



News Alert

Development Securities

Court of Appeal reverses Upper Tier Tribunal decision overturning First Tier Tribunal on Development Securities case and holds that Jersey SPVs were UK tax resident.

This is an important case in the determination of the tax residence status of Jersey SPVs, and the application of the tax residence central management and control test to a transaction recommended by a UK parent, which was considered uncommercial for the Jersey companies in question.

Summary

HMRC have been successful in their appeal to the Court of Appeal ("CA") in the case *Development Securities v HMRC* [2020] EWCA Civ 1705 concerning the tax residence of Jersey SPVs. The proposed planning in question involved various steps, which the First Tier Tribunal ("FTT") accepted worked as intended, leaving the only disputed issue as the residency of certain companies, a majority of whose directors were Jersey resident, and whose Board met in Jersey.

In 2017, the FTT had found that the Jersey companies were UK tax resident, which meant that the planning failed. The view of the FTT was that although the Board did not act improperly, the Jersey directors had implemented a plan, which was uncommercial for the Jersey companies, at the request of and financed by the UK parent, with the consequence that the Jersey directors had abdicated central management and control.

On appeal in 2019 however, the Upper Tribunal ("UT") found that the FTT's decision was incorrect in law and that the companies were Jersey resident. Per the UT, the FTT's essential error was an incorrect application of the central management and control test to the facts, which were not in dispute. The FTT had erroneously focused on the uncommerciality of the transactions without having regard to the actual duties the directors owed to those companies - their duties were to the shareholders, and they had satisfied them. It was irrelevant that the role of the Jersey companies was to participate in a tax-motivated set of transactions.

The CA has now found, in a decision handed down on 15 December 2020, that the UT was wrong to say that the FTT had fundamentally misunderstood whether the transactions were uncommercial. This error led them to mischaracterise the basis for the FTT's conclusion as being that the directors of the Jersey companies had "failed to decline to do something that was improper or inadvisable". This, said the CA, was not the basis of the FTT's conclusion. The basis of the FTT's conclusion was that the directors had regarded themselves as in effect instructed to carry out the transactions, and, subject to checking their lawfulness, proceeded to do so without engaging with the substantive decision. The FTT went out of their way to say that they were not suggesting that the directors acted improperly. One judge in the CA expressed very considerable reservations about the FTT's reasoning, on other grounds.

Facts of the case

The UK companies owned assets standing at a capital loss. A plan was devised to crystallise the value of the indexation allowance, increasing the quantum of the capital losses. Essentially the plan was designed to work (and was in fact implemented) as follows:

- Jersey companies were incorporated with a majority of Jersey resident directors;
- UK companies agreed to grant call options to the Jersey companies, under which the Jersey companies could acquire the assets for a price equal to the indexed base cost of the assets (which was significantly in excess of market value);
- UK Parent agreed to provide funds (including a capital contribution) to the Jersey companies to enable them to acquire the assets;
- At a subsequent board meeting, a decision was taken to exercise the options and the assets were acquired by the Jersey companies, with the UK gains being nil; and
- Shortly afterwards, the Jersey resident directors of the Jersey companies resigned, and UK resident directors were appointed, bringing the companies on-shore.

Under the above steps, when the Jersey companies were brought onshore and disposed of the assets, the Jersey companies crystallised capital losses which included indexation.

HMRC's challenge concerned whether the Jersey companies were resident in Jersey when the assets were acquired. The tribunals therefore considered the location and activities of the directors in detail.

One of the directors was a UK resident individual, Mr Stephen Lanes, who was company secretary of the Development Securities group, and travelled to Jersey to attend Board meetings. However, it was found that he did not exercise undue influence over the Board. The other directors were Jersey resident individuals, who were professional directors provided by Volaw, a firm of trust and company service providers associated with a well-known Jersey law firm.

FTT's decision

Particular consideration was given to the case *Wood v Holden* and the principle that the mere fact that a 100% subsidiary carries out the purpose for which it was set up, in accordance with the intentions, desires and even instructions of its parent does not mean that central management and control vests in the parent. Instead, in the case of SPVs, distinction needs to be made between 'influence over' the subsidiary and 'control of' the subsidiary.

The FTT's view was that, unlike *Wood v Holden*, this was not a case where the board considered a proposal and, having taken appropriate advice, decided that it was in the best interests of the companies to enter into it. Instead, the board of the Jersey companies were presented with a sole transaction, which had no commercial merit from the companies' own perspective and thereby required instruction or approval from the parent for it to be lawful. There was no reason for the directors to enter into the transaction other than that the parent company wanted them to do so and told them to do so. Although it was considered that the board did not act improperly, and that the Jersey directors were serious in their concern with the legality of the transactions, the FTT considered that the line was crossed from the parent influencing and giving strategic or policy direction to the parent giving an instruction.

The conclusion of the FTT was that by implementing a plan which was uncommercial for the company concerned, at the request of and financed by the UK parent, the Jersey companies were resident in the UK.

UT's decision

The UT disagreed with the FTT's conclusions that by entering into 'uncommercial transactions', (i) the Jersey directors had done something which was contrary to the interests of the Jersey companies and (ii) in declining 'to do something that was improper or inadvisable' they had abdicated responsibility for central management and control of the companies.

The UT found that although the FTT had correctly identified the relevant acts of central management and control as being the decisions of the Jersey boards, their conclusions rested on a fundamental misunderstanding of (i) the nature of the transactions entered into by the Jersey Companies and (ii) of the duties of the Jersey directors in relation to those transactions.

Regarding (i), although the assets were acquired at 'overvalue', this overvalue was funded by a UK parent, and it does not appear that the directors had concerns about the legality of the transactions.

Regarding (ii), given that the Jersey companies had no employees nor creditors, their primary consideration can only have been the interest of the shareholders. The scheme was properly considered in this context, and was in the interest of the shareholders. The fact that the scheme was tax driven was not relevant.

Consequently, the UTT concluded that the Jersey directors had acted in line with their duties, that the FTT were incorrect as a matter of law, by an incorrect application of the central management and control test, and that the Jersey companies were resident in Jersey at the time the assets were acquired. The fact that the companies became UK resident later was common ground.

CA's decision

All three judges expressed similar criticisms of the UT decision to those set out at the start of this note, and felt bound to decide that the UT's decision therefore cannot stand.

However, one judge expressed very considerable reservations about the FTT reasoning. He noted that the FTT's decision was the first time in any case where the local board of directors of a company 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, had been found not to have acted mindlessly, but had nevertheless been found not to have exercised central management and control. The judge noted that this was a significant departure from the previous case law.

It remains to be seen whether the case will or can be further appealed to the Supreme Court.

PwC contacts

If you would like further advice or information in relation to the issues outlined above, please get in touch with your local PwC contact or any of the individuals listed below:

Justin Woodhouse

Tax partner

M: +44 7700 838233

justin.woodhouse@pwc.com

Debbie Payne

Tax director

M: +44 7700 838284

deborah.payne@pwc.com

David Waldron

Tax director

M: +44 7781 138617


david.x.waldron@pwc.com

Tom Cowsill

Tax director

T: +44 7797 710529

tom.cowsill@pwc.com



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