

# Wood v. Holden: Clarifying the “Central Management and Control” Test

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Determining the residence of a taxpayer has long been the source of great conflict in the realm of international tax law. The fiscal health of many governments depends on the ability of revenue authorities to ensure that taxpayers are not able to easily manipulate their place of residence for tax purposes.

Over the course of many decades, an extensive body of jurisprudence has developed, detailing the tests to be applied when determining the residence of a corporation for tax purposes. Frequently, the location of a corporation’s “central management and control” is the determining factor in ascertaining the residency of a corporation and resolving inter-jurisdictional tax disputes.

Although the courts in many common law jurisdictions, including those in the United Kingdom and Canada, have been called upon to consider where the central management and control of a corporation resides under a variety of circumstances, the courts have seldom directly considered whether the location of the professional advisors of a corporation can influence a corporation’s place of residence.

However, the High Court Chancery Division did recently have occasion to examine whether the situs of a taxpayer’s professional advisors was relevant in assessing whether the taxpayer was resident in the United Kingdom for U.K. tax purposes. In *Wood v. Holden*,<sup>1</sup> the shareholders of a U.K. company (the “Company”) sought the assistance of Price Waterhouse (“PW”) in locating potential purchasers for the Company and structuring the resulting sale in a tax-efficient manner. In consultation with the shareholders, PW devised a series of transactions that would limit the imposition of Capital Gains Tax on the sale of the shares of the Company. Unfortunately, before PW’s plan could be fully executed, the operative U.K. tax legislation was amended, necessitating the development of a new disposition strategy. The new strategy that PW developed was predicated on the creation of an intermediary Dutch holding company to take advantage of the favourable terms of the *United Kingdom-Netherlands Income Tax Convention*. The intermediary Dutch holding company also retained PW to advise it on future asset disposition opportunities.

Ultimately, the shares of the Company were sold following the implementation of PW’s revised plan. Nevertheless, the Inland

Revenue chose to assess Capital Gains Tax on the sale of the shares of the Company on the basis that the intermediary Dutch company was resident in the United Kingdom for U.K. tax purposes. The Inland Revenue asserted that the influence enjoyed by the taxpayers or PW (on the taxpayer’s behalf) over the management of the Dutch company resulted in the “central management and control” of the company being situated in the United Kingdom.

The U.K. Special Commissioners confirmed the assessment of the Inland Revenue, ruling that the Dutch company was a U.K. resident for tax purposes. The Special Commissioners concluded that the taxpayers or PW exerted such strong influence over the affairs of the Dutch company that they effectively managed the corporation.

However, on appeal, the High Court Chancery Division found that the Special Commissioners had erred in their judgment and that the Dutch company was, in fact, resident in the Netherlands, despite PW’s extensive involvement in structuring the share sale. The Court ruled that the advice provided by PW was not binding on the Dutch company’s local board of directors and that, at all material times, final decision-making authority rested with the company’s local directors.

The decision rendered by the Court in *Wood* raises a number of important principles that should be borne in mind when structuring the managerial affairs of foreign subsidiaries, including the following:

- There is a clear distinction between exercising management and control of a corporation and advising the directors of the corporation.
- The directors of a foreign subsidiary should carefully document the steps taken to reach a managerial decision.
- Professional advisors and parent companies should only make managerial recommendations to the directors of a subsidiary and must refrain from making definitive commands.

Ultimately, the ruling in *Wood* may prove to be of particular significance in resolving residency disputes in cases involving both corporations and other entities, including trusts.

1 [2005] EWHC 547 (Ch).

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