VOISIN LAW

Welcome clarification on corporate residence of Jersey companies and Director duties | 1

The original Development Securities case in relation to tax residence caused a huge stir in the tax community in August 2017, when HMRC successful argued that a number of Jersey companies were tax resident in the UK.

By way of background, the Jersey-incorporated companies in this case had entered into call option arrangements with UK group companies to crystallise latent capital losses without losing the benefit of indexation allowance. To be successful, the arrangement required the Jersey-incorporated companies to be tax resident in Jersey for a specific period.

In the original case, HMRC contended that the companies were instead resident in the UK during this period and denied the claims to indexation allowance. The First-Tier Tribunal (**"FTT"**) rejected the taxpayer's appeal, finding that there was an abdication of central management and control on the part of the Jersey directors and that while the Jersey directors considered the proposals in detail, they were acting on the instructions of the UK parent company and were acting in a manner contrary to the commercial interests of the Jersey companies.

However, the Upper Tribunal decision (Development Securities PLC and Others v The Commissioners for HM Revenue and Customs: [2019] UKUT 0169 (TCC)) which has just been published completely reverses the outcome coming to the conclusion that the FTT findings were incorrect as a matter of law and that the Jersey companies remained resident in Jersey for tax purposes. In reaching its conclusions the Upper Tribunal provides helpful clarification on the role of SPV's, director duties, shareholder sanctions and the decision making process by the directors in Jersey, as examined below.

Role of Special Purpose Vehicles (SPV's)

In relation to SPV's it was reaffirmed that the mere fact that a 100% owned subsidiary carries out the purpose for which it was set up, in accordance with the intentions and desires of its parent does not mean that central management and control vests in the parent, with it being important to distinguish between influence over the subsidiary and control over the subsidiary. Where a parent company merely *"influences"* the subsidiary, central management and control remains with the board of the subsidiary. It is only where the parent company "controls" the subsidiary, i.e. by taking the decisions which should properly be taken by the subsidiary's board of directors, that central management and control vests in the parent.

Director Duties

In providing its conclusions, the Upper Tribunal also provided a helpful analysis of Article 74 (1) of the Companies (Jersey) Law 1991 (the **"Companies Law"**) which relates to the duties of directors and provides that a director, in exercising the director's powers and discharging the director's duties, shall act honestly and in good faith with a view to the best interests of the company and exercise the care, diligence and skill that a reasonably prudent person would exercising in comparable circumstances.

Article 74 (2) of the Companies Law establishes a statutory procedure for the ratification of any breach of a director's statutory duty under Article 74 (1) of the Companies Law.

The Upper Tribunal held that Article 74 of the Companies Law was similar, but not identical, to the equivalent English law provisions and that the duty to act in the best interest of the company requires consideration of the interests of the shareholders, employees and creditors.

In the case under consideration, as the Jersey companies had no employees and the transaction did not prejudice any creditors, the primary consideration can only be the interest of the shareholders, the Upper Tribunal holding that beyond the interests of the shareholders, employee and creditors it is extremely difficult to identify what other interests a board of directors might take into account.

On the basis of the aforementioned analysis, the primary regard of the Jersey directors in exercising their duties should be to consider what was in the best interests of the shareholder, with the Upper Tribunal concluding that as the transaction was in the best interests of the shareholder, it was therefore in the best interests of the Jersey companies (there being no prejudice to either employees or creditors) and that therefore in contrast to the decision of the FTT the directors in exercising their duties were indeed acting in the commercial interests of the Jersey companies.

Shareholder Sanction

The Upper Tribunal also held that as the transaction was in the best interests of the shareholder and therefore in the best interests of the Jersey companies, shareholder sanction pursuant to Article 74 (2) of the Companies Law was not required (as there was no breach) although in this case, the Upper Tribunal noted that such a shareholder resolution had been passed as a belts and braces measure.

Of crucial importance, the Upper Tribunal also went on to hold that such a shareholder authorisation or ratification of a course of conduct by the shareholders of the Company should not be confused as being an instruction from a parent company and that the FTT entirely misunderstood the nature of the Article 74(2) authorisation or ratification. In the Upper Tribunal's view, a shareholder authorisation or ratification was the very reverse of an instruction from an entity different from the company telling it what to do, as it was an authorisation or ratification from the appropriate organ within the company.

Therefore, the Upper Tribunal concluded that such a shareholder sanction cannot be taken as evidence that Jersey directors were acting on the instructions of the UK parent company.

Decision Making of the Directors

With regards to the decision making of the directors, the Upper Tribunal held that the Jersey directors had not abdicated their responsibilities such that central management and control was not vested in the Jersey directors and that the Jersey board: (i) knew exactly what they were being asked to decide; (ii) did so understanding their duties; and (iii) complied with those duties.

The Upper Tribunal further held that they did give sufficient consideration of the merits of the transaction, with examples of this including: (i) the length of the board minutes held; and (ii) the board minutes clearly demonstrating that the Jersey directors applied their minds to the relevant issues (for example, by querying various issues including the stamp duty position and commenting upon the terms of the documentation tabled at the meeting).

It was further held that the directors of the Jersey companies were entitled to rely upon the tax paper that had been presented to the directors prior to the first meeting and there was no need for the Jersey directors to take an independent view of the strengths and weakness of such advice.

The Upper Tribunal concluded that the FTT decision that the Jersey companies were resident in the UK was incorrect as a matter of law and that the directors of the Jersey companies properly considered the decisions they made on behalf of the Jersey companies and that central management and control remained vested in Jersey.

This decision provides welcome clarification on, amongst other things, director duties, shareholder sanctions under the Companies Law and the extent to which a parent company can influence a company without taking control from its directors. This decision represents a robust decision in favour of the taxpayer and it will be interesting to see if there is a further appeal.