The Legal Framework: International Law

Chapter 1

9-000 Introduction

> 'But as the Laws of each State respect the Benefit of that State; so amongst all or most States there might be, and in Fact there are, some Laws agreed on by common Consent, which respect the Advantage not of one Body in particular, but of all in general. And this is what is called the Law of Nations.'[1]

This seventeenth-century definition of international law by its founding father, Hugo Grotius, continues as the essential formulation of the body of law that governs the conduct of nations. The exercise of taxing powers by sovereign states, and the interaction between that exercise and the international legal order is the subject of this book. The scope of modern international law extends beyond matters between states such as the position of states, or peace and security but also into individual rights, notably human rights and, to many areas previously viewed as domestic matters, such as the environment and a host of private law topics including the recognition of trusts. Few areas of law reflect the tension between the autonomy of states embodied in theories of sovereignty and binding international legal norms than in the field of taxation.

The absence of a single law-making body, a universal mechanism or forum for resolving disputes and a comprehensive system of enforcement distinguishes international law from domestic law.[2] The legal order constituting the European Union, although established by treaty among otherwise sovereign states, is not international law in this sense itself since the EU has a law-making body and the treaty and other laws are interpreted by a court.[3]

Public international law impacts on every aspect of cross-border taxation. The right to tax as a manifestation of sovereignty, the delimitation of the territory of states including the law of the sea, the laws of airspace and outer space, the international effect of nationality and the use of treaties to address double taxation and international collaboration between tax administrations, all depend on the existence of an international legal order. This chapter introduces the key concepts of that international legal order that are engaged when national tax systems interact with each other. Aspects of international law are also addressed throughout this work.

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[1] Hugo Grotius, The Rights of War and Peace [1625] Book 1 para XVIII. (The Rights of War and Peace, 3 vols, edited and with an Introduction by Richard Tuck, from the Edition by Jean Barbeyrac (Indianapolis: Liberty Fund, 2005)).

[2] International lawyers refer to the internal law of states as 'municipal law'. The expression domestic law is frequently used by tax practitioners to refer to the same body of internal law. In this book, the term 'domestic' law is used in conformity with tax usage.

[3] See Chapter 3.

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9-050 Sources of international law

The absence of an overarching law-making machinery means that the sources of law are not identical to domestic law and the existence of a particular rule or principle as a law is to be established from sources that are special to the international legal order. Article 38 of the Statute of the International Court of Justice[4] authoritatively identifies the sources of international law thus:

> 'Article 38(1) The Court, whose function is to decide in accordance with international law such disputes as are submitted to it, shall apply:
>
> (a) international conventions, whether general or particular, establishing rules expressly recognized by the contesting States;
> (b) international custom, as evidence of a general practice accepted as law;
> (c) the general principles of law recognized by civilized nations;
> (d) subject to the provisions of Article 59[5] judicial decisions and the teachings of the most highly qualified publicists of the various nations, as subsidiary means for the determination of rules of law.'

International conventions

International conventions, or treaties, are by far the most important source of international law as it affects taxation. To qualify as a source of law, the treaty in question must establish rules. In other words, it must be law-making. An agreement between states for one to sell goods to the other, for example, would not be a source of law. Examples of law-making conventions that are important in the taxation field are the Vienna Convention on the Law of Treaties 1969 and the European Convention on Human Rights. Bilateral tax treaties are rule-making as between the parties but their terms do not evidence any rule of international law of general application beyond the particular treaty even if these treaties follow a fairly consistent pattern. This is for two related reasons: firstly, the rule must be expressly recognised by the contesting states, and, secondly, states exercise of taxing power under domestic law is typically exercised without regard to any treaty norms as a jealously guarded element of national sovereignty.

International custom

The practice of states may amount to a rule of law if the practice in question is 'accepted' as law. Thus both elements must be satisfied before a rule of customary international law exists. There must be a practice and it must be accepted as amounting to a binding rule. In the *Fisheries Jurisdiction Case*[6] the International Court of Justice observed that rules of customary international law between the parties evolved through the

[4] Statute of the International Court of Justice Charter, 59 Stat. 1055, TS No. 993 at 25, art. 38, para. 1. The Statute of the International Court of Justice is annexed to the Charter of the United Nations, of which it forms an integral part. The main object of the Statute is to organise the composition and the functioning of the Court.

[5] Article 59. The decision of the Court has no binding force except between the parties and in respect of that particular case.

[6] *Fisheries Jurisdiction (United Kingdom of Great Britain and Northern Ireland v Iceland)*, Merits, Judgment, ICJ Reports 1974, p. 3, International Court of Justice.

practice of states after the 1960 Conference on the Law of the Sea on the basis of the debates and near-agreements at the Conference. The Court ruled that two concepts had crystallised as customary law in recent years arising out of the general consensus revealed at that Conference. The first is the concept of the fishery zone, the area in which a state may claim exclusive fishery jurisdiction independently of its territorial sea; the extension of that fishery zone up to a 12-mile limit from the baselines appears now to be generally accepted. The second is the concept of preferential rights of fishing in adjacent waters in favour of the coastal state in a situation of special dependence on its coastal fisheries.[7] State practice, it found, reveals an increasing and widespread acceptance of the concept of preferential rights for coastal states, particularly in favour of countries or territories in a situation of special dependence on coastal fisheries.[8] Thus the practice need not be universal. However, adoption of rule by certain states where other states have adopted a different rule is insufficient for the first mentioned rule to acquire the authority of a general rule of international law.[9] The application of a well-defined and uniform system which would reap the benefit of general toleration, forms the basis of an historical consolidation which would make it enforceable as against other states. In that case the Norwegian practice was unchallenged for a period of more than sixty years.[10]

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The custom must be elevated to a rule of law. In *Right of Passage over Indian Territory*,[11] the International Court of Justice said that: 'It is a rule of law generally accepted, as well as one acted upon in the past by the Court'. The necessity for acceptance as a legally binding norm was emphasised by the Court in the *North Sea Continental Shelf Cases*:[12]

> 'The essential point in this connection - and it seems necessary to stress it - is that... two conditions must be fulfilled. Not only must the acts concerned amount to a settled practice, but they must also be such, or be carried out in such a way, as to be evidence of a belief that this practice is rendered obligatory by the existence of a rule of law requiring it. The need for such a belief, i.e., the existence of a subjective element, is implicit in the very notion of the opinio juris sive necessitatis. The States concerned must therefore feel that they are conforming to what amounts to a legal obligation. The frequency, or even habitual character of the acts is not in itself enough. There are many international acts, e.g., in the field of ceremonial and protocol, which are performed almost invariably, but which are motivated only by considerations of courtesy, convenience or tradition, and not by any sense of legal duty.'[13]

[7] *Fisheries Jurisdiction* at para. 52.

[8] At para. 58.

[9] *Fisheries case (United Kingdom v Norway)*, Judgment of 18 December, 1951: ICJ Reports 1951, p. 116 at p. 131.

[10] At p. 138.

[11] *Right of Passage over Indian Territory*, Preliminary Objections, Judgment, ICJ Reports 1957, p. 142.

[12] *North Sea Continental Shelf Cases* (Federal Republic of Germany/Denmark; Federal Republic of Germany/Netherlands) ICJ Reports 1969, p. 3.

[13] At para. 77.

General principles of law

The Statute of the International Court of Justice recognises that legal principle applied by the domestic courts of states is a source of international law. Obvious examples include the law of treaties which draws heavily on contract law[14] or tort.[15] This principle is underpinned by the requirement for the election of judges to the Court that:

> 'At every election, the electors shall bear in mind not only that the persons to be elected should individually possess the qualifications required, but also that in the body as a whole the representation of the main forms of civilization and of the principal legal systems of the world should be assured.'[16]

General principles of law also include international principles. In the *Corfu Channel* case, for example, the Court referred to 'certain general and well-recognised principles' in the context of the right of innocent passage of foreign ships through territorial waters.[17]

Ius cogens

Certain international legal principles are regarded as having a peremptory character and owed to the international community as a whole.[18] Such principles are regarded as representing the highest values in international law and cannot be overridden. Norms must be accepted and recognised by the international community of states as a whole as one from which no derogation is permitted to qualify as *ius cogens*. If they are so recognised, they can only be modified by a subsequent norm of general international law having the same character.[19] Prohibitions on slavery, torture and genocide are included.[20] In contrast, the basic principle of non-retroactivity of treaties reflected in Article 28 of the Vienna Convention on the Law of Treaties is not a peremptory norm of international law and it is open to parties to agree to the contrary.[21]

Judicial decisions and writing of jurists

The decisions of the ICJ itself are only binding on the parties to which the particular proceeding applies.[22] Despite the absence of a formal doctrine of judicial precedent in the court, its decisions form an essential source of international law. Decisions of

[14] See 9-350 below.

[15] *Corfu Channel case* ICJ Reports 1949, p. 4 (ICJ).

[16] Statute of the International Court of Justice Charter, 59 Stat. 1055, TS No. 993 at 25, art. 9.

[17] At p. 22.

[18] *Barcelona Traction, Light and Power Co Ltd (Belgium v Spain)* ICJ Reports 1970, 3, para. 33–34.

[19] Vienna Convention on the Law of Treaties (Vienna, 23 May 1969; TS 58 (1980); Cmnd 7964), art. 53.

[20] See for example, Application of the Convention on the Prevention and Punishment of the Crime of Genocide (Bosnia and Herzegovina v Serbia and Montenegro), ICJ Reports, 26 February 2007.

[21] *Ben Nevis (Holdings) Ltd v Revenue & Customs* [2013] EWCA Civ 578, at para. 43, citing *Mavrommatis Palestine Concessions* (1924) PCIJ Ser. A, No. 2, 34.

[22] Statute of the International Court of Justice Charter, 59 Stat. 1055, TS No. 993 at 25, art. 59.

other courts including national courts and the Court of Justice of the European Union are similarly recognised.

Although the statute of the ICJ identifies separately customary international law, general principles of law and judicial decisions, in practice, the distinction between them is frequently unclear or illusory.

9-100 International law and domestic law

Public international law is a distinct and separate body of law. Nonetheless, it has an intimate relationship with domestic or municipal law. Customary international law in the broad sense is part of the domestic law of England and Wales without the need for any domestic statute or judicial decision.[23] In *R v Jones (Margaret)*, Lord Bingham observed, obiter, that it may be better expressed that international law is one of the sources of English law. In the tax context, the principles of treaty interpretation derived from customary international law have been consistently applied by the English courts.[24] Once a domestic court has expressed a view on a matter of international law, the decision is both one of domestic and international law. Treaties, on the other hand, require implementation by legislation in order to have effect in domestic law of the UK.[25] On the other hand, where a treaty codifies customary international law, the courts make reference to the terms of the treaty notwithstanding the lack of legislative incorporation into domestic law.[26] This may include a treaty to which the UK is not a party.[27]

One important consequence of the incorporation of international law into English law is that international law is to be established by argument, as a matter of law before the courts. It is therefore distinguished from foreign law which must be proved as a matter of fact, usually by expert evidence.[28] It is for this reason that expert evidence on the interpretation and application of a treaty is inadmissible.[29]

[23] See authorities cited in *R v Jones (Margaret)* [2006] UKHL 16; [2007] 1 AC 136 at para. 11.

[24] See generally chapter 4.

[25] See chapter 4.

[26] *Fothergill v Monarch Airlines Ltd* [1981] AC 251 at 282; [1980] 2 All ER 696 at 706 (HL).

[27] *Republic of Ecuador v Occidental Exploration and Production Co* [2005] EWCA Civ 1116; [2006] QB 432; [2006] 2 All ER 225.

[28] For example see *First Nationwide v Revenue and Customs Commissioners* [2012] EWCA Civ 278; [2012] STC 1261; *Revenue and Customs v Anson* [2013] EWCA Civ 63.

[29] *Revenue and Customs v Ben Nevis (Holdings) Ltd* [2012] EWHC 1807 (Ch) at para. 41, affd by the Court of Appeal: *Ben Nevis (Holdings) Ltd v Revenue & Customs* [2013] EWCA Civ 578 at para. 39.

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9-150 Public international law and private international law

Public international law is to be distinguished from private international law (or conflict of laws). Public international law refers to the body of law comprising the legal norms regarded as binding on all members of the international community. Private international law is the body of, largely domestic, law dealing with circumstances where local law has to deal with some system of foreign law. Foreign law is the law of another foreign country and always remains such. Public international law, as has been explained,[30] is in many respects part of the domestic law of a country.

With the exception of tax treaties, tax law, as a creature of statute, is entirely a matter of domestic law. Nonetheless, private international law plays an important role in cross-border taxation. Two aspects are of prime significance: choice of law and jurisdiction.

In particular, when considering the application of tax law to foreign persons or transactions, the choice of law normally points in relation to powers with which a legal person is endowed its proper law namely, that of the state under whose laws it was created.[31] The same is true in considering the nature of property rights[32] or the character of foreign entities.[33]

Although primarily a matter of domestic law, questions of choice of law are frequently addressed by international treaty in order to produce uniform treatment among contracting states.[34] Similarly, tax treaties frequently contain provisions directing the application of the domestic law of one of the contracting states. Thus treaties patterned on the OECD model define 'dividends' by reference to the tax law of the state of residence of the paying company. For example, the Germany-UK Income Tax Treaty includes any 'item which is subjected to the same taxation treatment as income from shares by the laws of the state of which the company making the distribution is a resident, and income from distributions on certificates of a German "Investment vermögen"'.[35]

The jurisdiction of English courts (and other countries comprising the UK), although a matter of domestic law, derives in important respects from customary international law, general principles of law recognised by civilised nations and international treaties.

[30] See para. 9-100 above.

[31] *Rae (Inspector of Taxes) v Lazard Investment Co Ltd* (1963) 41 TC 1; [1963] 1 WLR 555, HL.

[32] *Archer-Shee v Baker (H M Inspector of Taxes)* (1927) 11 TC 749 ; [1927] AC 844; *Garland (H M Inspector of Taxes) v Archer-Shee* [1931] AC 212, (HL).

[33] *Revenue and Customs v Anson* [2013] EWCA Civ 63.

[34] See for example, The Convention on the Law Applicable to Trusts and on their Recognition ('the Hague Convention'), 20 October 1984 (Cmnd 9494), given effect in the UK by the *Recognition of Trusts Act* 1987.

[35] Convention between the United Kingdom of Great Britain and Northern Ireland and the Federal Republic of Germany for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and on Capital of 30 March 2010 (SI 2010/2975), art. 10(3).

These include the 'Revenue Rule'[36] and the limits on the amenability of foreign states to the jurisdiction of local courts and thus to taxation.[37]

9-200 States

States are the main subject of international law. The 1933 Montevideo Convention on Rights and Duties of States,[38] although only ratified by some Latin American countries and the United States, contains a useful summary of the criteria for statehood:

> 'Article 1
>
> The state as a person of international law should possess the following qualifications: a) a permanent population; b) a defined territory; c) government; and d) capacity to enter into relations with the other states.
>
> Article 2
>
> The federal state shall constitute a sole person in the eyes of international law.'

Each of the criteria may give rise to difficulties. However, disputes over boundaries or the absence of effective government does not necessarily mean that a state ceases to exist. In the tax context, the first three criteria set out in Article 1 are essential for the imposition of tax. The fourth, namely the capacity to enter into relations with other states, is essential for the conclusion of a valid treaty. In federal systems, national constitutions will determine whether members of the federation, or the federation as a whole, have this capacity.[39]

9-250 State immunity from tax

In certain circumstances, a foreign state is entitled to immunity, that is, freedom from the jurisdiction of another state. This may extend to the legislative, judicial and administrative powers of the other state. The United Nations Convention on Jurisdictional Immunities of States and Their Property, adopted by the UN General Assembly[40] represents a codification of customary international law on this subject.[41] The general principle set out in the convention is that 'A state enjoys immunity in respect of itself and its property from the jurisdiction of the courts of another state

[36] See chapter 21.

[37] See para. 9-250 and Chapter 11, para. 19-550 regarding diplomats and consular officers.

[38] Convention on Rights and Duties of States (Montevideo, 26 December 1933) 49 Stat. 3097 TS 881.

[39] See Chapter 2, para. 10-500 on state succession and Chapter 11, para. 19-550 (Diplomats and consular officers) and 19-600 (government service).

[40] United Nations Convention on Jurisdictional Immunities of States and Their Property (New York, 2 December 2004), adopted by United Nations General Assembly Resolution 59/38 of 16 December 2004.

[41] *Jones v Ministry of the Interior of the Kingdom of Saudi Arabia* [2006] UKHL 26; [2007] 1 AC 270; [2007] 1 All ER 113 at para. 47.

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maintains a stock of goods or merchandise from which he or she regularly delivers goods or merchandise for or on behalf of the enterprise.[93]

These provisions were considered by the Indian Income Tax Appellate Tribunal in *Airline Rotables Ltd UK v Joint Director of Income Tax*,[94] The tribunal rejected as absurd the contention of the assessing officer that the Indian airline was a dependent agent who habitually maintained a stock of goods or merchandise from which he regularly delivers goods or merchandise for or on behalf of the enterprise in giving out the replacement components.[95]

Only preparatory or auxiliary activities must be undertaken to qualify for exclusion. The German Bundesfinanzhof (Federal Tax Court) ruled that an editorial office in London of a German newspaper was a permanent establishment because it not only collected information, which would be preparatory or auxilliary, but processed it by translating or commenting.[96]

15-650 Parent companies and subsidiaries as permanent establishments

Modern treaties such as that with Cyprus specify that:

> '5(7) The fact that a company which is a resident of one of the Contracting States controls or is controlled by a company which is a resident of the other Contracting State, or which carries on business in that other Contracting State (whether through a permanent establishment or otherwise), shall not of itself constitute either company a permanent establishment of the other.'

This curious provision is not found in the domestic definition of permanent establishment in the FA 2003, s. 148. The statement does, however, emphasise, along with art. 9 (Associated enterprises), that tax is imposed on each legal person separately rather than on the group, and that the actual course of interaction between the parent and subsidiary must be examined.[97]

[93] Article 5(4)(b), incorporating art. 5(4)(b) of the UN Model.

[94] *Airline Rotables Ltd UK v Joint Director of Income Tax*, International Taxation ITA No 3254/Mum/06, 13 ITLR 226.

[95] At para. 16.

[96] Case IR 292/81Bundesfinanzhof (Federal Tax Court), 23 January 1985 (IBFD Online Database).

[97] See para. 15-450 and 15-500 for examples: *Rolls-Royce plc v Director of Income Tax* ITA Nos 1496-1501/Del/2007, [2007] 10 ITLR 327; Société; *Zimmer Ltd v Ministre de l'Économie, des Finances et de l'Industrie* No 304715, 308525; *GE Capital Rail Limited, Cour Administrative d'Appel de Paris* (Paris court of Administrative Appeals), No 09PA06295, 10 February 2011 (IBFD Online Database).

Distributive Provisions of Income Tax Treaties

Chapter 8

16-000 Allocation of taxing jurisdiction

The distributive provisions of income tax treaties constitute the heart of the treaty system. These rules allocate taxing jurisdiction between the contracting states and determine the source of income and agreed maximum levels of taxation in source states. The distributive provisions of income and capital gains tax treaties are set out in Chapter III of the OECD Model which covers the various items of income and capital gains that form the basis of tax systems typical of OECD member states. These are identified in para. 16-050. Any remaining double taxation after the application of these rules falls to be addressed by the double tax relief article (OECD Model Chapter V Elimination of double taxation, art. 23), which in the UK generally allows credit for foreign tax paid against related UK tax liability. The steps required in the application of any treaty provision of illustrated by the *Smallwood* case.[1] The Special Commissioners observed that:

> 'Article 13 in general deals with a conflict between taxation on the basis of source and on the basis of residence. It states that if the alienator is Treaty Resident in one state, the gains are taxable only in that state. Any dual residence, which we have equated with chargeability, should have been solved by the tie-breaker determining the Treaty Residence before one arrives at Article 13.'[2]

Thereafter, Patten LJ in the Court of Appeal noted that:

> 'The 1977 Model Convention adopted in the DTA eliminates the possibility of double taxation by what the commentary describes as two categories of rules. The first allocates the right to tax by reference to the situs or source of the taxable income or gain or the place where the person in receipt of the profit is treated as resident for tax purposes. The second category of rules (represented by Article 24) comes into play when the first set of rules leaves both Contracting States as eligible to tax the same gain and operates by allowing tax payable in one Contracting State to be credited against the taxpayers' liabilities in the other.'[3]

In the context of non-UK residents, the distributive articles determine the limits of the UK tax base. Collectively, the distributive provisions cover the whole of the UK tax system. As with domestic law, treaties have evolved significantly since the oldest of

[1] *Trevor Smallwood Trust v Revenue & Customs* [2008] UKSPC SPC669; [2009] EWHC 777 (Ch); [2010] EWCA Civ 778.

[2] [2008] UKSPC SPC669 at para. 107.

[3] [2010] EWCA Civ 778 at para. 28.

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them was first negotiated. Furthermore, given the fact that each treaty is individually negotiated with its own trade-offs, taking into account the interests of both contracting states, there is a wide variation in the detail. There is, as a result, no substitute for examining the precise wording of each treaty in considering its application.

Treaties patterned on the OECD Model allocate taxing jurisdiction in relation to any particular item of income or gain according to one of three approaches. Firstly, exclusive taxation by the country of residence may be authorised. This is the starting point of the OECD Model which allows the country of residence broad authority to tax. Where exclusive jurisdiction is granted to the country of residence, then the other contracting state may not tax the item.[4] Secondly, taxing jurisdiction may be allocated concurrently to the country of residence and to the country of source of the income or situs of the asset. The majority of distributive provisions specify when this may be the case. Within this category, treaties may impose a maximum amount of tax. This is most commonly the case in relation to dividends, interest and royalties.[5] Where double taxation arises by reason of concurrent taxing jurisdiction, relief may be claimed pursuant to art. 23.[6] Thirdly, exclusive taxing jurisdiction may be granted to the country of source. In this last category, exclusive taxing jurisdiction emerges frequently from the exemption granted in the residence country under art. 23B of the OECD Model, rather than in the distributive provisions themselves. The scheme of distributive provisions of the UN Model Treaty is similar to the OECD Model but seeks to widen the range of circumstances in which source countries are entitled to exercise taxing jurisdiction. The UN Model is styled to apply 'between developed and developing countries', and it is implicit that the residence countries are assumed to be developed, capital exporting countries with developing countries being implicitly the source jurisdictions. The extent to which this continues to reflect trade and investment patterns may be open to question. It is, however, noticeable that a shift in emphasis among the OECD members as reflected in the 2008 commentary to the OECD Model hints at adopting a similar stance to that found in the UN Model, such as recognition of service permanent establishments.[7]

The distributive provisions of treaties allocate the right to tax. They do not require a state to exercise that right. For example, many UK treaties authorise a positive rate of tax on dividends but, generally, as a matter of domestic law, this right is not exercised. There may, as a result, be circumstances where the item is not liable to tax in either jurisdiction. For example, a disposal of shares by a UK-resident company of shares in a Mauritian company qualifying for the substantial shareholding exemption within TCGA 1992, Sch. 7AC, may not be subject to tax in the UK and precluded from Mauritian tax by art. 13 of the UK-Mauritius Treaty. Although the principal purpose

[4] *Trevor Smallwood Trust v R & C Commrs* (2008) Sp C 669 at para. 103.

[5] See Chapter 10, para. 18-100, 18-150 and 18-200.

[6] See Chapter 15, para. 23-000ff..

[7] Commentary to OECD Model, art. 5, paras. 42.11ff. See Chapter 7, para. 15-600.

of treaties as commonly set out in their title is the avoidance of double taxation,[8] there is no overarching principal that denies treaty benefits where such taxing jurisdiction is not exercised by the other contracting state. To the extent that contracting states wish to limit the availability of benefits in such circumstances, specific limitations to that effect are normally included.[9]

16-050 Classification of sources

The broad classification of sources of income for treaty purposes parallels the schedular system of UK taxation to a large extent.[10] Table 7.1 is a general guide to assist classification under treaty and domestic law in relation to the main UK sources and the common application of treaty provisions to them. It will be noted that within certain broad categories, various sectors are identified for special treatment. This is most notable in relation to business profits where shipping and air transportation, as well as artists and sportspeople, have their own rules.[11] Similarly, in the employment area, general rules are provided for dependent personal services with specific treatment applicable to directors' fees, artists and sportspeople, pensions and government services.[12]

Delimiting the boundaries between the categories does give rise to difficulties under both domestic law and treaties independently. It should be emphasised that these broad classifications will form a general guide only and that treaty classification and domestic law classification will not necessarily coincide in all cases. For example, in *Memec plc v IRC*,[13] the treaty meaning of 'dividend' under the German Treaty was not the same as the domestic meaning of the expression for the purpose of credit in relation to underlying tax under what is now TIOPA 2010, s. 57. Changes in classification also occur both in domestic law and treaties, such as the abolition of the charge under Sch. C by the FA 1996 in domestic law and the abandonment of art. 14 for independent personal services under the latest OECD Model (29 April 2000), with those activities being subsumed in the notion of business profits under arts. 5 and 7. A further source of complexity in dealing with treaties arises from potential mismatches in classification between the UK and the other contracting state. This may arise because of different legal analysis of the underlying issues, differing approach to the determination of the source of income for tax purposes or interpretation of the treaty.

[8] In *Imperial Chemical Industries Limited v Caro* (1960) 39 TC 374 by Lord Evershed MR at 379.

[9] See Chapter 17, para. 25-000ff..

[10] The schedular system has survived the tax rewrite project in concept although the various sources of income are no longer referred to by reference to 'schedules'. This overall approach to the drafting of the distributive provisions of tax treaties reflects the long-standing influence of the UK on thinking about double taxation relief in the OECD.

[11] See Chapter 9, para. 17-000ff..

[12] See Chapter 11, para. 19-000ff..

[13] [1998] BTC 251; [1998] STC 754, CA.

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Table 7.1: General guide to classification under treaty and domestic law

Treaty article	Principle domestic source – corporation tax	Principle domestic source – other taxpayers
Article 6 – income from immovable property	CTA 2009, Pt. 4 – property income	ITTOIA Pt. 3 – property income
Article 7 – business profits	CTA 2009, Pt. 3 – trading income	ITTOIA Pt. 2 – trading income
Article 8 – transport	CTA 2009, Pt. 3 – trading income	ITTOIA Pt. 2 – trading income
Article 10 – dividends	CTA 2009, Pt. 9A – company distributions	ITTOIA, Pt. 4, Ch. 3 – dividends from UK-resident companies; Ch. 4 dividends from non-UK-resident companies
Article 11 – interest	CTA 2009, Pts. 5 and 6 — loan relationships	ITTOIA Pt. 4, Ch. 2 – interest
Article 12 – royalties	CTA 2009, Pt. 9 – intellectual property	ITTOIA Pt. 5, Chs. 2–4 – intellectual property receipts
Article 13 – capital gains	TCGA, chargeable gains	TCGA, chargeable gains
Article 14 – independent personal services		ITTOIA Pt. 2 – trading income
Article 15 – dependent personal services		ITEPA – employment income
Article 16 – directors' fees	CTA 2009, s. 969	ITEPA – employment income
Article 17 – artistes and sportsmen		ITEPA – employment income/ITTOIA, Pt. 2 – trading income
Article 18 – pensions		ITEPA, Pt. 9 – pension income
Article 19 – government service		ITEPA – employment income
Article 20 – students		Various
Article 21 – other income	Various	Various

Business Profits

Chapter 9

17-000 Business profits

The permanent establishment article, in conjunction with the business profits article, forms the core of the treaty regime regulating the taxation of cross-border business activities. Article 7(1) of the OECD Model sets out the general rule. It is reflected in art. 7(1) of the Italy Treaty, which reads as follows:

> 'The profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein. If the enterprise carries on or has carried on business as aforesaid, the profits of the enterprise may be taxed in the other State but only so much of them as is attributable to that permanent establishment.'

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Thus the right to tax profits is, in the first instance, granted exclusively to the state of residence of an enterprise. The most important exception to the general rule is where the enterprise carries on business through a permanent establishment in the other contracting state.

Article 7(1) refers to profits of an enterprise that carries on business through a permanent establishment. The starting point is that 'profits' means all profits. The scope of the article is then restricted by art. 7(7), which specifies that where profits include items of income which are dealt with separately in other articles, then those articles are not affected by the business profits article. It is thus a general provision which may be excluded by more specific rules. Special rules may apply for the two specific types of business or income. These normally include, in treaties following the current OECD Model, income from immovable property, profits from the operation of ships all aircraft in international traffic, business activities of entertainers and sportsmen and as well as dividends, interest and royalties. Earlier OECD style treaties further distinguish independent personal services from business profits, as is the case with treaties adopting the UN Model. A number of treaties with developing countries also draw a distinction between the provision of certain services provided through a permanent establishment and others where there is no permanent establishment. Article 7(7) is absent, however, from a number of UK treaties.

The effect of this article is that such profits can only be taxed in the state of residence of the enterprise. Any domestic law of the other contracting state seeking to tax these profits would be prevented from doing so. This has been overridden, however, by the FA 2008, s. 59, from 12 March 2008 by the insertion of what is now TIOPA 2010, s. 130, so that article does not prevent income of a person resident in the UK being chargeable to income tax or corporation tax. Thus, where business profits, for

example, are attributed to a UK resident under ITA 2007, Pt. 13, Ch. 2 (Transfer of Assets Abroad), no treaty protection will be available in the UK to such a resident as a matter of domestic law.[1]

17-050 Enterprise

An 'enterprise of a contracting state' is normally defined in art. 3(1)(d) to mean an 'enterprise carried on by a resident of a contracting state' and has been present in treaties at least since the 1963 OECD Draft. Several definitions were added to art. 3 of the OECD Model in 2000, which have appeared in UK treaties since then. 'Enterprise' now 'applies to the carrying on of any business'.[2] Likewise, the term 'business' since then includes 'the performance of professional services and of other activities of an independent character'.[3] The newer definitions are not found in treaties concluded in the twentieth-century and comprise the majority of UK treaties. Although the international tax term 'permanent establishment' has found its way into UK domestic law, 'enterprise' is not a term of art used in UK domestic tax law.[4] In treaty language, which is more common in civil law jurisdictions and in this context, 'enterprise' is likely the same or similar to 'business'.[5] This would appear to be supported by the new definitions, although the commentary indicates that these should be understood by reference to domestic law.[6] The use of 'enterprise' may not be identical in all parts of a treaty. In *Boake Allen Ltd & Ors (including NEC Semi-Conductors Ltd) v Revenue and Customs Commissioners*[2007] BTC 414; [2007] UKHL 25.,[7] the reference to 'enterprise' in art. 25(5) (non-discrimination on the basis of ownership) and in similar treaties was taken, without discussion, to refer to the companies that were the subject of the alleged discrimination and not the business they undertook. A similar approach was taken in *Sun Life Assurance Co. of Canada v Pearson* by Fox LJ, who said, 'SLAC is a "Canadian enterprise" for the purposes of the treaty'[8] in relation to the attribution of profits to a UK permanent establishment. The definitions now in art. 3, which refer to activities rather than to persons, appear more suited to art. 7 questions. That said, the identification of the enterprise with a resident of a contracting state who carries it on, is central to the allocation of taxing jurisdiction.

A fair rewrite of the treaty language might be that 'business profits of a resident of one contracting state are taxable exclusively in that state in the absence of a permanent establishment in the other contracting state'. Thus, business profits may only be liable

[1] See Chapter 2, para. 10-600 on the treatment of UK-resident partners.

[2] For example, see UK-France, art. 3(1)(f); UK-Germany 2010, art. 3(1)(f).

[3] For example, see UK-US, art. 3(1)(d); UK-South Africa, art. 3(1)(d).

[4] *Ostime v Australian Mutual Provident Society* (1960) 38 TC 492; [1960] AC 459 at 517.

[5] See the discussion on the meaning of business in Chapter 7, para. 15-150.

[6] Commentary to art. 3, para. 4 and 10.2.

[7] [2007] UKHL 25; [2007] BTC 414.

[8] 59 TC 250 at p. 323. See also in relation to a partnership, *Padmore v Inland Revenue Commissioners* [1989] BTC 221; 62 TC 352; [1987] STC 36, (CA).

to tax in the other contracting state if the resident carries on business there through a permanent establishment. In such circumstances, tax in the contracting state is limited to the amount of profits attributable to the permanent establishment. However this is expressed, the breadth of the principle is made clear by the policy explained in the OECD Commentary: unless a permanent establishment exists, the enterprise is insufficiently engaged in the economy of the state to justify taxing its profits.[9]

While articulating this principle is relatively straightforward, determining the profits attributable to a permanent establishment is one of the more difficult issues in the application of tax treaties. The principles to be applied in attributing profits are set out in the remaining paragraphs of art. 7.

17-100 Which profits are 'business' profits?

The notion of 'business' has a wide meaning in UK domestic tax law but does not generally express taxing jurisdiction (other than in the context of property business,[10] which is addressed under art. 6 (income from immovable property)). 'Profits' in art. 7(1) covers all profits of an enterprise in principle, and since it applies to all profits other than those dealt with specifically in other articles, addresses all residual profits.[11] In *Sun Life Assurance Co. of Canada v Pearson*,[12] the Court of Appeal discussed the meaning of profit in art. 7 at length, concluding that in art. 7(4) of the 1980 Canadian Treaty, it referred to investment income of a non-resident life insurance company and not to its 'income less expenses'. Its meaning must therefore be understood in the context of particular circumstances.

Treaties following the colonial pattern and some other early treaties refer to 'commercial and industrial profits' in the context of permanent establishment provisions. This term may not be coextensive with 'profits' in art. 7 of the OECD Model, as noted by Vinelott J in the High Court in the *Sun Life* case.[13] The scope of the expression varies from treaty to treaty, where different sources of income are included or excluded.

The most important and common application of art. 7 in the UK context, relating to non-UK residents, is in respect of trade profits. In domestic law, a non-UK resident is chargeable to income tax:

- on profits of a trade carried on wholly in the UK; or
- in the case of a trade carried on partly in the UK and partly elsewhere, on the part of profits of the trade carried on in the UK.[14]

[9] OECD Commentary to art. 7, para. 9.

[10] CTA 2009, Pt. 4, for corporation tax and ITTOIA 2005, Pt. 3 for income tax.

[11] This corresponds with the corporation tax meaning of 'profits' in CTA 2009, s. 2(2).

[12] (1986) 59 TC 250; [1986] BTC 282; [1986] STC 335 (CA).

[13] 59 TC 250, p. 310. See also *Ostime v Australian Mutual Provident Society* 38 TC 492.

[14] ITTOIA 2005, s. 6(2).

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Taken literally, this would not allow the exemption except when the UK domestic law applies. If that is the case, the UK gives no binding commitment to maintain the exemption. An illustration of the difficulty of that approach may be seen in relation to the Hong Kong-UK Income Tax Treaty. Hong Kong has no domestic tax concept of residence. Accordingly, in relation to small companies receiving a distribution from a Hong Kong company, the residence requirement in CTA 2009, s. U31B(a), cannot be met.[76] However, Hong Kong residence is given a specific meaning for the purpose of the treaty under article 4. In the case of a company incorporated in Hong Kong or centrally managed and controlled in Hong Kong, it will be a Hong Kong resident for the purposes of the treaty. The better view is that on a purposive interpretation of this provision, the exemption is extended to dividends paid by Hong Kong companies meeting the treaty definition of residence to UK small companies.

[76] A company is a resident of a territory if under the laws of the territory of the company it is liable to tax thereon by reason of its domicile, residence or place of management but not in respect only of income from sources in that territory or capital situated therein. (CTA 2009, s. 931C(3)).

Non-discrimination

Chapter 16

24-000 Introduction

In his influential work *An International Bill of the Rights of Man*,[1] Professor Hersch Lauterpacht wrote:

> 'The claim to equality before the law is in a substantial sense the most fundamental of the rights of man.'

Lord Bingham, in endorsing this statement in *A (FC) and others (FC) v Secretary of State for the Home Department*,[2] observed that:

> 'The Universal Declaration of Human Rights 1948 affirmed, in articles 1 and 2, the general principles of equality and non-discrimination.'

It is not uncommon for domestic tax systems to treat foreigners less favourably than locals. Likewise, it is not unusual for investments made abroad to be more heavily taxed than those made at home. Treaty stipulations against such discrimination need to be seen against both the desire by states to see that their citizens or taxpayers are not treated unequally and the broader context of international legal norms outlawing discrimination that emerged following the Second World War to address abuses of state power by totalitarian and racist regimes. The importance of such stipulations cannot be underestimated. Their inclusion in tax treaties is not to address double taxation but to prevent unfair taxation.

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24-050 Tax treaty non-discrimination

The most common prohibitions against tax discrimination found in bilateral treaties appear in art. 24 of the OECD Model, which contains six distinct basic principles:

(1) Nationals of a contracting state may not be subject to any taxation or any requirement connected therewith which is more burdensome than the other contracting state imposes upon its own nationals in the same circumstances. This prohibition applies notwithstanding the fact that the persons are not residents of one or both of the contracting states.

(2) Stateless persons who are residents of one contracting state are similarly to be protected from tax discrimination.

[1] Lauterpacht, H, *An International Bill of the Rights of Man* (1945), Columbia University Press, p. 115.

[2] [2004] UKHL 56 at para. 58.

(3) A permanent establishment in a contracting state may not be taxed in a way less favourably than local enterprises of that state.

(4) Generally, deductions for expenditure made by a resident of one state to a resident of the other are deductible on the same conditions as if they had been paid to a resident of the state in which payment takes place (subject to arm's length provisions).

(5) Enterprises which are owned by the residents of one contracting state may not be subject to taxation or connected requirements which are more burdensome than similar enterprises in the other contracting state.

(6) The non-discrimination provisions apply to all taxes and are not limited to those specifically enumerated in the treaty.

These rules are at the heart of an international consensus against discrimination as it relates to tax. The extent to which the article is included in treaties, and its interpretation and application does, however, vary. Other treaty articles may also address equal treatment. The non-discrimination articles operate separately from the allocation of taxing jurisdiction and double tax relief provisions of treaties. Limitations non-discrimination articles place on taxing power are by reference to equality of treatment rather than source of income and gains. They are not a comprehensive ban on all forms of tax discrimination but a series of specific prohibitions only loosely connected and not entirely consistent with each other. In particular, there is no prohibition on discrimination against outward investment. It is only host states that are prohibited from discriminating against foreigners in certain respects. Unequal treatment provided for in the treaty itself will not give rise to discrimination prohibited by the article.[3]

24-100 Tax treaty non-discrimination and EU law

While the fundamental freedoms of EU law are essentially anti-discriminatory, they may not be identical to the tax treaty prohibitions. Lord Hoffman in *Boake Allen Ltd & Ors (including NEC Semi-Conductors Ltd) v Revenue and Customs Commissioners*[4] regarded the prohibition on discrimination implied in art. 49 of the TFEU[5] as having the purpose of preventing a restriction on the freedom of establishment. Tax treaties do not grant such freedoms but simply prohibit discrimination.[6] Nonetheless, where discrimination is found under tax treaty provisions, it is likely to give rise to a breach

[3] In *Percival v Commissioners for Her Majesty's Revenue & Customs* [2013] UKFTT 240 (TC), the First-tier Tribunal concluded that a distinction between the treatment of pensions in respect of government service and other pensions in art. 18 of the Ireland-UK Income Tax Treaty does not infringe the prohibition on discrimination on grounds of nationality in art. 23. Mr Percival would have been exempt under art. 18 of the Ireland-UK Income Tax Treaty if he was an Irish national but was not exempt because he was British.

[4] [2007] UKHL 25 at para. 20.

[5] See Chapter 3, para. 11-000.

[6] At para. 22.

of Union law as well.[7] The concept of equality is a universal notion. Simply put, like cases ought to be treated alike and different cases ought to be treated differently. In this context, the jurisprudence of the ECJ provides useful analysis of when taxpayers are in comparable circumstances, and the tax consequences that ought to flow from that despite the fact that they may apply in different circumstances. As a practical matter, the elimination of discriminatory tax rules in UK domestic law flowing from decisions of the ECJ has thereby reduced the cases in which such discrimination might otherwise applied to non-EU-based foreign taxpayers.

The standard treaty non-discrimination article is, however, a general prohibition against the specified forms of discrimination rather than being aimed at particular domestic rules. In *NEC Semi-Conductors Ltd & other test cases v Inland Revenue Commissioners*,[8] Park J emphasised the general 'precautionary' nature of non-discrimination articles:

> 'A non-discrimination article by its nature is unlikely to be directed at one or more specific provisions of a contracting state's tax legislation as respects which discrimination was already present in the minds of the negotiators. Rather it is in the nature of a general precautionary provision, meaning that if … it emerges that some provision of the tax law of one of the contracting states … is discriminatory within the terms of the article, the discrimination ought not to be permitted.'[9]

As this chapter shows, the courts in the UK have upheld a number of claims of tax discrimination against foreigners. Taxpayers have, however, failed to obtain redress for these breaches because HMRC has consistently and successfully invoked the non-incorporation of non-discrimination provisions into domestic law in defending claims of discrimination.[10] The extent to which taxpayers rights are given voice in domestic law requires careful attention. In some cases, parallel breaches of EU law by the UK may provide the only practical remedy. HMRC administrative practice does recognise the implications of non-discrimination articles in limited cases. HMRC requires all cases where discrimination is alleged by a taxpayer but is not specifically accepted by HMRC in its manuals to be referred to CT & VAT, International CT.[11] In 2008, the OECD adopted a tendentious revision of the commentary of the article[12] reflected in the public discussion draft on the 'Application and interpretation of Article 24'[13] at odds with much jurisprudence of the ECJ and that of national courts construing tax treaty non-discrimination articles. In *FCE Bank Plc v HMRC*,[14] the First-tier Tribunal rejected an argument based on passages from the OECD Commentary, which, were

[7] For example, *R v Inland Revenue Commissioners, ex parte Commerzbank AG* [1991] BTC 161; 1991 STC 271, QBD.

[8] [2004] BTC 208; [2003] EWHC 2813 (Ch).

[9] At para. 25.

[10] See Chapter 2, para. 10-250. In *Boake Allen Ltd & Ors (including NEC Semi-Conductors Ltd) v Revenue and Customs Commissioners* [2007] BTC 414; [2007] UKHL 25, two of the five law lords relied on this ground.

[11] HMRC, *Double Taxation Relief Manual*, DT1950.

[12] OECD Commentary to art. 24 (2008) revision.

[13] OECD, 3 May 2007.

[14] *FCE Bank Plc v Revenue & Customs* [2010] UKFTT 136 (TC).

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all added in the 2008 update noting decisions to the contrary of the highest courts of the Netherlands, Finland and Sweden. The OECD Commentary was ignored in the Upper Tribunal and the Court of Appeal. The cases that concern the UK's troubled former imputation system and its unanticipated cross-border implications have no doubt triggered a defensive response from the administration and much thought by judges as to their proper resolution. As with the construction of the predecessor to TIOPA 2010, s. 6[15] the extent to which the special circumstances these cases ought to inform on the matter of construction of the non-discrimination principles generally is a matter of conjecture.

24-150 Discrimination against foreign nationals and stateless persons

Discrimination against foreign nationals was claimed in *R v IRC ex parte Commerzbank AG.*[16] Under art. 20 of the UK-Germany Income Tax Treaty (adopting the OECD Model, art. 24(1), language in this respect) and reads in part:

> '20(1) The nationals of one of the Contracting States shall not be subject in the other State to any taxation or any requirement connected therewith which is other or more burdensome than the taxation or connected requirements to which nationals of that other State in the same circumstances are or may not be subjected.'

Commerzbank was incorporated and resident in Germany. It qualified as a national of Germany within the definition in art. 20(2).[17] It operated through a permanent establishment in the UK. Its claim to a repayment supplement, the statutory right to recover interest or its equivalent on the repayment of corporation tax that has been paid in excess of legal liability was refused on the basis that ICTA, s. 825, as it then read only permitted the repayment supplement to be paid to UK residents. By contrast, interest which was charged on overdue payments of tax without making such distinction.

The prohibition is on both 'taxation' which is other or more burdensome, and on 'connected requirements' which are other or more burdensome. Nolan LJ agreed that Commerzbank, like a UK national (or resident), had to pay tax on demand, but unlike a UK national, is denied the repayment supplement on proof that it has made an overpayment. It is thus subjected to a requirement connected with taxation which is more burdensome than that imposed on UK nationals. However, the comparison required by art. 20(1) was a comparison between German and UK nationals in the same circumstances. The bank as a German national must be compared with that of a company which is a UK national, that is to say, a company which derives its status

[15] See Chapter 2, para. 10-250.

[16] [1991] BTC 161; (1991) 68 TC 252.

[17] National art. 3(1)(g) means any individual possessing the nationality or citizenship of that contracting state; and any legal person, partnership or association deriving its status as such from the laws in force in a contracting state. See Chapter 6, para. 14-050. At common law the nationality of a corporation is determined by its place of incorporation: *Janson v Driefontein Consolidated Mines Ltd* [1902] AC 484 (HL), at p. 501; *Daimler Co v Continental Tyre and Rubber Co. (Great Britain) Ltd* [1916] 2 AC 307 (HL).

as a legal person from the laws in force in the UK. But the comparison was held to be meaningless, because UK tax law in general and corporation tax, in particular, does not depend upon nationality, nor upon the law from which a legal person derives his or her status: it depends upon residence. Thus, a company deriving its status from the laws of the UK, which was resident in the Federal Republic, and which traded through a branch in the UK, would be treated for tax purposes in precisely the same manner as the bank.

This reasoning may have been more appropriate prior to FA 1988, s. 66, which adopted incorporation, and thus nationality as a taxing criteria by equating UK incorporation with UK residence for companies. In *Saipem UK Limited v The Queen*[18] the taxpayer was incorporated and resident in the UK and not resident in Canada for the purposes of the Canadian domestic law and the Canada-UK Income Tax Treaty (1978). It carried on a business in Canada, through a permanent establishment. Deductions it claimed were denied on the basis that it was not a 'Canadian corporation,' that is, incorporated and resident or merely resident in Canada. It argued that the deductions should be allowed on the basis that the Canadian corporation requirement of the Act amounts to discrimination. This was held not to amount to discrimination prohibited by art. 22(1) of that treaty. Non-Canadian incorporated companies could qualify as Canadian residents under the management and control test and thus the difference in treatment was residence, rather than nationality, based. In relation to the fact that Canadian incorporated companies are deemed resident in Canada, Angers J, in the Tax Court of Canada, observed that there was an exception in relation to companies resident in another contracting state by reason of the treaty residence tiebreaker. This observation is, at least in part, misconceived in relation to the Canada-UK Income Tax Treaty (1978) where dual residence is resolved by agreement between the competent authorities. Thus in the absence of such agreement, a Canadian incorporated company that is managed and controlled in the UK remains Canadian resident. The court referred to the New Zealand Court of Appeal decision in *CIR v United Dominions Trust Ltd*[19] on art. XIX(1) of the New Zealand-UK Treaty (1966). New Zealand too had adopted incorporation as a test of residence. In that case, a UK carrying on business in England, had to pay income tax at a higher rate on the interest it received from its New Zealand subsidiary, than if it had it been a New Zealand resident, and likewise had to pay tax at a higher rate on a proportionate share of the proprietary income of its New Zealand subsidiary for which it was assessed. The court said:

> '. . . the important words in deciding the first issue are "in the same circumstances". The word "same" carries the connotation of uniformity, of exactness in comparison. The phrase does not ordinarily mean in roughly similar circumstances: it means in substantially identical circumstances in all areas except nationality.'[20]

[18] *Saipem UK Limited v The Queen* [2011] TCC 25 (CanLII); Upheld on appeal without comment by the Federal Court of Appeal, [2011] FCA 243 (CanLII).

[19] *CIR v United Dominions Trust Ltd* [1973] 2 NZLR 555.

[20] At p. 561–562.

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The difficulty in distinguishing residence from nationality, where both are based on incorporation, was recognised by McCarthy P, in the New Zealand Court of Appeal when he said:

> 'I bear in mind that these two terms, residence and nationality, and especially the latter, are treacherous words for they are somewhat artificial when applied to corporate bodies.'[21]

Ultimately, despite the analytically unsatisfying conclusion, these courts seem to have adopted, on a policy basis, the conclusion that where incorporation is adopted as a test of residence, differences in treatment are likely to be viewed as by reason of residence and therefore not discriminatory.[22]

It is a curious result, perhaps indicating the lack of coherence and connection between the various sub-articles, that if the comparator was correctly analysed in *Commerzbank*, a stateless person, as a resident of a contracting state, may enjoy better protection than nationals. Stateless persons who are residents of a contracting state shall not be subjected in either contracting state to any taxation or any requirement connected therewith, which is other or more burdensome than the taxation and connected requirements to which nationals of the state concerned in the same circumstances, in particular with respect to residence, are or may be subjected.[23] The 1951 convention relating to the status of refugees and the 1954 convention relating to the status of stateless persons both contain specific references to taxation. These are reflected in art. 24(2) of the OECD Model. 'Other taxation' means different taxation. In *Woodend Rubber v CIR*,[24] the Privy Council ruled in the context of a pre-OECD Model Treaty between the UK and Ceylon that income tax other than that to which resident companies were subjected is 'other taxation'. In the same case, the Privy Council upheld the view of the Supreme Court of Ceylon that more burdensome taxation means a higher amount of same tax. The comparison was made by looking at the amount of tax the non-resident would have paid, had it been resident.

A state cannot be considered to discriminate under these provisions if it imposes more burdensome taxation on its own nationals.[25]

[21] At p. 561.

[22] The US Federal Court of Appeals drew no distinction between residence and nationality under art. 24(1) of the US-UK Income Tax Treaty (1975) in *Unionbancal Corporation, F.k.a. Union Bank, Successor in Interest to Standard Chartered Holdings, Inc. and Includable Subsidiaries v Commissioner of Internal Revenue*, United States Court of Appeals, 9th Circuit (18 September 2002) 305 F.3d 976. There, the taxpayer, a US bank belonged to a group comprising UK and US companies. The taxpayer sold a loan portfolio at a loss to a UK member of the group and then left the group. Relief for the loss was permitted by temporary regulations only if the buyer was a US company. The court rejected the taxpayer's contention of unequal treatment in any event without exploring the issue.

[23] OECD Model, art. 24(2).

[24] [1971] AC 321 (PC).

[25] *Percival v Commissioners for Her Majesty's Revenue & Customs* [2013] UKFTT 240 (TC).

24-200 Discrimination against permanent establishments

The prohibition on discrimination against permanent establishments is aimed at business taxation. Article 23(2) of the UK-Switzerland Treaty, tracking art. 24(3) of the OECD Model, reads:

> 'The taxation on a permanent establishment which an enterprise of a Contracting State has in the other Contracting State shall not be less favourably levied in that other State than the taxation levied on enterprises of that other State carrying on the same activities.'

The purpose of this provision is to end all discrimination in the treatment of permanent establishments as compared with resident enterprises belonging to the same sector of activity. The form of a particular provision may be examined to ascertain whether it constitutes discrimination. It is also permissible to look at the results, but, a higher tax burden in a given year than that which would have fallen on the branch if it had been a UK resident enterprise, is not necessarily a breach of the principle if the domestic rules accords with the principles in art. 7.[26]

The criteria for differentiation in relation to permanent establishments, is that taxation must not be less favourably levied. In *Commerzbank*, the argument that, irrespective of nationality and residence, the bank was entitled to the repayment supplement because otherwise, taxation would be 'less favourably levied' upon its UK permanent establishment than upon a UK enterprise carrying on the same activities,[27] was rejected because the repayment supplement, although connected with the levy of taxation, does not affect the amount of that levy. This narrow view of 'taxation' and the absence of a prohibition on discrimination relating to 'connected requirements' offers a more restricted scope of protection afforded to permanent establishments than to nationals of the other contracting state.

In *UBS AG v Revenue and Customs Commissioners*,[28] a bank resident in Switzerland, carried on a banking business through a branch in London. It acted as a market maker on the London Stock Exchange, buying and selling securities in the course of a trade. In the course of its activities as a market maker it received dividends from UK-resident companies and received and paid 'manufactured dividends'.[29] The branch had substantial trading losses but a surplus of UK dividends (and manufactured dividends) received by the appellant over manufactured dividends paid. Had the appellant been a UK-resident company, the distributions would have carried with them tax credits.[30]

[26] *Sun Life Assurance Company of Canada v Pearson (HM Inspector of Taxes)* [1984] BTC 223 at p. 277. See Chapter 9 for analysis of art. 7.

[27] UK-Germany Treaty, art. 20(3).

[28] [2006] BTC 232; [2006] EWHC 117 (Ch).

[29] See ICTA 1988, s. 737 and Sch. 23A (now CTA 2010, s. 783 and 784).

[30] As then provided by ICTA 1988, s. 231.

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International Administrative Cooperation

Chapter 21

29-000 Introduction

Dramatic changes in cross-border cooperation among tax administrations and improvements in the treaty framework within which such cooperation is undertaken are the hallmark of early twenty-first century tax treaty developments. While tax treaties have long provided for exchange of information, the scope of such exchange was initially extremely limited. Even where the subject matter of information exchange permitted by treaty was expanded, actual use by tax administrations was modest. Innovations in the treaty area include agreements with non-tax or very low tax jurisdictions to obtain information,[1] agreements requiring states to render assistance in the collection of taxes and provide other cooperation including the imposition of withholding taxes not mandated by domestic law have become commonplace. Frenetic renegotiation of exchange of information provisions in existing UK treaties, conclusion of tax information exchange agreements and similar instruments have characterised UK tax treaty policy in recent years. The UK has been at the forefront of international developments in this area including the formation of the Forum on Tax Administration[2] and The Global Forum on Transparency and Exchange of Information for Tax Purposes.[3] Differing standards and requirements in overlapping international instruments, however, make this a complex developing area of tax treaty law.

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29-025 The Revenue rule

The rule that the courts of one country will not enforce the penal and revenue laws of another country has been described by Dicey[4] as well established and almost universal. Two explanations for the rule were set out by Lord Keith in *Government of India, Ministry of Finance (Revenue Division) v Taylor*.[5] One is that enforcement of a claim for taxes is an extension of sovereign power. The second is that a court will not recognise liabilities running in a foreign state, if they run counter to the 'settled public policy' of its own. A court should not pass upon the provisions for the public order of

[1] See para. 29-400.

[2] www.oecd.org/site/ctpfta/ Exchange of Information Portal accessed on 17 May 2013.

[3] http://eoi-tax.org/ accessed on 17 May 2013.

[4] Dicey and Morris on the Conflict of Laws, 13th edn, Vol 1, Collins, L. *et al.*, p. 97.

[5] *Government of India, Ministry of Finance (Revenue Division) v Taylor* [1955] AC 491.

another state. In *Revenue and Customs Commissioners v Ben Nevis (Holdings) Ltd*[6] a broad attack on the revenue rule was made by HMRC and the South African Revenue Service. They argued that the existence of agreement on assistance in collection of taxes in Art. 25A of the South Africa-UK Treaty of 4 July 2002[7] as introduced by protocol of 8 November 2010,[8] abrogates the Revenue Rule, so that it can no longer be said that there is a public policy that prevents the collection of revenue debts due to the South African Revenue Service as the competent authority for the assessment and collection of tax in South Africa. In consequence they submitted, there is now no reason why a foreign state to whom the tax is due cannot take enforcement action directly. The High Court rejected this contention, holding that the Revenue Rule remains good law in England and Wales. Public policy objection to a foreign tax authority from taking action itself remains. Thus the South African Revenue Service has no standing to bring the claim for the purpose of recovering either directly or indirectly taxes owed under the laws of South Africa.[9] Thus the inability of revenue services of foreign governments to collect or otherwise enforce foreign taxes in England or of the UK tax administration to enforce UK tax law abroad forms the context in which instruments that have been developed to permit such enforcement must be placed.[10] The ruling on the standing of the South African Revenue Service was not pursued on appeal to the Court of Appeal who only noted that the principle is subject to contrary agreement by treaty and in recent years very substantial inroads have been made into the principle by treaties.[11]

The rule may be somewhat different in relation to the provision of information. In *Re State of Norway's Applications*,[12] evidence was requested by a Norwegian tax tribunal, by way of application made by the State of Norway, supported by the taxpayer, to issue letters of request to the High Court in England. These requested the court, inter alia, to summon two named bankers to give oral evidence in London relevant to the issues in the proceedings before the Norwegian tribunal. The House of Lords ruled that jurisdiction was not affected by the rule that English courts would not entertain an action for the enforcement of a foreign revenue law. The letter of request issued by the Norwegian court did not amount to the attempted enforcement, either directly or indirectly, of Norwegian revenue laws in England but merely sought the assistance of the English court to obtain evidence to enable Norwegian revenue laws to be enforced in Norway. In coming to this conclusion the House observed that treaties allowing exchange of information provide for matters going far beyond simple requests by foreign courts for assistance in obtaining evidence in relation to pending or contemplated proceedings.

[6] *Revenue and Customs Commissioners v Ben Nevis (Holdings) Ltd* [2012] BTC 240; [2012] EWHC 1807 (Ch); [2012] STC 2157 (ChD).

[7] SI 2002/3138.

[8] SI 2011/2441.

[9] At para. 51 to 53.

[10] At para. 16.

[11] *Ben Nevis (Holdings) Ltd v Revenue & Customs* [2013] EWCA Civ 578 at para. 6.

[12] *In Re State of Norway's Applications (Nos 1 and 2)* [1989] 1 All ER 745; [1989] 2 WLR 458; [1990] 1 AC 723.

Indirect enforcement of foreign revenue laws, indicates in particular, where a foreign company in liquidation seeks to recover from one of its directors assets under his or her control and where the liquidator is appointed by a foreign tax authority only for the purpose of satisfying the foreign authority's unsatisfied claim for taxes due.[13]

The last airing of the question of enforcement of the revenue laws of one state in another in the absence of a treaty authorising such enforcement (and its implications under European law) occurred before the Court of Appeal in England at the end of the 20th century in *QRS1 Aps and Others v Frandsen*.[14] The case involved an attempt by the Danish tax authorities to collect unpaid taxes in England. The respondent (Mr Frandsen) was resident in the UK and domiciled in England within the meaning of the Brussels Convention on Jurisdiction and the Enforcement of Judgements in Civil and Commercial matters. He was therefore within the jurisdiction of the English courts. Until 1992, the respondent owned several Danish companies directly or indirectly. In November 1992, all of the assets of the companies were disposed of for cash. This cash was then used by the companies to purchase the respondent's shares. In 1994, the companies were put into liquidation on the ground that they had been engaged in asset stripping. In March 1995, the Danish tax authorities claimed corporation taxes of DKr 30 million plus DKr 10 million in interest against the companies. At that stage, the companies had no assets and their only creditor was the Danish tax authorities. The Danish tax authorities appointed a liquidator and agreed to fund an action by the companies against the respondent based on Danish law prohibiting companies from providing financial assistance for the acquisition of their own shares.

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Claims were commenced both in England and Denmark for restitution of the value of the assets which were disposed of to finance the purchase of Mr Frandsen's shares. The companies also claimed, as an alternative, damages arising out of the respondent's negligence or reckless default in allowing the companies to suffer loss as a result of the asset stripping in which he had been involved. Mr Frandsen applied to strike out the action in the English courts on the basis that it was for the enforcement of a foreign revenue law.

29-050 What are the Revenue matters?

In the High Court,[15] it was argued that although the principle on the indirect enforcement of foreign revenue laws still applied, the issue should be approached from the point of view of the Brussels Convention. In particular, art. 1 provides:

> 'This Convention shall apply in civil and commercial matters whatever the nature of the Court or tribunal. It shall not extend, in particular, to revenue, customs or administrative matters.'

[13] See *Peter Buchanan Limited v McVey* [1955] AC 516.

[14] [1999] BTC 8023; [1999] STC 616, CA.

[15] *QRS 1 Aps v Frandsen* [1999] BTC 8023; [1999] STC 616, ChD. See para. 29-025 above.

It was argued that proceedings by a liquidator to realise a company's assets are 'civil and commercial matters' for the purposes of art. 1. Furthermore, indirect enforcement of a claim at the behest of a revenue authority is not a revenue matter. There is no definition of 'revenue matters' in the convention and no decision of the ECJ as to what the words mean. Sullivan J saw no reason to restrict 'revenue matters' in the context of the convention to direct as opposed to indirect enforcement of revenue claims. It was necessary to look at the substance and not merely the form of the claim.

In the Court of Appeal,[16] Simon Brown LJ noted that the facts were in all material respects indistinguishable from those in the *Buchanan* case. In the absence of a definition in the convention or any ECJ decisions on the meaning of the term, the test was to ask what the original member states would have regarded as revenue matters for the purposes of the convention. After reviewing both foreign jurisprudence and commentary, it was held, therefore, that a claim of this kind plainly fell within the compass of revenue matters as that expression would be understood by all member states for the purposes of art. 1 of the convention.

29-100 Is the rule against enforcing foreign revenue judgments contrary to the EU Treaty?

The companies in *QRS 1 Aps and Others v Frandsen*[17] argued that the rule against indirect enforcement of revenue laws is incompatible with Community law. It was based on the assumption that the Brussels Convention does not extend to the claim (because it is a revenue matter), and therefore national rules on jurisdiction and enforcement apply. Those rules are subject to the rules of the EU Treaty, which is not altered or reduced by the Brussels Convention. The liquidator, it is argued, was seeking to provide a cross-border service protected by art. 49[18] of the treaty. That service was the recovery in England of monies owed to Danish companies for which the liquidator is remunerated by the Danish tax authorities. The rule against enforcing foreign tax judgements has the effect of restricting the liquidator's rights under art. 49. Any restriction on these rights must be objectively justified.

For the purpose of this argument, the court only addressed the question of objective justification, assuming for this purpose the correctness of the earlier aspects of the argument. The question of justification was to be determined by examining the reasoning underlying the rule against enforcing foreign tax claims. The two explanations for the rule as set out by Lord Keith in *Government of India, Ministry of Finance (Revenue Division) v Taylor*.[19] One is that enforcement of a claim for taxes is an extension of sovereign power. The second is that a court will not recognise liabilities running in a foreign state if they run counter to the 'settled public policy' of

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[16] *QRS 1 Aps v Frandsen* [1999] BTC 8023; [1999] STC 616, ChD. See para. 29-025 above.

[17] Ibid. See para. 29-025 and 29-050 above.

[18] Formerly art. 59.

[19] *Government of India, Ministry of Finance (Revenue Division) v Taylor* [1955] AC 491.

its own. A court should not pass upon the provisions for the public order of another state. It was argued by the companies that the first explanation is a justification for the exclusion of direct enforcement claims. However, in the case of indirect claims, it was agreed that there is no need to scrutinise the Danish tax law, and therefore the second explanation does not apply. These arguments were rejected by the court on the basis that once it is recognised that an indirect claim is caught by the rule, simply because in substance it is a claim brought by a nominee for a foreign state to give extra-territorial effect to that state's revenue law, both explanations apply equally to justify a bar on indirect claims as on direct claims. If the claim that this is a private law claim is rejected, there can be no better reason for allowing indirect claims than direct ones. The court had no doubt on the interpretation of the relevant Community law and therefore felt it unnecessary to make a reference to the ECJ.

Although the courts had no difficulty in dismissing the claim and, in particular, rejecting the suggestion that the long-standing rule was amended by the EC Treaty or by the Brussels Convention. Simon Brown LJ acknowledged that within the EU, there may be good arguments for disapplying the rule with regard to both direct and indirect claims, while rejecting the idea that the law currently permitted this. He noted the words of Lord Templeman in *Williams and Humbert Limited v W & H Trademarks (Jersey) Limited*,[20] in which he said:

> 'This rule with regard to revenue laws may in the future be modified by international conventions or by the laws of the European Economic Community in order to prevent fraudulent practices which damage all states and benefit no state.'

The most dramatic development in twenty-first century treaty practice has been the rapid expansion of international cooperation among tax administrations and the development of international instruments to facilitate this. The UK is at the forefront of this. Key milestones in the OECD have been the introduction of art. 27 (Assistance in the collection of taxes) in the 2003 Model Treaty, and a revised art. 26 (Exchange of information) in the 2005 Model Treaty and the OECD Model Agreement on Exchange of Information on Tax Matters. The 2005 version of art. 26 has been labelled the 'internationally agreed tax standard' and was endorsed by G20 Finance Ministers at their Berlin Meeting in 2004 to promote tax transparency. It was included in article 26 of the UN Model Treaty by the UN Committee of Experts on International Cooperation in Tax Matters at its October 2008 Meeting.

29-150 Authority for administrative cooperation

While historically, sovereign states did not cooperate with each other in the administration of taxation, an important exception over the last 60 years (at least) is in the area of exchange of information. This has been viewed as the single route whereby contracting states gave effect to the purpose stated in the heading of model treaties in relation to the prevention of tax evasion.

[20] *Williams and Humbert Limited v W & H Trademarks (Jersey) Limited* [1986] AC 368.

Exchange of information with foreign tax administrations has long been associated with UK tax treaties. The domestic authority for such exchange has undergone significant change in the first years of the twenty-first century. Historically, domestic authority to exchange information was linked to the authority to relive double taxation by treaty.[21] Until 2000, exchange of information with treaty partners was only possible within the framework of a double tax treaty generally. However, as part of the UK's participation in the OECD Programme against Harmful Tax Practices, FA 2000, s. 146(1) contemplated the conclusion of agreements between the UK and any territory with a view to the exchange of information necessary for carrying out the domestic laws of the UK concerning income tax, capital gains tax and corporation tax in respect of income and chargeable gains; and those of the other territory. This was to give effect in domestic law to tax information exchange agreements entered in to with tax havens pursuant to the OECD programme. The second legislative change was expansion of the domestic authority to disclose information to foreign tax administrations; in the relevant legislation, the terms 'necessary for carrying out' in relation to this expansion were changed to 'foreseeably relevant to the administration or enforcement of' by FA 2003, s. 198(1). Any treaty made before that date was required to be read as including this wider language, thus overriding the treaties with retrospective effect.[22]

The principal current authority to give effect to treaties that deal with all forms of administrative cooperation between HMRC and foreign tax administrations is found in FA 2006, s. 173, which reads:

> '(1) If Her Majesty by Order in Council declares that–
>
> (a) arrangements relating to international tax enforcement which are specified in the Order have been made in relation to any territory or territories outside the UK, and
>
> (b) it is expedient that those arrangements have effect,
>
> those arrangements have effect (and do so in spite of anything in any enactment or instrument).
>
> (2) For the purposes of subs. (1) arrangements relate to international tax enforcement if they relate to any or all of the following–
>
> (a) the exchange of information foreseeably relevant to the administration, enforcement or recovery of any UK tax or foreign tax;
>
> (b) the recovery of debts relating to any UK tax or foreign tax;
>
> (c) the service of documents relating to any UK tax or foreign tax.'

The authority thus now applies to all taxes or duties imposed by the UK. In the case of foreign taxes, it is restricted to tax or duty imposed under the law of the territory, or any of the territories, in relation to which the treaty has been made.[23] This authority bears some resemblance to the authority in relation to treaties for the relief of double

[21] See, for example, former ICTA 1988, s. 788(2), and TCGA 1992, s. 277(4).

[22] FA 2003, s. 198(3).

[23] See FA 2006, s. 173(3).

taxation authorised by TIOPA 2010, Pt. 2, Ch. 1.[24] It does not contain the language in TIOPA 2010, s. 6 limiting the extent of incorporation treaties relating to international tax enforcement.[25]

29-200 Exchange of information: duty of confidentiality

At common law, there appears to have been no duty of confidentiality, although there is apparently a convention that the Revenue does not supply the Treasury or other government departments with confidential information relating to individual taxpayers.

Since 2005, all taxation is under the management of the Commissioners for Revenue and Customs.[26] The Revenue and Customs officials may not disclose information which is held by the Revenue and Customs in connection with a function of the Revenue and Customs.[27] Under domestic law, Each person who is appointed as a Commissioner or officer of the Revenue and Customs must make a declaration acknowledging this obligation of confidentiality.[28] In addition, a person who discloses revenue and customs information relating to a person whose identity is specified in the disclosure, or whose identity can be deduced from it, is guilty of an offence.[29] Article 8 of the European Convention of Human Rights has the effect of imposing a duty of confidentiality. A mandatory 'Taxpayers' Charter' requires HMRC to protect taxpayers' information and to respect their privacy.[30] The duty of confidentiality is subject to any enactment permitting disclosure.[31]

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Under UK domestic law, HMRC may disclose personal information to other government departments under a variety of statutes. As will be seen in this chapter, the extent to which HMRC is able to disclose information under domestic law, impacts on the breadth of disclosure to foreign tax administrations. Statutes authorising domestic disclosure include:

- *Land Registration Act* 1925, s. 129;
- *Parliamentary Commissioner Act* 1967, s. 8;
- *Finance Act* 1972, s. 127;
- *Social Security Pensions Act* 1975, s. 59K(6);[32]

[24] Chapter 2.

[25] See Chapter 2, para. 10-250.

[26] *Commissioners For Revenue And Customs Act* 2005, s. 5.

[27] *Commissioners For Revenue And Customs Act* 2005, s. 18(1). See also FA 1989, s. 182.

[28] *Commissioners For Revenue And Customs Act* 2005, s. 3(1).

[29] *Commissioners For Revenue And Customs Act* 2005, s. 19(1).

[30] Taxpayers' Charter M09/2009 issued by HMRC on 12 November 2009 under authority of the *Commissioners for Revenue and Customs Act* 2005, s. 16A.

[31] *Commissioners For Revenue And Customs Act* 2005, s. 18(3).

[32] From 18 July 1990 by virtue of SI 1990/1446.