tax planning exercises may become more time consuming and costly as a result

What should you do?

- Check all precedent documents, policies and protocols to ensure they emphasise the need to avoid language relating to "instructions" or "directions" and that there are drafting/correspondence guidelines for staff
- Ensure all statutory and other correspondence is centrally held and easily accessible if HMRC request it
- Try and avoid having directors attend from the UK, or particularly if they represent a shareholder
- Ensure that board meeting papers properly consider and document the commercial rationale for transactions which is intended to deliver a particular outcome for English tax purposes
- Ensure that directors fully consider the matters before them at board meetings

The CA's decision also serves as a timely reminder that Jersey resident directors cannot provide a purely "administrative" service for the benefit of the parent owner but each director carries all the duties and responsibilities of a director generally and as such must ensure that they have sufficient knowledge and understanding of the business of the company.

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