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## MANAGEMENT AND CONTROL



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## CORPORATE TAX RESIDENCE

Corporate tax residence is the concept by which the taxing rights over a company's profits and gains are determined. Different countries have different ways of defining corporate tax residence, which creates further complexity for companies operating in more than one country.

Corporate tax residence is of importance as a company needs to ensure that it is only subject to tax in the jurisdiction it intends to be taxed in. If for any reason the company does not secure this right, it can end up having multiple tax liabilities in a number of countries.

Definitions of corporate residence for tax purposes vary considerably from country to country. Some countries determine the residence of a company based on its place of incorporation. Other countries determine the residence of a company by reference to its place of management and control. Some countries use both a place-of-incorporation test and a place-of-management and control test.

## PLACE OF CENTRAL MANAGEMENT AND CONTROL

The place of central management and control as a test of residence is becoming established as the first rule that companies need to satisfy in order to avoid any tax adverse consequences. This is true in many countries now.

The mere fact that the company has been incorporated in a particular jurisdiction does not automatically make the company tax resident in that particular jurisdiction.

In most of the countries around the world there is no statutory definition of the meaning of "central management and control" but nevertheless court judgements on the meaning of central management and control can be treated and can be used as guidance on how the courts in a particular jurisdiction will interpret its meaning.

How court judgments are to be applied in a particular case involves a question of fact. This cannot be too heavily emphasised.

## COMMON LAW COUNTRIES

According to most common law countries, a company is resident in the country where the central management and control of the company is carried out. The mere fact that the company has been incorporated in a particular country does not automatically make the company to be tax resident in that Country.

UK court decisions can be easily applied to similar situations involving other countries that are also based on common law.

## THE POWER OF THE DIRECTORS

In seeking an answer to the question of where the exercise of management and control lies, the first natural step is to ask who, in law, has the right and duty to exercise it. A company being an abstraction cannot itself perform any real acts. The abstraction can act only through the agency of other people. In practice the constitution of the company, its Articles that is, will provide that the power of management lies with the board of directors; the power of management is delegated to the directors as a board.

Of course the shareholders in the General Meeting have rights and duties. They can appoint and dismiss the directors, they can approve the accounts and approve the distribution of a dividend, they have a voice in such matters as issuing new capital, reduction of capital and in changes of the objects clause of the Memorandum or changes in the Articles. These things do not constitute the management and control of the business. They are rather keeping a critical eye on the interests of the shareholders.

## AGENTS

The board is thus emerging as something more than an agent and it is becoming in its own manner, the company. Of course the board of directors can still appoint agents and as long as they are mere agents they do not, by the bare fact of being there and fulfilling their agencies, detract from the management and control of the board. However if the board assigns all its powers to a person, i.e. by issuing a general power of attorney, or in reality that person exercises all of the powers of the board in such a way that that person purports to confer exclusive powers without expressly reserving a right of supervision, then that person is the Board and the management and control of the company is carried out by that person. It follows then that a company's residence status should be where that person resides. That is the place where he takes all decisions concerning the administration of the company.

## UK COURT DECISIONS

Although management and control of a company will generally reside at the place where the directors meet and where the main functions of a company are carried out, there are cases in which these factors do not determine the place of central management and control.

For example, the House of Lords held in the case of *Bullock v The Unit Construction Co Ltd* (1960) 38 TC 712 that, because it was quite clear from the stated case that the boards of directors of the UK company's African subsidiaries were standing aside in all matters of real importance. real control and management of those

subsidiaries was being exercised by the board of directors of the parent company in London.

In another famous court case *De Beers Consolidated Mines Ltd Vs Howe*, Lord Loreburn stated:.....the principle that a company resides for the purposes of income tax is where its real business is carried on....I regard that as the true rule, and the real business is carried on where the central control and management actually abide.

Another decision of the Special Commissioners' of the UK Inland Revenue has, however, highlighted how important it can be for the directors of a company to make informed decisions, rather than merely "rubber-stamping" resolutions, if they are to demonstrate that they are exercising effective management and control of their company. In their decision in *Mr. R and another v Holden* (Inspector of Taxes) SpC 422, the Special Commissioners stated:

"We do not consider that the mere physical acts of signing resolutions or documents suffice for actual management. Nor does the mental process which precedes the physical act. What is needed is an effective decision as to whether or not the resolution should be passed and the documents signed or executed and such decisions require some minimum level of information. The decisions must at least to some extent be informed decisions. Merely going through the motions of passing or making resolutions and signing documents does not suffice. Where the geographical location of the physical acts of signing and executing documents is different from the place where the actual effective decision that the documents be signed and executed is taken, we consider that the latter place is where 'the central management and control actually abides'."

This case emphasises how important it can be for the directors of a company that is being managed and controlled in a jurisdiction, to be fully involved in any proposed transaction from the earliest stages and for them to have full knowledge and a thorough understanding of the transaction, including the anticipated benefits and liabilities. It certainly is not good practice for the directors to be presented at a late stage with a fully worked-out set of proposals and documentation that they are asked to sign off on without any prior involvement in negotiations on the transaction; indeed, that is likely to put the company's tax residence in jeopardy.

In our experience, the position can be improved by appointing directors who have knowledge and experience in the area of business in which the company is engaged and who are thus better qualified to take decisions on matters affecting the company.

**Laerstate BV v Revenue & Customs [2009] UKFTT 209 (TC)**

In brief, the Laerstate case concerns corporate tax residence, in particular, the meaning of acts of central management and control and the circumstances in which it should be concluded that a company's directors are not exercising that central management and control themselves.

The tribunal concluded that Laerstate, a Netherlands incorporated company, was UK tax resident for the period in dispute, because the company's shareholder, who was himself residing in the UK during the period in question, exercised central management and control. The case is now finally decided in favour of HMRC following the recent decision by the taxpayer not to appeal against the First Tier Tribunal's decision.

Laerstate had two directors, Mr B (who was also the sole shareholder) and Mr T. Neither Mr B nor Mr T were themselves UK residents. Directors' meetings were held on a reasonably frequent basis and were always held outside the UK. Both Mr B and Mr T were persons of substance who would be capable of conducting the company's strategic business in an informed manner.

However, on examining the substantive facts as to how the company was managed, the Tribunal held that the company was, in reality, being managed solely by Mr B outside the formal directors' meetings and that Mr B was managing the company to a substantial extent whilst in the UK, notwithstanding that he was not himself UK resident. As a result, the Tribunal found that the company was UK tax resident during the relevant period and, therefore, that the

profits which the company realised from its share transactions during this period were subject to UK corporation tax.

**ESTABLISHING EFFECTIVE MANAGEMENT AND CONTROL OF A COMPANY IN A PARTICULAR JURISDICTION**

We believe that to establish effective management and control of a company in a particular jurisdiction we need to include sufficient elements from the guideline below. This list is not exhaustive and it is not implied that all the below should be followed in all cases. Rather, the below list is a broad guideline to be used, depending on the jurisdictions involved, the activities of the company and a number of other factors:

- All or the majority of the board of directors should be residents in the jurisdiction the company intends to be taxed in. If only the majority of directors reside there the majority should be enough to form a quorum for the conducting of board meetings under the articles of association. The minority directors who are not resident(s) should consider traveling to country of company residence for occasional board meetings.
- Board meetings should actually be held in the country of residence and must be properly documented.
- The general policy of the company should be formulated in the country of residence. The place of effective management is generally understood to be the place where the Head Office is: the Head Office in the sense of - not the registered office - but the central directing source.

That is major/important decisions such as the provision of loan facilities, the purchase of a significant interest in other companies etc should be taken by the board in the country of residence.

- The appointed directors of the company should be fit to hold office or be employed in the administration of the Company's affairs. When appointing a board of directors, the individual members should be persons of high caliber, such as successful business men, Chartered and Certified accountants, lawyers, or persons with a relevant background in relation to the company's proposed activities. The directors should have the knowledge and expertise to really understand and know the business activities of the company and should actually be part of the strategic decision making process of the company. They should not just rubber stamp any decisions taken by the shareholders or their advisors. They should formulate and implement the strategy of the company.
- With regards to decision making at Directors level, a minimum level of information should always be provided, that would enable the directors of a company to consider whether or not they should make a decision. It is also prudent to ensure that board minutes properly document the information the directors have used to consider and then make decisions.
- Related to the point above, care should be taken to ensure that the board meetings are properly documented, i.e. detailed notes taken outlining the matters for consideration of the board, and should include the information provided in the board pack to enable them to make their decisions.
- Company bank accounts should be controlled and operated by the resident directors. Money movements in the accounts should be properly documented, so that they are seen to be effected under the Control of the directors.
- Day to day management must actually be carried out in the country of residence.
- Any issuance of POAs to third parties should be limited and when this is done the scope of the services assigned should be limited and specific. Of course the board of directors can still appoint agents and as long as they are mere agents they do not, by the bare fact of being there and fulfilling their agencies, detract from the management and control of the board. However if the board assign all its powers to a person, i.e. by issuing a general power of attorney, or in reality that person exercises all of the powers of the board in such a way that the person purports to confer exclusive powers without expressly reserving a right of supervision, then that person is the Board and the management and control of the company is carried out by that person. It follows then that a company's residence status should be where that person resides. That is the place where he takes all decisions concerning the administration of the company.

It may also be advisable to show a presence in the country of residence, thereby making the case for management and control stronger. The company should not be just a paper company. This can be done by:

- The company renting an office.
- Applying for telephone and fax lines to be installed.
- Employ people and pay monthly salaries and social contributions
- The Company should get a Social Security number and pay the relevant social insurance contributions for all its employees on a monthly basis.
- The company should be registered with local telephone directories.
- All local documents, application forms, rental agreements etc. should be signed by the resident directors.
- Last but not least, the company should have a valid commercial reason for its existence. Even though this can sometimes be a tax oriented reason, there should also be commercial benefits for setting up a company in a particular jurisdiction and the decision to establish a company in a particular jurisdiction should not be taken solely based on tax considerations.

## Conclusion

A company can very easily inadvertently become tax resident and subject to tax in a different jurisdiction from the one it intends to be taxed in and thus incorporated. By following the few simple steps outlined above, this adverse consequence can be avoided. Our experience shows us that many companies seek tax advice on corporate tax residence matters prior to establishing an offshore business, however, few seek further advice on implementation and maintenance of these structures. It is often during the implementation phase and thereafter that mistakes are made with regard to residence.

At Centaur Trust our focus is on the effective implementation of international tax structures related to the use of Cyprus or other Companies as standalone vehicles or as part of an international tax structure. We work closely with all major legal, tax and accounting firms worldwide and based on our Total Quality Management philosophy we translate high quality advice into high quality solutions.

**Thank you**



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