

# The Determination of UK Corporate Residence: *Laerstate BV*

**In this note, the author examines the recent decision by the first-tier Tribunal in *Laerstate BV* concerning the determination of UK corporate residence.**

## 1. Introduction

This note examines a significant decision by the first-tier Tribunal concerning the determination of UK corporate residence. The case<sup>1</sup> heard by Mr John Avery Jones, involved a Dutch incorporated company, *Laerstate BV*, which was purchased by Mr Bock, a German national, to hold his interests in Lonrho plc (Lonrho), a company in which he was to become joint managing director. The key issue that required determination by the Tribunal concerned appeals against assessments raised by the Inland Revenue which assessed the Appellant:

- to corporation tax on the basis that it was UK resident at the time of its disposal of its holding in Lonrho in November 1996; and
- to Advance Corporation Tax in respect of franked payments and relevant payments.

The Appellant appealed on the basis that it was not UK resident, either at the dates that it purchased and sold its shareholding in Lonrho or at any time between those events.

## 2. The Facts

The company was incorporated in the Netherlands on 1 August 1988 as a wholly owned subsidiary of another Dutch company. Its sole director on incorporation was Mr Trapman. Mr Bock acquired the company on 9 December 1992 at which date he was appointed a director;<sup>2</sup> he remained a director until his resignation on 30 August 1996. Mr Trapman, who had been heavily involved in Mr Bock's other businesses, continued to be a director. Mr Trapman received no remuneration for his role.

Prior to this, in November 1992, Mr Bock had negotiated with the head office of a German Bank, BfG Bank, in order to secure a loan to finance the purchase of the holding in Lonrho. The bank made an offer in writing of a GBP 100 million loan. The loan agreement was made on 7 December 1992. A Board resolution was passed on that date, approving the purchase.

On 9 December 1992, whilst Mr Bock was non-UK resident, the Appellant entered into an underwriting and subscription agreement with Lonrho and Morgan Grenfell. Also on that date it entered into a sale and option agreement with Yeoman Investments Limited (Yeoman) and Mr Bock to purchase from Yeoman 43,478,260 Lon-

rho shares of 25p. The agreement also provided for associated put and call options between Yeoman and the Appellant over a further 45,529,447 shares in Lonrho and assignments of the right to subscribe.

After the making of the Appellant's investment in Lonrho, Mr Bock became a director and joint chief executive of Lonrho on 10 February 1993. At this point he remained resident in Germany, staying in a hotel in London when required. A flat for his use was purchased in London, which he moved into in April 1994. He retained his Frankfurt office with a private secretary from which he mainly dealt with non-Lonrho business. He travelled extensively spending 232 days outside the United Kingdom in 1993, 207 days in 1994, 210 days in 1995 and 163 days in 1996.

Despite Mr Bock fearing his UK phones were bugged, the Tribunal considered that Mr Bock did conduct Appellant's business in the United Kingdom as he communicated on numerous occasions with the Appellant's advisors whilst in the United Kingdom.

The Tribunal considered the acquisition of shares in Lonrho by the Appellant. It should be emphasized that the acquisition took place at a time in which Mr Bock was not UK resident and was not even a director of the Appellant so that these events should not directly concern the determination of UK residence status. The events however demonstrated how central management and control was being exercised during that period. The Tribunal found "that all the transactions were decided by Mr Bock and Mr Trapman signed in accordance with his wishes while in the UK."<sup>3</sup>

During the period while Mr Bock was a director<sup>4</sup> the Tribunal found that Mr Bock carried out significant negotiations in the United Kingdom concerning key matters affecting the Appellant. For example, following extensive negotiations between Mr Bock and Mr Rowland, which took place in London, the agreement of 3 November 1994 between Mr Bock and Mr Rowland under which they agreed to procure that their respective companies

\* BBS MA (TCD) ACA CTA (Fellow) AITI ADIT TEP, Senior Tax Consultant, Hazlems Fenton LLP. The author can be contacted at David.Hughes@HazlemsFenton.com.

1. *Laerstate BV v. HMRC*, FTT [2009] SFTD 551.

2. Under Dutch law, if the company has more than one director, each director can individually bind the company, unless the Articles of Association provide otherwise. The ability of the directors to represent and bind the company is unrestricted and unconditional, provided that the law or the Articles of Association do not provide otherwise.

3. *Laerstate BV*, note 1, Para. 13.

4. *Id.*, Para. 14.

cancel the option agreement of 9 December 1992, and replace it with a right of first refusal in favour of Mr Bock, was signed in London. Under the agreement Mr Bock also agreed to procure that the Appellant would vote its stake in Lonrho in favour of the proposed resolution that Mr Rowland be appointed President of Lonrho.

Regarding negotiations with Anglo American Corporation (Anglo), a company which wished to acquire an interest in Lonrho, the Tribunal concluded:

There is no evidence other than Mr Bock's witness statement, which we have not accepted, that Mr Trapman was being kept informed, and this seems contrary to the fact that Mr Bock was carrying out all the negotiations [on behalf of the appellant] without any papers being sent to Mr Trapman. When Macfarlanes faxed the counter notice to Mr Trapman... they gave no advice but merely asked him to sign it before 5 pm; ..... While there was a board meeting on 8 April 1996, we have found that "the proposal of an option agreement" was not before Mr Trapman in the form of a draft agreement. In any case Mr Bock negotiated further changes after that meeting. ... From the Appellant's point of view this is the strongest example of Mr Trapman being involved in decision making but in our view it falls far short of showing that Mr Trapman was really taking part in the decision-making process as opposed to signing documents that were sent to him. ...<sup>5</sup>

The Tribunal therefore found that throughout the period during which Mr Bock was a director "he carried out activities of the Appellant of a strategic and policy nature and managed the business of the Appellant, and that he did so to a substantial extent in the UK".<sup>6</sup>

Mr Bock ceased to be a director of the Appellant on 30 August 1996. This is less than a month before the Appellant gave notice of intention to exercise the put option on 24 September 1996.

The Tribunal did not accept Mr Bock's explanation that a conflict of interest was the reason for his resignation. They suspected that he had concluded that he should not be a director at the time of disposal of the Appellant's shares in Lonrho.<sup>7</sup>

The Tribunal then considered the sale of Lonrho shares by the Appellant to Anglo.<sup>8</sup> Mr Bock met Anglo's CEO on 4 and 13 September 1996 in the United Kingdom.

On 24 September 1996, the Appellant, in a document signed by Mr Trapman, gave notice to Anglo of its intention to exercise the put option (the notice of intention). This was acknowledged by Anglo on 26 September 1996 stating that the earliest date for exercising the put was 9 October 1996 and the latest date for completion was 22 October 1996.

In relation to the notice of intention Mr Bock stated that after he resigned as a director, he did not take any further part in decisions about the put option. In the light of conflicting evidence, the Tribunal did not accept this.

On 29 October 1996, Mr Trapman signed the notice of exercise of the put option specifying that completion would take place on 7 November 1996 in Zurich and sent it to Anglo. On 5 November 1996, Mr Trapman gave notice of the split of bankers' drafts required on completion on 7 November 1996.

In November 1996, Mr Bock ceased to be chief executive of Lonrho and on 13 December 1996 Mr Trapman resigned and a new director was appointed.

The Tribunal then summarized the minutes of the board meetings and noted that there were only minutes of five meetings attended by both directors: one of which was a formal one; one of which a decision had been made at; and the three others effectively ratified agreements already negotiated by Mr Bock. The other four meetings were records of actions taken by Mr Trapman. All other acts of management were taken outside board meetings.<sup>9</sup>

### 3. Dominant Directors and a Failure of Creditability

Various factors indicated that Mr Bock was playing a dominant role in the exercise of the Appellant's central management and control, both whilst a director and also after he resigned. Mr Bock's position was then further weakened by the Tribunal's rejection of many assertions made in his witness statement.

#### *Signing of documents*

Mr Bock signed various documents on behalf of the Appellant both in the United Kingdom and abroad, for example:

- instruction to Credit Suisse to deliver the Lonrho shares out of escrow to Macfarlanes (a law firm) on behalf of the Appellant (London); and
- the deed of priorities over Lonrho shares (Germany).

#### *Professional advisors*

Significant amounts of correspondence were entered into by the Appellant's professional advisors either directly with Mr Bock or between themselves concerning the Appellant and Mr Bock, which indicated that the advisors considered that Mr Bock was the key individual whose wishes concerning the Appellant had to be ascertained and instructions followed.

#### *Negotiation in the United Kingdom*

Mr Bock negotiated important agreements on behalf of the Appellant whilst in the United Kingdom, for example, the cancellation of the 9 December 1992 option agreement and the agreement with Anglo.

#### *Mr Trapman's minor role*

In contrast, Mr Trapman's involvement was held to be administrative in nature:

- there was no evidence to suggest that he was being kept informed by Mr Bock on various important matters; and

.....

5. Id., Para. 15.  
 6. Id., Para. 16.  
 7. Id., Para. 18.  
 8. Id., Para. 19.  
 9. Id., Para. 20.

- various documents including resolutions were signed by Mr Trapman. However the Tribunal concluded that he had not considered these.

#### **Mr Bock's witness statement**

The Tribunal found Mr Bock's witness statement to be unreliable. For example at Para. 14(47) concerning the proposal of an option agreement for 143,478,260 shares in Lonrho. Mr Bock's witness statement states that "Ed Trapman was kept informed throughout ...." However, the Tribunal did not accept that Mr Trapman was kept informed throughout, as there was no evidence to substantiate this.

#### **Delay in coming before the Tribunal**

The appeal concerned events between 1992 and 1996. In this regard the Tribunal placed on record its concern that appeals took so long to come before it as this affected the quality of the evidence.

### **4. Alternative Arguments concerning Central Management and Control**

Mr Phillip Baker, for the Appellant argued that the act of central management and control (CMC) is the resolution where this precedes the signing of a document, or the signing of the document itself where there is no resolution. He set these out as a table which on that basis clearly indicated all the key acts of central management and control were taken outside the United Kingdom.<sup>10</sup>

Mr Timothy Brennan, for HMRC, accepted that where a company is run at board meetings the place of CMC is likely to be where the board meets, However, he contended that:

- the decisions about the Appellant were not made at board meetings at all;
- the "meetings" were not really meetings and that no discussion took place;
- this should not be seen as a case of "usurpation." "It is a case where the board did not function as a board of management but where one dominant director, who was at all relevant times the 100% shareholder ... made the business decisions." His decision-making did not cease after his resignation as a director; and
- there was no substantial evidence that Mr Trapman was exercising CMC.<sup>11</sup>

### **5. The Tribunal's Decision**

The Tribunal first set out the legal test determining corporate residence. They noted that this was expounded by Lord Loreburn LC in *De Beers Consolidated Mines Limited v. Howe*:<sup>12</sup>

A company cannot eat or sleep, but it can keep house and do business. We ought, therefore, to see where it really keeps house and does business... a company resides for purposes of income tax where its real business is carried on. .... I regard that as the true rule, and the real business is carried on where the central management and control actually abides.

The Tribunal further observed that:

[t]here is no assumption that CMC must be found where the directors meet. It is entirely a question of fact where it is found. ... [I]f the management is carried out outside board meetings one needs to ask who was managing the company by making high level decisions and where, even where this is contrary to the company's constitution.<sup>13</sup>

This is a test that does not confine itself to a consideration of particular actions of the company, such as the signing of documents or the making of certain board resolutions outside the UK if, in a given case, a more general overview of the course of business and trading demonstrates that as a matter of fact central management and control abides in the UK....<sup>14</sup>

This is consistent with the analogy with individual residence which was the basis on which Lord Loreburn propounded the central management and control test. ...., the residence of a company will not fluctuate merely by reason of individual acts of management and control taking place in different territories. The whole picture must be considered in each case.<sup>15</sup>

*Bullock v. The Unit Construction Co Ltd*<sup>16</sup> is relevant in this case only to the periods during which Mr Bock was not a director. Whilst Mr Bock was a director he had full authority under the Articles of Association of the Appellant to bind the Appellant to a third party. Similarly, the Tribunal also considered that *Wood v. Holden*<sup>17</sup> was applicable only to the periods during which Mr Bock was not a director.<sup>18</sup>

In relation to the actions taken by the Appellant and the Appellant's board, it is clear that the mere physical acts of signing resolutions or documents do not suffice for actual management. This finding of the Special Commissioners in *Wood v. Holden* was approved by Park J, but he went on to say at Para. 66 that "if they [the directors] apply their minds to whether or not to sign the documents, the authorities, which I will not repeat, indicate that it is a very different matter".<sup>19</sup>

A majority shareholder, whether a parent company or an individual majority shareholder, may indicate how the directors of the company should act. If they consider the wishes and act on them, it is still their decision.<sup>20</sup>

The key distinction is between the directors actually making the decision or not making any decision at all.<sup>21</sup>

It is not sufficient even where the directors know what they are signing if they sign without considering whether

10. Id., Para. 25.

11. Id., Para. 26.

12. *De Beers Consolidated Mines Limited v. Howe (Surveyor of Taxes)* [1906] AC 455, p. 458.

13. *Laerstate BV*, note 1, Para. 27.

14. Id., Para. 28.

15. Id., Para. 29.

16. *Bullock v. The Unit Construction Co Ltd* [1960] AC 351, 38 TC 712.

17. *Wood v. Holden* 2006 STC 443.

18. *Laerstate BV*, note 1, Para. 30.

19. Id., Para. 33.

20. Id., Para. 34.

21. At the extreme end is the case where, for example, an agreement is put in front of the directors open at the signature page and they sign it regardless. This is an example of the mindless signing to which Park J refers.

it would be better to sign or not. In that case there is still no decision by the directors.<sup>22</sup>

The Tribunal considered that:

[a]n objective way of testing whether this is the case is to ask whether the directors have the absolute minimum amount of information that a person would need to ... make a decision at all on whether to agree to follow the shareholder's wishes or to decide not to sign.<sup>23</sup>...

Where the directors follow the wishes of the shareholder after considering whether or not to follow them and have at least the absolute minimum information ... but less information than a reasonable director would require in order sensibly to decide whether or not to follow the shareholder's wishes they nevertheless make the decision:

"Ill-informed or ill-advised decisions taken in the management of a company remain management decisions" (*Wood v Holden* in the Court of Appeal at [43])....<sup>24</sup>

At the other extreme is where the directors have sufficient information to make an informed decision.<sup>25</sup>

The Tribunal applied the law as set out above, differentiating between the period in which Mr Bock was a director and the period after he resigned.

In the period to 30 August 1996, during which Mr Bock was formally a director of the Appellant, the Tribunal found that during this period central management and control was exercised in the United Kingdom. Mr Baker's proposition that the Tribunal should attempt to classify certain acts as "acts of central management and control" and have regard only to those acts, was rejected. The Tribunal found that Mr Bock's activities as a director in the United Kingdom "were certainly concerned with policy, strategic and management matters, and, included decision-making in relation to the Appellant's business in this period."<sup>26</sup>

The Tribunal noted that after Mr Bock ceased to be a director, only Mr Trapman could sign for the Appellant in a way that would bind a third party:

The issue is whether Mr Trapman acted on Mr Bock's instructions without considering the merits of them, or whether he considered Mr Bock's wishes and made the decision himself while in possession of the minimum information necessary for anyone to be able to decide whether or not to follow them. There are three particular actions (or inactions) of the Appellant to consider: (1) giving the notice of intention on 24 September 1996; (2) not exercising the option on 9 October 1996, the earliest possible date following the notice of intention; and (3) the giving of the exercise notice on 29 October 1996. [In relation to (1),] ... [i]f he [Mr Bock] said that he discussed the matter fully with Mr Trapman before the telephone call, indicated to Mr Trapman that he wanted him to give the notice and why it needed to be given immediately, and if Mr Trapman had said that he considered the alternatives of giving the notice or doing nothing, and decided to give the notice, we would have concluded that Mr Trapman made the decision. But they deny that this is what happened. Mr Bock said in oral evidence: "I left it completely up to his [Mr Trapman's] discretion what to do insofar I supported whatever he decided;". If the timing was not discussed between Mr Bock and Mr Trapman the only alternative possibility is that Mr Bock made the decision that the notice would be given and told Mr Trapman to sign it, which Mr Trapman did without considering whether or not to do so and not

having the necessary information to make such a decision anyway."<sup>27</sup>

[In relation to item (2)] if Mr Trapman was a decision-maker he would also have decided to do the natural follow-up to the notice of intention of giving the notice of exercise at the earliest possible date, 9 October 1996.... Why did he not do so? [The Tribunal made arguments analogous to those directly above and found that] Mr Bock told Mr Trapman not to give the notice... which Mr Trapman accepted without considering whether or not to do so and not having the necessary information to make such a decision anyway... The existence of item (2) fortifies our conclusion on item (1).<sup>28</sup>

[In relation to item (3), in view of (1) and (2), the Tribunal considered that] Mr Trapman was not in possession of the minimum information to be able to make a decision... Mr Bock told Mr Trapman to sign the exercise notice on 29 October 1996, which he did without considering it because that was what Mr Bock wanted.<sup>29</sup>

Therefore, in relation to items (1), (2) and (3), the decisions were found to be those of Mr Bock who predominantly made those decisions in the United Kingdom. The Appellant was therefore also UK resident in the period from 30 August 1996 until at least 31 December 1996.<sup>30</sup>

Finally, the Tribunal considered the question of effective management. Where a company is resident in the United Kingdom under domestic law, and resident in the Netherlands under the Netherlands law (on account of incorporation there), Art. 4 of the 1980 United Kingdom-Netherlands tax treaty provides that "... it shall be deemed to be a resident of the State in which its place of effective management is situated"<sup>31</sup>

The United Kingdom-Netherlands tax treaty was relevant, both in relation to the claims for repayment of treaty tax credits, and, from 30 November 1993,<sup>32</sup> in determining whether the Appellant, was UK resident under UK domestic law.<sup>33</sup>

The Tribunal adopted the Special Commissioners' approach on the interpretation of the place of effective management (POEM) in *Smallwood v HMRC*:<sup>34</sup>

111. ... CMC is essentially a one-country test; the purpose is not to decide where residence is situated, but whether or not it is situated in the United Kingdom...

22. The Tribunal referred to the Commissioners' finding in *Wood v Holden* at [145]:

We do not consider that the mere physical acts of signing resolutions or documents suffice for actual management... 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.

23. *Laerstate BV*, note 1, Para. 35.

24. *Id.*, Para. 36.

25. *Id.*, Para. 37.

26. *Id.*, Para. 40.

27. *Id.*, Para. 42.

28. *Id.*, Para. 43.

29. *Id.*, Para. 44.

30. *Id.*, Para. 45.

31. *Id.*, Para. 46.

32. The date on which Sec. 249 of the Finance Act 1994 "Certain companies treated as non-resident" took effect.

33. *Laerstate BV*, note 1, Para. 47.

34. *Smallwood v HMRC* [2008] STC (SCD) 209.

112. POEM, on the other hand, must be concerned with what happens in both states since its purpose is to resolve residence under domestic law in both states, ... One must necessarily weigh up what happens in both states and ... decide in which state the place of effective management is found.<sup>35</sup>

As the Tribunal had found that Mr Bock's activities were concerned with policy, strategic and management mat-

ters throughout the time when he was a director and also after he ceased to be a director and that Mr Trapman's activities were limited to signing documents when told to do so and dealing with routine matters such as the accounts, it found that effective management was located in the United Kingdom.<sup>36</sup>

## 6. Conclusion

The Tribunal applied separate tests for determining corporate residence by reference to:

- the period that Mr Bock was formally a director; and
- the period following his resignation.

In the period in which Mr Bock was a director, the Tribunal found that he was engaged in policy, strategic and management matters in the United Kingdom. This was broadly on the basis that:

- he was the only director negotiating key contracts and these negotiations took place in the United Kingdom; and
- the fact that the Appellant's other director Mr Trapman was not involved in negotiations and no information was sent to him concerning these matters.

In the period following Mr Bock's resignation, the Tribunal found applying *Wood v. Holden* that Mr Trapman was never given even the minimum information necessary to make a decision. They considered, Mr Bock issued instructions to Mr Trapman and Mr Trapman signed the relevant resolutions in accordance with those instructions.

Ostensibly the Tribunal's decision seems to closely follow *Wood v. Holden*, however the implicit criticism of Chadwick J's judgment and its focus on the Special Commissioners (over turned) approach in that case together with the Tribunal's truncation of the much

quoted passage from *The Special Commissioners in Untelrab Ltd v. McGregor*<sup>37</sup> at Para. 74<sup>38</sup> suggests that while lip service is being paid to previous judgments the reality is that the Tribunal is attempting to move the goal posts by effectively raising the minimum information bar. It remains to be seen whether higher courts will endorse this tougher approach.

Notwithstanding the above, where it is wished to avoid a determination of UK residence, the decision is uncontroversial in as far as it confirms:

- the dangers of appointing UK directors in general, and dominant UK directors in particular;
- the need to ensure the articles of association are carefully drafted and complied with;
- the need to create and retain creditable contemporaneous evidence, as a practical matter the Tribunal's rejection of the Appellant's witness statements entirely undermined the appeal;
- the need to ensure that all directors receive sufficient information prior to board meetings and that such information is provided in good time;
- the need to ensure that matters are actually discussed at meetings, decisions made and comprehensive minutes taken;
- it is not sufficient to conclude agreements whilst in the United Kingdom and subsequently ratify these at a board meeting held abroad; and
- non-UK resident directors are kept fully updated during the course of any negotiations taking place in the United Kingdom and decisions are not made in the United Kingdom.

35. *Laerstate BV v. HMRC*, FTT [2009] SFTD 551, Para. 48.

36. *Id.*, Para. 50.

37. *Untelrab Ltd v. McGregor* [1996] STC (SCD) 1.

38. "[S]o long as the board exercised their discretion when coming to their decisions and would have refused to carry out an improper or unwise transaction..."