BRICOM AGAIN

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In Volume 6, Issue 3, Robert Venables QC questioned on several counts the correctness of the decision of the Special Commissioners in *Bricom Holdings Ltd v IRC* and made the point that as the legislation started by establishing what the chargeable profits of the overseas subsidiary would be on the assumption that it was UK resident these should be nil. This is because even if it was deemed UK resident the overseas subsidiary would still have its effective management abroad so that the dual residence article and other provisions of the UK tax treaty with the overseas jurisdiction should exclude its profits from the hypothetical computation. In response, John F Avery Jones, one of the two Special Commissioners in the case, pointed out that he had put forward the same argument ten years ago in *British Tax Review* but he now rejects it for the reason that, in ascertaining the chargeable profits of the overseas subsidiary (on the assumption that it was UK resident), it would not attract treaty protection as:

> "A CFC is assumed to be resident, it is not liable to tax in the UK by reason of domicile, residence, place of management or any other criteria of a similar nature (Article 4(1) of the treaty). It is liable to tax by virtue of control by UK residents, which is not of a similar nature to the one specified. Accordingly one never reaches the dual residence provision."

This seems over subtle because if the overseas subsidiary is "assumed to be resident" to establish what its chargeable profits would be then surely this is simply assuming it to be "liable to tax in the UK by reason of residence". If subtle arguments are needed then, as Robert Venables QC noted in his article, one can invoke the observations in *Marshall v Kerr* that when you make a statutory assumption you have also to assume "the consequences and incidents inevitably flowing from or accompanying that deemed state of affairs". The assumption of

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residence must mean that, as a foreign incorporated company, the central management and control of the subsidiary is assumed by the CFC legislation to be in the UK (i.e. *Mitchell v Noble* residence as mentioned further below) despite the place of effective management remaining abroad. The residence assumption does not require that the foreign subsidiary is regarded as UK incorporated so that its place of effective management must then also be assumed located in the UK for it to be UK resident in the light of section 249 Finance Act 1994.

With treaty protection in a dual residence context the relevant question, in relation to being liable to tax by reason of domicile, residence or place of management, is to ask which other liability pre-requisites would all be classed as being "*criteria of a similar nature*". What is the "genus"? - which by the use of the foregoing words seems intended to be very wide and encompass a range of possibilities.

The correspondence in Volume 7, Issue 1, rejecting notional treaty protection for the overseas subsidiary emphasises that it is *control* by UK residents which makes the overseas subsidiary "liable to tax": by attracting notional UK residence and therefore deemed liability to UK tax for computing its chargeable profits on this assumption. This UK control basis of liability is said not to be of a similar nature to the specified "one" in the treaty (or, more precisely, to any of the three specified tests in the treaty). However, deeming an overseas subsidiary to be UK resident and therefore liable to tax on account of being under the control of UK residents does not seem that dissimilar to the concept of personal domicile of dependency, and if the UK tax system were brought closer to the US model by making all UK domiciled individuals who lived abroad taxable on world-wide income rather than just UK source income (whether by expressly deeming them to be resident or not), then surely any individuals brought into charge by their domicile of dependency would be able to invoke the benefit of UK tax treaties as regards their foreign income or, more to the point, the tie-breaker residence article to take them out of charge to UK tax if they live in a treaty country.

Equally, if section 66(1) Finance Act 1988 was extended to treat as UK resident all overseas companies which were under UK corporate or personal control, why should one regard these as outside of the scope of UK treaties? Although in the UK we currently do not treat UK shareholder control of a company as making it resident and chargeable to tax, we take a different view of ultimate control exercised in the UK by directors even if this is only passively exercised through mere oversight of business activities conducted wholly abroad by the company's overseas managers (*Mitchell v B W Noble Ltd* (1926) 11 TC 372). Can it truly be said that these are not "criteria of a similar nature"? If such an extension of UK corporate residence rules was made to cover all UK controlled foreign companies by giving liability from deemed residence based on UK shareholder control then why should this not be regarded as similar to liability which can arise based on the passive control of UK directors?

In establishing the scope of the residence genus which a treaty is seeking to cover, guidance can be found in Paragraphs 3, 4 & 8 of the OECD Commentary on Article 4(1) of their Model Tax Treaty. This indicates that the intention is to cover taxpayers on whom a State imposes a comprehensive liability to tax - "full tax liability" - based on the taxpayers' personal attachment to the State concerned. There seems no reason why comprehensive liability to tax based on attachment through shareholder control in a particular State should be excluded. Indeed, Paragraph 8 of the commentary goes further and says that the test covers cases where a person is, according to the taxation laws of a State, deemed resident in that State and so made fully liable to tax therein (i.e. when in reality they are operating full-time elsewhere). An example given is non-resident employees working abroad in a foreign embassy of the State.

Apart from the issue of notional availability of treaty protection to the overseas subsidiary when assumed to be UK resident, another point which hopefully will be explored in the Court of Appeal (where the case is understood to be heading) is whether the CFC charge on Bricom was a charge to corporation tax. While the Special Commissioners felt that CFC tax was something other than corporation tax, so that the question of Bricom itself having treaty protection under section 788 did not arise (as subsection (3)(a) thereof only covers income tax and corporation tax), arguably the terms of section 754 provide a basis for section 788 to operate as it applies for CFC purposes all the provisions of the Taxes Act that operate in relation to corporation tax generally. If on appeal it is established that either CFC tax is in fact corporation tax after all, or is not corporation tax but through section 754 Bricom is entitled to any treaty protection that would apply under section 788(3)(a) for corporation tax, then in addition to the issue of whether the treaty "protects" the notionally UK resident overseas subsidiary from having chargeable profits for UK tax, there is the point of whether it can also protect other parties, such as a UK parent company, from being indirectly taxed by anti-avoidance legislation on the profits of its overseas subsidiary. As Robert Venables QC noted at paragraph 1.4.2 of his article, the key question is whether any immunity given from UK tax on the income of an overseas company is personal to that overseas company or is directed towards the income of that company so as to prevent a charge to UK tax thereon being made on a connected UK resident.

It might be thought relevant to ask what the negotiators or signatories of a UK double tax treaty would have agreed if the point had been raised at negotiation or signature stage (i.e. what would be their presumed intention). The UK authorities might say to the negotiators or signatories from the Overseas State that although the UK agreed not to tax a company resident in the Overseas State if it had no income from or permanent establishment in the UK, if anyone (whether a resident of the UK or the Overseas State or elsewhere) had a direct or indirect interest, however remote, in a company resident in the Overseas State then that Overseas State should accept that the Business Profits article, Other Income article, etc of the proposed treaty was not to prevent the UK from taxing an appropriate part or (if it wished) all of the income of the Overseas State company, but doing so by treating such tax as recoverable from the relevant owners, whether residents of the UK, the Overseas State (at least regarding UK source profits) or elsewhere.

The negotiators or signatories of the Overseas State would no doubt recognise that apart from imposing tax on owners in their own territory this restrictive view of the treaty could discourage the establishment of companies there by residents of the UK or elsewhere, or could result in a drain on the resources of companies in the Overseas State from the pressure for dividends from owners charged to UK tax on profits of such companies, or could cause companies in the Overseas State to discourage shareholders from disposing of shares to any purchasers in circumstances resulting in a relevant interest becoming held by a UK resident. The reality of course is that with the treaty negotiation teams coming from the tax departments of the respective countries then, if both teams either had or contemplated future severe anti-avoidance legislation regarding overseas companies, they might be happy to accept that each would remain free to tax residents of their own countries or of third countries to the hilt through the use of such legislation. However, if it is accepted that the Overseas State would contend that its own resident shareholders in local companies were to be indirectly protected from UK taxation by, say, the "Business Profits" article (e.g. against a section 776 charge), it is difficult to see how such an intended interpretation would not extend to all shareholders. In addition, the appropriate response consistent with the objective of double taxation treaties, and arguably correct to infer as an intention of the signatories, would be for each to accept that the UK should not seek to indirectly tax the profits of a company resident in the Overseas State by assessing owners located there or in the UK or elsewhere. This involves recognising that a treaty for the avoidance of double taxation requires not simply that two countries should avoid taxing the same company on its profits but also that the profits of the company should not be subjected to tax twice through this being levied firstly on that company in the Overseas State and then on its owners by the UK as well. One hopes this view will prevail as the proper response to be imputed, at least in the absence of evidence that matters have been agreed otherwise, and the Court of Appeal case report is eagerly awaited.