Will a virtual server give rise to a taxable presence in the UK?

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Q My client runs a successful crypto-trading business and would like to cease UK tax residence in order to avoid UK income tax on the profits of the trade. He uses a virtual server in London to ensure he is physically proximate to the crypto exchange. Could this virtual server give him a taxable presence in the UK?

A The UK takes a relatively categoric stance that a server physically located in the UK cannot give a person a permanent establishment in the UK. However, the limits of this principle have not been tested and, as ever, the devil is in the detail.

Background to co-location services

Crypto assets are extremely volatile. The price of a particular asset can change multiple times per second. This volatility creates an opportunity for those traders who are able to execute contracts more quickly than other market participants. In order to capitalise on this opportunity, and to avoid the loss that could occur if an order is executed after the price has changed, co-location was born. This involves a trader having access to a server which is in the same physical building as the crypto-exchange. The server is then connected to the exchange with high-speed cables. The server can either be a physical server – i.e. a physical computer stack reserved exclusively for the trader – or a virtual server whereby the trader pays for the use of computing power of a server owned by a third party. The trader uploads their trading algorithm to the co-located server which sends orders to the exchange when the conditions are met. While co-location services are prevalent (and were first introduced) in other financial markets, their importance is particularly pronounced in the volatile world of crypto.

The UK's position on the Model Tax Convention

An enterprise will have a permanent establishment (PE) in the UK where there is a fixed place of business in the UK through which the business of the enterprise is wholly or partly carried on; or where there is an agent acting on behalf of the enterprise that has, and habitually exercises in the UK, authority to do business on behalf of the enterprise. This is the standard two-pronged test for a PE as set out in the OECD's Model Tax Convention and on which guidance can be found in the OECD Commentaries (Commentaries).

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Importantly, while the Commentaries set out at length the circumstances in which a physical server can constitute a PE, the UK has exercised its right to enter an Observation. Accordingly, para 176 of the Commentaries states that 'the United Kingdom takes the view that a server used by an e-tailer, either alone or together with web sites, could not as such constitute a permanent establishment'. The UK's position is also set out in HMRC's *International Manual* (at INTM266100) which states that:

> 'The UK does not concur with other OECD Member States on whether a server of itself can constitute a fixed place of business permanent establishment ... In the UK, we take the view that a server either alone or together with web sites could not as such constitute a PE of a business that is conducting e-commerce through a web site on the server.'

Ordinarily, the reliance that can be placed on HMRC statements of practice is extremely limited. However, in this case the UK has committed its position to an international document agreed with the member states of the OCED. Without entering the vexed debate as to whether the Commentaries are binding on member states, it is safe to say that a court will place much more weight on the concession in the Commentaries than it would if the concession appeared in the manual alone.

The question that then arises is the scope of the concession. On the plain words of the concession as quoted above, there is room for argument that it only applies to e-commerce, i.e. websites such as Amazon which use the internet to sell physical goods. The context of the Commentaries makes clear, however, that the principles espoused apply to all servers and the focus on e-commerce is because e-commerce was the new problem for the OECD in the late 90s and early 2000s when the commentary on computer servers was first introduced. For example, para 124 of the Commentaries makes general statements about the nature of software (which cannot have a physical place of business) as compared to hardware (which can). The UK's position does therefore appear to be a broad one that a server simply cannot create a PE, and this would apply equally to a co-located server.

Mitigating the risks

Many clients will be content to know that the UK does not regard a server as giving rise to a PE. For the more risk adverse, or where servers may be located in other jurisdictions, there are steps which can be taken to reduce the PE risk. In particular, it will be recalled that it is possible to get many, if not all, of the same co-location benefits from a virtual server. Such a server does not have a physical location because it is merely a right to use another's computing power. Put another way, the enterprise cannot point to a particular server rack as 'their' server and they could not sub-lease it to another. The enterprise therefore does not have a physical server at its own disposal and so should not have a PE in the jurisdiction in which the server is located. This analysis accords with the Commentaries even where the trader is contracting for computing power in a particular data centre (para 124 of the Commentaries).

Other risks

The preceding analysis focuses on whether a server alone is sufficient to give an enterprise a PE in the UK, but it must not be forgotten that this requires the jurisdiction in question to have a double tax treaty with the UK. Some of the jurisdictions of choice for crypto traders do not have such a convention. Consideration must then be given to, among other matters, whether the taxpayer is trading in the UK including the difficulties of applying cases about telegrams, champagne and cement to algorithmic crypto trading! ■