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Blind Guides: The Professional Trustee Deemed Residence Rule—A Critique of HMRC's Guidance

Capital gains tax; Income tax; Residence; Trustees

''If the blind lead the blind, both shall fall into the ditch''.[1] *HMRC's Guidance on Trustee Residence must be read with a large pinch of salt.*

Professional Trustee Deemed Residence Rule

The Taxation of Chargeable Gains Act 1992 s.69 contains rules for determining where the trustees of a settlement are resident and ordinarily resident for the purposes of that Act and the Income Tax Act 2007 ss.475 and 476 contain similar rules for income tax purposes. These definitions of residence were first enacted in Finance Act 2006 with effect from April 6, 2007 and were first published in draft in January 2006. The draft definitions were in a form which has been carried unchanged into the Taxation of Chargeable Gains Act 1992 s.69 whilst the income tax legislation was rewritten under the Rewrite Project, so that the two residence tests are now in different terms.[2] .

The draft legislation included a deeming provision (the ''Professional Trustee Deemed Residence Rule'') which is now found in both the Taxation of Chargeable Gains Act 1992 s.69(2D) and in the Income Tax Act 2007 s.475(6) which treats a trustee who is not resident in the United Kingdom as if he were so resident:

[1] St Matthew's Gospel Ch.15 Verse 14.

[2] The intention of the Rewrite Project was that the rewritten legislation should have the same effect as the legislation from which it derived.

> '' . . . any time when he acts as trustee in the course of a business which he carries on in the United Kingdom through a branch, agency or permanent establishment there''.[3]

The publication of the Guidance

The Society of Trust and Estate Practitioners warned[4] that the Professional Trustee Deemed Residence Rule was a major threat to the practice of professional trustees in the United Kingdom. The Government's response to this criticism was to promise that HMRC would publish ''guidance''. That Guidance was published on July 1, 2009. This article examines the Guidance and considers whether it is accurate or useful.

The guidance's conceptual framework

Different tests for companies and other taxpayers?

After some introductory material the Guidance begins by stating:

> ''. . . that for trustees the '*branch*' and '*agency*' tests apply to non-corporate trustees and the ''*permanent establishment*'' test to corporate trustees. Non-UK resident trust companies that are trustees therefore need only be concerned about being treated as UK resident if they carry on a business through a permanent establishment in the UK''.

It can be seen from s.69(2D) which is quoted above that there is nothing in that sub-section which suggests that different tests apply according to whether the trustee is a natural or legal person.[5]

The Guidance goes on to say in para.7:

> ''As the legislation refers to a business carried on in the UK through a 'branch, agency or permanent establishment' the same principles

[3] Taxation of Chargeable Gains Act 1992 s.69(2D). It will be noted that this provision uses the masculine gender. The Interpretation Act 1978 s.6 provides that words importing the masculine gender include the feminine and vice versa, but it does not provide that words importing the masculine gender include the neuter. Is it perhaps arguable that the Taxation of Chargeable Gains Act 1992 s.69(2D) applies only to natural persons? The equivalent provision in the Income Tax Act 2007 s.475(6) is differently worded, being in the Rewrite style, and does not use the masculine pronoun to refer to the trustees.

[4] See the author's previous article S. McKie ''Trustee Residence: Bring Back King Log'' [2008] P.C.B. 72.

[5] The Finance Act 2003 s.148 which contains a statutory definition of a permanent establishment applies only for the purpose of determining whether a company has a permanent establishment in a territory (see below). It may be because of this that HMRC have adopted their view of the dual structure of s.69(2D). If so, that is surely too shifting a ground on which to found such a radical restructuring of the provision.

> . . . and . . . examples . . . apply in the case of non-corporate trustees (a branch or agent) as they apply in the case of corporate trustees (permanent establishment). Because most cases will in practice involve non UK resident trust companies the examples refer only to them. However where particular concepts that are peculiar to permanent establishment are concerned e.g. the independent agent exemption, then they affect only corporate trustees, and the language used reflects that.''[6]

When the Guidance was released in draft the Chartered Institute of Taxation commented that the Guidance:

> ''. . . needs, for completeness, to deal with non-corporate trustees, who may be acting in the course of business or acting as trustees where they do so through a branch or agency in the UK''.

It was, presumably, in response to this comment that the authors inserted para.7, which was not in the original draft, hoping to justify making the minimum of changes to the Guidance.

Neither ''branch'', nor ''permanent establishment'', however, are terms with clearly defined meanings in law and agency is also, to a lesser extent, a legal concept of uncertain limits. What is clear is that they don't mean the same thing. Each term requires explication and illustration by means of examples but the Guidance has chosen, effectively, to deal only with permanent establishments.

No reference to the statutory definitions

It is a peculiarity of the Guidance that it develops its examination of the meaning of ''permanent establishment'' without referring to the statutory definition which applies for the purpose of determining whether a company has a permanent establishment in a country. That definition is found in the Finance Act 2003 s.148, for the purposes of the Tax Acts[7] and is incorporated into capital gains tax by the Taxation of Chargeable Gains Act 1992 s.288(1). Rather, the Guidance refers to the OECD's Model Treaty which contains a definition of a permanent establishment for the purposes of the Treaty in art.5 and the OECD's Commentary thereon. Clearly neither the Model Treaty nor the Commentary is directly part of UK law. The Treaty's definition of ''permanent establishment'' in art.5 shows a number of differences from that of s.148. It is true that a court, in the absence of more direct authority, is likely to have regard to the views expressed in the OECD Commentary in construing phrases in s.148 which are identical to those used for the same purpose in art.5 of the Model Treaty. Nonetheless, the

[6] Paragraph 7. All references in this article are to the Guidance unless otherwise stated.
[7] The Income Tax Acts and the Corporation Tax Acts.

reader needs to be aware that there are important differences between the two definitions and that the opinion of the OECD is by no means determinative of the construction of s.148 under English law.

Strangely Annexe A to the Guidance highlights one of the key differences between the definition in art.5 of the OECD Model Treaty and the statutory definition given by s.148 without explaining that there is a statutory definition.

The three questions

The Guidance goes on to set out three questions which it says are relevant to deciding whether or not a trustee is deemed to be resident in the United Kingdom.[8] Those tests are:

(a) Is the trustee carrying on a business in the United Kingdom?
(b) If the trustee is carrying on a business in the United Kingdom, is it carrying on a business through a branch, agent or permanent establishment in the United Kingdom?
(c) If so, is the trustee carrying on the activity of being a trustee of that particular trust in the course of its business through the branch agent or permanent establishment?

Question (a)

In relation to question (a) the Guidance says:

> ''This question is not related to the business of particular trusts that might be conducted by the trustees. It enquires whether the person who is a trustee carried out business activities (as a professional businessman and not as a trustee of a particular trust) in the UK.''

That certainly seems to the author to be an arguable view of the provision but it is also arguable that the provision is not restricted in this way. Rather, that it is only necessary for the trustee to act:

> '' . . . as trustee in the course of a business which he carries on in the United Kingdom though a branch, agency or permanent establishment there'',

and that that condition is satisfied both if he carries on a business of acting as a professional trustee and if he carries on a business for the account of the trust fund of the settlement concerned. HMRC's Guidance should distinguish between situations where it is stating a view of the law about which there can be no

[8] Taxation of Chargeable Gains Act 1992 s.69(2)(d) and Income Tax Act 2007 s.475(6).

reasonable dispute and those where one of two or more tenable constructions of the law has been adopted.

Question (b)

Under question (b) the Guidance says:

> ''Again this means that the trustee is carrying on through the branch, agency or permanent establishment the sort of activities from which it substantially derives its world-wide profits—providing professional services for a fee—and not what it is doing in relation to an individual trust.''

It is difficult to see what distinction the Guidance is trying to make. It may be that this point is simply repeating the view set out above in respect of question (a) in which case, as we have seen, the Guidance has failed to give due weight to a tenable, alternative construction.

Question (c)

Question (c) is ambiguous. Section 69(2D) requires the person concerned to be acting as a trustee in the course of a business. That business must be carried on in the United Kingdom through a branch, agency or permanent establishment in the United Kingdom. Question (c) could be read as being consistent with this construction.. It could, however, also be read as stating that the test will be satisfied only if acts of the trustee in respect of the particular trust concerned are carried on through a branch, agency or permanent establishment in the United Kingdom. If so, that seems to be a narrower view of the test than is justified by a close reading of the legislation.

Core activities

The Guidance then goes on to say that:

> '' . . . in line with the Commentary of the OECD Tax Model Convention, 'carrying on the function of being a trustee' means in this context activities which are the core activities of a trustee and not those activities which are auxiliary or preparatory''.

In fact the Commentary refers to core activities only at two points and neither of those in relation to carrying on the function of being a trustee. Section 69(2D) makes no distinction between the core activities of trustees and other activities. It provides that if the person concerned acts as trustee in the course of business which he carries on in the United Kingdom through a branch, agency or permanent

establishment, that person will be resident in the United Kingdom. There is no provision that this will not apply if the acts are preparatory or auxiliary.

The definition of a ''permanent establishment'' in s.148[9] does refer to activities that are preparatory or auxiliary in character providing that:

> ''A company is not regarded as having a permanent establishment in a territory by reason of the fact that—
>
> (a) a fixed place of business is maintained there for the purpose of carrying on activities for the company; or
>
> (b) an agent carries on activities there for and on behalf of the company.
>
> if, in relation to the business of the company as a whole, the activities carried on are only of a preparatory or auxiliary character.''

That, however, is relevant only to deciding whether or not a company has a permanent establishment, not to whether a person is acting as a trustee.

The Guidance goes on to say that:

> ''There are other activities which trustees carry on which are not core activities central to [the trustees'] conduct and management of the trust, but are instead preparatory or auxiliary activities. These generally can include information gathering meetings, including meetings with independent agents or with beneficiaries but, as mentioned below, each case will have to be considered individually.''

This shows an important misunderstanding. Gathering relevant information about beneficiaries' circumstances or about the performance of the duties of an independent agent are important parts of the duties of trustees. Meetings with beneficiaries, lawyers, investment managers, land agents and others for the purpose of gathering information relevant to the trustees' stewardship of the settled property or the exercise of their dispositive powers will inevitably be acts by a professional trustee in the course of his business of providing professional trustee services.

The Guidance goes on to say that:

> ''In deciding whether the conduct and management of a particular trust is being carried on in the course of the corporate trustees' business through a permanent establishment, HMRC . . . would also consider the issue of frequency.''

[9] The OECD Model Treaty art.5 contains similar provisions.

The Guidance is unreliable here. It may be true that in deciding whether or not the trustee is carrying on a professional trustee business in the United Kingdom through a branch, agency or permanent establishment the frequency of his actions in the United Kingdom will be relevant. Once one has established that the trustee provides professional trustee services in the United Kingdom through a permanent establishment, however, a single act in the course of that business in respect of a settlement will be sufficient to make the trustee resident in the United Kingdom in relation to that trust.

The examples

The Guidance then provides a series of examples of the application of the Professional Trustee Deemed Residence Rule in accordance with HMRC's understanding of the rule set out in the preceding part of the Guidance.

Having ignored the statutory definition of a permanent establishment, invented a wholly illusory distinction between corporate and individual trustees for the purposes of the rule and confused the provisions relevant to deciding whether there is a permanent establishment with those relevant to whether a trustee carries on business in the United Kingdom through a permanent establishment, branch or agency, it is unsurprising that these examples are, in the main, incorrect or misleading.

Example 1

Example 1 is, however, helpful. It gives an example of a non-UK resident trust company which holds several meetings in the United Kingdom with a potential settlor to discuss proposed terms for the trust and suitable investments. As the settlement does not yet exist, the trust company cannot be acting as a trustee in respect of that settlement in these discussions.

Example 2

Example 2, however, illustrates the danger of the Guidance's error of applying a core activities test in deciding whether or not the trust company is acting as a trustee. It gives an example of a trust company which:

> '' . . . holds quarterly meetings in the UK at its London offices [presumably in respect of the settlement concerned] with investment advisors. The purpose of these meetings is for . . . [the trust company] . . . to collect purely factual information about potential assets to inform future investment strategy for the . . . [trust]. The actual decisions about the investment strategy are taken by . . . [the trust company] . . . outside the UK''.

The Guidance correctly says that the trust company has a permanent establishment in the United Kingdom. It goes on to say, however, that:

> ''. . . the significance of the meetings with the investment advisors is not sufficient for [the trustee] to be regarded as acting as trustee in respect of [the trust] through that permanent establishment. They will not, therefore, be regarded as UK resident for the purposes of [the trust]''.

Obtaining information to enable the trustees to make prudent investment decisions, however, is an important duty of trustees and when it does so it is clearly acting as a trustee and in the course of its business of providing trustee services. If the offices at which the meetings take place are a permanent establishment and part of the company's business of acting as professional trustee is carried on in the United Kingdom through those offices all the ingredients for deemed residence under the Professional Trustee Deemed Residence Rule are present.

Example 2b

Example 2b shows how the view expressed in the Guidance that the frequency of the trustee's acts is relevant to deciding whether the Professional Trustee Deemed Residence Rule is satisfied leads to an incorrect conclusion. The example is as follows:

> ''July Ltd, a non-UK resident trust company is trustee of the August Trust. It always carries out the core activities of the August Trust at its office overseas. The beneficiary of the trust has a single one-off meeting with July Ltd at July's Manchester office to discuss the potential release of capital from the August Trust. The discussion involves the imposition of certain conditions on the beneficiary before such a release.
>
> HMRC view: On the face of it July Ltd by discussing the release of capital and the imposition of conditions with the beneficiary has engaged in a core activity and this has taken place at what is July's permanent establishment in the United Kingdom. So *prima facie* July Ltd is acting as trustee of the August Trust through a permanent establishment However, the whole context has to be looked at—i.e. where the decision making on the trust is being carried on and if the meeting in the United Kingdom was a one-off. If the trustee took the information from the meetings out of the United Kingdom with them and then discussed and made the decisions outside the United Kingdom, they would not be UK resident. If there was any doubt as to where the decision making is taking place we would as part of our considerations consider the frequency of any meetings both within and outside the United Kingdom.''

Assuming that July Ltd's offices are used for the purposes of its trade as a professional trustee generally, it is clear that it carries on a business in the United Kingdom through a permanent establishment here. Discussions with a beneficiary in respect of a proposed capital advance are clearly an act undertaken as a trustee of the particular trust concerned and that act is in the course of the trustees business of providing professional trustee services. So the conditions of the Taxation of Chargeable Gains Act 1992 s.69(2D) are clearly satisfied. The frequency of the meetings in respect of the particular trust concerned are irrelevant.

Agents of independent status

The Finance Act 2003 s.148(3) provides that:

> '' . . . a company is not regarded as having a permanent establishment in a territory by reason of the fact that it carries on business there through an agent of independent status acting in the ordinary course of his business''.

The Guidance refers to creating, ''a dependent agency permanent establishment''. If this phrase has any meaning, the Guidance has converted a negative rule (''is not regarded as having a permanent establishment'') into a positive one.

The Guidance goes on to say:

> ''Where the services that are provided to the trust are only those that the person is contractually obliged to provide under their agreement with the non-UK resident trustee and are remunerated at arm's length, then this is unlikely to create a dependent agency permanent establishment.''

Because the Guidance has transformed a negative test into a positive one it does not deal with the difficulties which emerge where the relationship with a service supplier is not a simple agency. For example, it is common for investment managers to hold the managed assets as nominee for their clients so that the assets are held by the managers as trustee and not as agent. Trustees exercise many of their activities of holding and dealing with the trust assets through the mechanism of such nominee arrangements. If the investment manager operates through a permanent establishment in the United Kingdom it is clear that a trustee will be acting through that permanent establishment. The Guidance says, however:

> ''Where, say, a UK subsidiary is providing services to a trust, then unless the powers granted to it by a non-resident trust company are such that it becomes a '*dependent agent with authority to do business on behalf of the non-resident trustee*' (see paragraph 5 of Annex A) we will not contend that the UK company's actions cause the non-UK resident trustee company to have a permanent establishment.''

Perhaps the phrase ''we will not contend'' acknowledges that here the Guidance is actually offering a disguised concession. If so, it is arguable that the disguised concession is ultra vires.[10]

Example 3a

In Example 3a, a non-resident trustee engages an investment manager on terms that the manager has the authority to buy and sell commodities with a view to realising profits for the trust subject to trading limits set by the trustee. The Guidance says that:

> '' . . . the investment manager is appointed by the trustee and so is its agent. If it receives an arm's length fee for the investment management services, it will not ordinarily constitute a dependent agent of the non-UK resident trustee''.

As we have seen, that may not be true because it is likely that the investment manager will hold the investment assets as nominee, that is on bare trusts, for the trustee. The example goes on to say:

> ''If, however, October Ltd was providing investment management services to the trustees other than on arm's length terms i.e. was acting as their dependent agent, rather than simply providing a service to them, in that case the trustees would be likely to have a dependent agent permanent establishment.''[11]

If all the Guidance is saying here is that a person charging less than the market rate for a service is likely also not to be independent, then that is no doubt true, but it is hardly useful to say so. If, however, the Guidance is attempting to say that charging less than a market rate for services has the result that the provider is a dependent agent then this is clearly not the case.

Accurate and useful?

In summary, then, the Guidance is imprecise and in places misleading. Is it useful in that it can be relied upon as indicating that HMRC will not apply the full rigour of the statutory provisions? Unfortunately, it is not. The Guidance is liberally sprinkled with words and phrases such as ''generally'', ''unlikely'', ''could not by itself'', ''will be likely'' and ''normally'' which indicate HMRC's determination not to be too closely bound by its general statements.

[10] *R. (on the application of Wilkinson) v Inland Revenue Commissioners* [2005] S.T.C. 270 HL.

[11] It may be that FA 2003 s.448(3) and Sch.26 paras (3) and (4) will provide some relief here, but that is dependant upon falling within the detailed terms of those provisions.

The Guidance will do nothing to retrieve the business which has been lost to the United Kingdom due to the uncertainty which the introduction of the Professional Trustee Deemed Residence Rule created. As the author commented in his 2008 article[12]:

> '' . . . publishing 'guidance' rather than revising the legislation, is entirely beside the point. Offshore trustees selecting investment managers, stock exchanges or accountancy firms are not going to rely on the UK Government relieving them of a liability due under the law by unacknowledged concessions when they can obtain similar services in other jurisdictions without taking that risk''.

[12] S. McKie ''Trustee Residence: Bring Back King Log'' [2008] P.C.B. 72.