[2015] UKUT 0039 (TCC)

Appeal number: FTC/145/2013

INCOME TAX – UK-USA double tax agreement – whether pension income from the World Bank's retirement scheme was eligible for relief from UK income tax as income from a "pension scheme established in" the USA for the purposes of the agreement – articles 3(1)(o) and 17(1)(b) of the agreement

UPPER TRIBUNAL (TAX AND CHANCERY CHAMBER)

MICHAEL MACKLIN

Appellant

- and -

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE AND CUSTOMS

Respondents

TRIBUNAL: MR JUSTICE NEWEY

Sitting in public in London on 13 and 14 January 2015

Mr Jonathan Schwarz, instructed by Thomas Westcott, Accountants, for the Appellant

Mr David Yates, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

Introduction

1. The appellant, Mr Michael Macklin, formerly worked for the World Bank and now receives a pension from its staff retirement plan ("the SRP"). The principal question raised by this case is whether article 17(1)(b) of the UK-USA Convention for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital Gains ("the DTA") entitles Mr Macklin to claim partial exemption from the income tax that he would otherwise have to pay on his pension. Mr Macklin contends that it does, on the footing that he would enjoy such an exemption if he were resident in the United States. In a decision dated 10 October 2013 ("the Decision"), the First-tier Tribunal (Judge Walters QC and Mr Speller) ("the FTT") ruled against Mr Macklin. Mr Macklin, however, appeals against the Decision.

2. A key issue is whether the SRP is "established in" the United States within the meaning of the DTA. The FTT concluded that it is not, taking the view that, in the context of the DTA, the phrase "established in" refers to "being established under and in conformity with the relevant contracting state's tax legislation relating to pension schemes" (see paragraph 105 of the Decision). Mr Macklin, in contrast, maintains that the SRP is "established in" the United States because it was set up and has always been administered there.

Basic facts

3. The World Bank is an international organisation which enjoys privileges and immunities in both the United States (under the International Organizations Immunities Act of 1945) and the United Kingdom (under the International Organisations Act 1968). It was created at the end of the Second World War and has throughout its existence had its principal office and headquarters in Washington DC. Two thirds of its staff are based there.

4. Mr Macklin worked for the World Bank between 1976 and 1998. During this period, he lived in the United States (under what is called a "G-IV visa") and participated in, and made contributions to, the SRP.

5. The SRP came into being pursuant to a resolution that directors of the World Bank passed in Washington DC in 1948. The World Bank is the SRP's trustee, and the management and administration of the SRP is carried out at premises of the World Bank in Washington DC. Most of the SRP's assets are in the custody of the Bank of New York Mellon. The privileges and immunities that the World Bank enjoys are stated to extend to the SRP in the latter's governing document.

6. On his retirement from the World Bank, Mr Macklin returned to the United Kingdom. He has since received pension payments from the SRP.

The DTA

7. The DTA was concluded between the United Kingdom and the United States on 24 July 2001. It is given effect in the United Kingdom by the Double Taxation Relief (Taxes on Income) (The United States of America) Order 2002 (SI 2002/2848).

8. Article 17 of the DTA, on which Mr Macklin founds his case, is headed "Pensions, Social Security, Annuities, Alimony, and Child Support". The key part for present purposes is article 17(1). This reads as follows:

> "(a) Pensions and other similar remuneration beneficially owned by a resident of a Contracting State shall be taxable only in that State.
>
> (b) Notwithstanding sub-paragraph a) of this paragraph, the amount of any such pension or remuneration paid from a pension scheme established in the other Contracting State that would be exempt from taxation in that other State if the beneficial owner were a resident thereof shall be exempt from taxation in the first-mentioned State."

9. Guidance as to interpretation of the DTA is to be found in article 3. By article 3(1)(o), the term "pension scheme" (which is used in article 17(1)) means:

> "any plan, scheme, fund, trust or other arrangement established in a Contracting State which is:
>
> (i) generally exempt from income taxation in that State; and
>
> (ii) operated principally to administer or provide pension or retirement benefits or to earn income for the benefit of one or more such arrangements".

Article 3(2) states:

> "As regards the application of this Convention at any time by a Contracting State, any term not defined therein shall, unless the context otherwise requires, or the competent authorities agree on a common meaning pursuant to the provisions of Article 26 (Mutual Agreement Procedure) of this Convention, have the meaning which it has at that time under the law of that State for the purposes of the taxes to which this Convention applies, any meaning under the applicable tax laws of

that State prevailing over a meaning given to the term under other laws of that State."

10. It is also relevant to note article 18 of the DTA, headed "Pension Schemes". This includes the following:

> "(2) Where an individual who is a member or beneficiary of, or participant in, a pension scheme established in a Contracting State exercises an employment or self-employment in the other Contracting State:
>
> (a) contributions paid by or on behalf of that individual to the pension scheme during the period that he exercises an employment or self-employment in the other State shall be deductible (or excludable) in computing his taxable income in that other State; and
>
> (b) any benefits accrued under the pension scheme, or contributions made to the pension scheme by or on behalf of the individual's employer, during that period shall not be treated as part of the employee's taxable income and any such contributions shall be allowed as a deduction in computing the business profits of his employer in that other State.
>
> The reliefs available under this paragraph shall not exceed the reliefs that would be allowed by the other State to residents of that State for contributions to, or benefits accrued under, a pension scheme established in that State.
>
> (3) The provisions of paragraph 2 of this Article shall not apply unless:
>
> (a) contributions by or on behalf of the individual, or by or on behalf of the individual's employer, to the pension scheme (or to another similar pension scheme for which the first-mentioned pension scheme was substituted) were made before the individual began to exercise an employment or self-employment in the other State; and
>
> (b) the competent authority of the other State has agreed that the pension scheme generally corresponds to a pension scheme established in that other State."

The Exchange of Notes

11. On the day the DTA was concluded, notes were exchanged between the British and American Governments in connection with it ("the Exchange of Notes").

12. The Exchange of Notes included this:

> "*With reference to sub-paragraph (o) of paragraph 1 of Article 3 [of the DTA](General Definitions):*
>
> It is understood that pension schemes shall include the following and any identical or substantially similar schemes which are established pursuant to legislation introduced after the date of signature of the Convention:
>
> (a) under the law of the United Kingdom, employment-related arrangements (other than a social security scheme) approved as retirement benefit schemes for the purposes of Chapter I of Part XIV of the Income and Corporation Taxes Act 1988, and personal pension schemes approved under Chapter IV of Part XIV of that Act; and
>
> (b) under the law of the United States, qualified plans under section 401(a) of the Internal Revenue Code, individual retirement plans (including individual retirement plans that are part of a simplified employee pension plan that satisfies section 408(k), individual retirement accounts, individual retirement annuities, section 408(p) accounts, and Roth IRAs under section 408(A), section 403(a) qualified annuity plans, and section 403(b) plans."

13. The following was stated with reference to article 18(3)(b) and (5) of the DTA:

> "It is understood that the pension schemes listed with respect to a Contracting State in this exchange of notes in connection with sub-paragraph (o) of paragraph 1 of Article 3 (General Definitions) shall generally correspond to the pension schemes listed in this exchange of notes with respect to the other Contracting State."

The interpretation of double tax treaties

14. A helpful summary of the approach to be adopted when interpreting instruments such as the DTA is to be found in the judgment of Mummery J in *IRC v Commerzbank AG* [1990] STC 285. At 297-298, Mummery J explained that, in the light of the decision of the House of Lords in *Fothergill v Monarch Airlines Ltd* [1981] AC 251, the following principles apply:

"(1) It is necessary to look first for a clear meaning of the words used in the relevant article of the convention, bearing in mind that 'consideration of the purpose of an enactment is always a legitimate part of the process of interpretation': per Lord Wilberforce (at 272) and Lord Scarman (at 294). A strictly literal approach to interpretation is not appropriate in construing legislation which gives effect to or incorporates an international treaty: per Lord Fraser (at 285) and Lord Scarman (at 290). A literal interpretation may be obviously inconsistent with the purposes of the particular article or of the treaty as a whole. If the provisions of a particular article are ambiguous, it may be possible to resolve that ambiguity by giving a purposive construction to the convention looking at it as a whole by reference to its language as set out in the relevant United Kingdom legislative instrument: per Lord Diplock (at 279).

(2) The process of interpretation should take account of the fact that—

> 'The language of an international convention has not been chosen by an English parliamentary draftsman. It is neither couched in the conventional English legislative idiom nor designed to be construed exclusively by English judges. It is addressed to a much wider and more varied judicial audience than is an Act of Parliament which deals with purely domestic law. It should be interpreted, as Lord Wilberforce put it in *James Buchanan & Co. Ltd v. Babco Forwarding & Shipping* (*UK*) *Limited*, [1978] AC 141 at 152, "unconstrained by technical rules of English law, or by English legal precedent, but on broad principles of general acceptation': per Lord Diplock (at 281–282) and Lord Scarman (at 293).

(3) Among those principles is the general principle of international law, now embodied in art 31(1) of the Vienna Convention on the Law of Treaties, that 'a treaty should be interpreted in good faith and in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose'. A similar principle is expressed in slightly different terms in McNair's *The Law of Treaties* (1961) p 365, where it is stated that the task of applying or construing or interpreting a treaty is 'the duty of giving effect to the expressed intention of the parties, that is, their intention as expressed in the words used by them in the light of the surrounding circumstances'. It is also stated in that work (p 366) that references to the primary necessity of giving effect to 'the plain terms' of a treaty or construing words according to their 'general and ordinary meaning' or their 'natural signification' are to be a starting point or prima facie guide and 'cannot be allowed to obstruct the essential quest in the application of treaties, namely the search for

the real intention of the contracting parties in using the language employed by them'.

(4) If the adoption of this approach to the article leaves the meaning of the relevant provision unclear or ambiguous or leads to a result which is manifestly absurd or unreasonable recourse may be had to 'supplementary means of interpretation' including travaux préparatoires: per Lord Diplock (at 282) referring to art 32 of the Vienna Convention, which came into force after the conclusion of this double taxation convention, but codified an already existing principle of public international law. See also Lord Fraser (at 287) and Lord Scarman (at 294).

(5) Subsequent commentaries on a convention or treaty have persuasive value only, depending on the cogency of their reasoning. Similarly, decisions of foreign courts on the interpretation of a convention or treaty text depend for their authority on the reputation and status of the court in question: per Lord Diplock (at 283–284) and per Lord Scarman (at 295).

(6) Aids to the interpretation of a treaty such as travaux préparatoires, international case law and the writings of jurists are not a substitute for study of the terms of the convention. Their use is discretionary, not mandatory, depending, for example, on the relevance of such material and the weight to be attached to it: per Lord Scarman (at 294)."

15. There is mention in this passage of the Vienna Convention on the Law of Treaties. Article 31 of this, which is headed "General rule of interpretation", reads:

> "1. A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose.
>
> 2. The context for the purpose of the interpretation of a treaty shall comprise, in addition to the text, including its preamble and annexes:
>
> (a) any agreement relating to the treaty which was made between all the parties in connection with the conclusion of the treaty;
>
> (b) any instrument which was made by one or more parties in connection with the conclusion of the treaty and accepted by the other parties as an instrument related to the treaty.
>
> 3. There shall be taken into account, together with the context:

(a) any subsequent agreement between the parties regarding the interpretation of the treaty or the application of its provisions;

(b) any subsequent practice in the application of the treaty which establishes the agreement of the parties regarding its interpretation;

(c) any relevant rules of international law applicable in the relations between the parties.

4. A special meaning shall be given to a term if it is established that the parties so intended."

Article 32 is in these terms:

"Recourse may be had to supplementary means of interpretation, including the preparatory work of the treaty and the circumstances of its conclusion, in order to confirm the meaning resulting from the application of article 31, or to determine the meaning when the interpretation according to article 31:

(a) leaves the meaning ambiguous or obscure; or

(b) leads to a result which is manifestly absurd or unreasonable."

16. While a signatory to the Vienna Convention, the United States has not ratified it. However, "[t]he rules of interpretation set out in arts 31 and 32 of the Vienna Convention are rules of customary international law and therefore binding on all states regardless of whether or not they are parties to that Convention" (see *Ben Nevis (Holdings) Ltd v HMRC* [2013] EWCA Civ 578, [2013] STC 1579, at paragraph 17, per Lloyd Jones LJ).

17. The task of the Court when interpreting a treaty is to determine the "autonomous meaning" of the relevant provision (see *R v Secretary of State for the Home Department, ex p Adnan* [2001] 2 AC 477, at 515, per Lord Steyn). That principle, Lord Steyn said, is "part of the very alphabet of customary international law".

18. American Courts can, it seems, take account of a wider range of materials than their English counterparts when interpreting tax treaties. Thus, in the *Commerzbank* case Mummery J found an American decision of no real assistance "because it is clear from the report that different principles were applied by the court to the interpretation of that convention than an English court would have applied in accordance with the decision of the House of

Lords in *Fothergill v Monarch Airlines Ltd*" (see 302). Mummery J explained (at 302):

> "The [American] court was greatly influenced in its decision by the fact that the Departments of State and Treasury interpreted art XII of the Canadian Convention as not conferring the exemption claimed and had negotiated other treaties on that basis. As appears from the decision in *Fothergill v Monarch Airlines Ltd* no such principle is applied by the English courts to the provisions of a convention which had been incorporated into municipal law by primary or secondary legislation."

19. In the *Ben Nevis* case, there was an attempt to rely on expert evidence as to the interpretation of the relevant double tax treaty. When the case reached the Court of Appeal, Lloyd Jones LJ said (at paragraph 34) that the first instance judge had been "clearly correct" to reject this evidence as inadmissible. "Questions of interpretation," Lloyd Jones LJ observed, "are for the court."

20. In *UBS AG v Revenue and Customs Commissioners* [2007] EWCA Civ 119, [2007] STC 588, Arden LJ noted (at paragraph 63) that, "[w]hen interpreting a double tax convention, it is important to recall that double tax treaties are generally the subject of hard bargaining between contracting states …, and that contracting states have their own reasons for entering into such treaties".

The SRP and American tax law

21. As is indicated by its heading, section 401 of the United States Internal Revenue Code ("the IRC") identifies "qualified pension, profit-sharing, and stock bonus plans". By virtue of section 401(a), a trust will constitute such a plan (a "qualified trust") if, among other things, "created or organized in the United States and forming part of a stock bonus, pension, or profit-sharing plan of an employer for the exclusive benefit of his employees or their beneficiaries".

22. Section 501 of the IRC provides for organisations described in section 401(a) to enjoy exemption from taxation. However, for certain purposes, including those of section 402(a), "a stock bonus, pension, or profit-sharing trust which would qualify for exemption from tax under section 501(a) except for the fact that it is a trust created or organised outside the United States shall be treated as if it were a trust exempt from tax under section 501(a)": see section 402(d).

23. Section 402(a) of the IRC provides for a distribution made to an employee by an employees' trust described in section 401(a) to be taxable under section 72. Under section 72, payments to an employee are excluded from his gross income for tax purposes to the extent that they are attributable to "investment in the contract". Pension income can thus be exempt from tax in so far as it represents contributions made to the scheme

24. In 2002, the Internal Revenue Service ("the IRS") explained in a letter that it had made a "favorable determination" on the SRP. The letter explained:

> "Not having been created or organized in the United States, the trust is not a qualified trust under Code section 401(a) and is not exempt under section 501(a). Based on the information you submitted, however, we have determined that the trust is part of a plan which meets the requirements of section 401(a) in all other respects. It would have qualified for exemption under section 501(a) except for the fact that it was created or organized outside the United States. Therefore, distributions to beneficiaries will be taxable as though made through an exempt trust, as provided in section 402(e)(5). Deductions are allowable as provided in Code section 404(a)(4) for contributions made by the employer, which is a domestic corporation or resident of the United States."

The letter also stated:

> "Continued qualification of the plan under its present form will depend on its effect in operation. See section 1.401-1(b)(3) of the Income Tax regulations."

The FTT noted (in paragraph 58 of the Decision) that "[b]oth experts agreed that the favourable determination was not concessionary."

25. The FTT referred to the implications of the "favorable determination" letter in paragraph 59 of the Decision:

> "In consequence of the IRS's determination, beneficiaries of the SRP are taxed in the USA as if the pensions received from the SRP qualified for exemption from US federal income tax under IRC § 501(a) – that is, beneficiaries of the SRP do not suffer the adverse tax consequences which would otherwise flow from a determination of the IRS that the SRP was not 'created or organized in the United States' and for that reason does not itself qualify for exemption under IRC § 501(a). In addition to this measure of exemption from US federal income tax for beneficiaries of the SRP, the SRP itself is generally exempt from US federal income tax by reason of the immunities contained in art VII of the articles [of agreement relating to the World Bank]."

26. It is common ground that, in the light of the "favorable determination" letter, "benefits paid by the SRP to pensioners and other beneficiaries who are resident aliens of the USA are exempt from US federal income tax to the extent of contributions made by the World Bank as employer and by the

employee" (see paragraph 57 of the Decision). As can be seen from paragraph 57 of the Decision, it is also agreed that:

> "if, at the time he received pension benefits, Mr Macklin had been a US resident, pension benefits received from the SRP would have been exempt from US federal income tax to the extent of contributions made by him and the Bank while he was an employee".

27. With regard to the SRP's liability to tax, the FTT said this (in paragraph 56 of the Decision):

> "[A]part from its immunity, the SRP would generally be subject to US federal income tax on its income and capital gains because it is not an exempt trust under IRC § 501(a). This also is agreed by both experts, and we so find."

The issues

28. Most of the argument before me was devoted to whether the SRP was "established in" the United States within the meaning of the DTA. Mr Jonathan Schwarz, who appeared for Mr Macklin, took issue with the basis on which the FTT held that it was not. He argued that the words "established in" should be given their ordinary meaning and that, so construed, the words refer to the "geographic location where [a pension scheme] is set up, funded, managed and administered on a continuous and stable fashion through human and material resources". In contrast, Mr David Yates, who appeared for HM Revenue and Customs ("HMRC"), supported the Decision. According to Mr Yates, the word "established" means (as the FTT said) "established under and in conformity with the relevant Contracting State's tax legislation relating to pension schemes". Mr Yates further submitted that the FTT rightly considered that the SRP was not "generally exempt from income taxation" within the meaning of article 3(1)(o) of the DTA. In Mr Yates' submission, a pension scheme must enjoy exemption from taxation *as such* if it is to be regarded as "generally exempt from taxation".

29. The other issue before me relates to costs. Mr Macklin asked the FTT to make a limited costs order in his favour, but it did not do so. Mr Schwarz maintains that the FTT erred in law and that the matter should be remitted to it. On the other hand, Mr Yates' position is that the FTT's decision of costs cannot be impugned.

30. I shall take these issues in turn.

The substantive issue: construction of the DTA

The FTT's reasoning

31. As already mentioned, the FTT concluded that article 17(1)(b) of the DTA does not apply to Mr Macklin's income from the SRP. Its reasons appear from the following paragraphs of the Decision:

> "[103] As the 'essential quest in the application of treaties' is 'the search for the real intention of the contracting parties in using the language employed by them' (*Commerzbank* [1990] STC 285, 63 TC 218), it would, we consider, be strange if we were to conclude that the SRP, which we have found as a fact would not be considered, as a matter of US law, to be 'established in' the USA for the purposes of the DTA, was, as a matter of English or UK law, 'established in' the USA for those purposes.
>
> [104] We accept that our finding of fact as to the position in US law is not determinative of (although it is relevant to) the matter before us and that, pursuant to art 3(2) of the DTA we must attribute to the phrase 'established in' a state the meaning which it has (or had at the relevant time(s)) under UK law for the purposes of income tax or, failing such a meaning, the meaning which it has (or had) under general English or UK law.
>
> [105] Applying the *Commerzbank* principles of interpretation, we agree with Mr Yates that we must take account of the exchange of notes of 24 July 2001 as the best evidence of the real intention of the contracting parties in using the language employed in the definition in art 3(1)(o) of the DTA. We accept that the list of schemes intended to be included in the definition, as set out in the exchange of notes is not exclusive or exhaustive, but we agree with Mr Yates that the language and structure of the exchange of notes is very persuasive in support of his main proposition, that the contracting parties meant by the phrase 'established in' a contracting state the concept of being established under and in conformity with the relevant contracting state's tax legislation relating to pension schemes.
>
> [106] This provides a sensible and workable definition in accordance with what we discern as the purpose of the provision, which is to recognise the special categories of pension scheme to which the contracting states have chosen to give exemption from income taxation under their respective domestic laws because they are schemes operated principally to administer or provide pension or retirement benefits, etc. The exemption from income taxation in the USA which the SRP enjoys does not, we are satisfied, arise from its status as a pension scheme, but from the relevantly unconnected privileges and indemnities enjoyed by the World Bank.
>
> [107] We entirely accept Mr Schwarz's point that the SRP is an arrangement set up physically in the USA. Although it would not be a misuse of ordinary language to describe it as 'established in' the

USA, that is not the meaning which we have concluded should be attributed to the phrase 'established in' a contracting state for the purposes of arts 3(1)(o) and 17(1)(b) of the DTA as a matter of UK law.

[108] We do not accept that the SRP has a sufficient legal nexus with the USA to support the case that it is 'established in' the USA for relevant purposes. This conclusion follows from our finding above that a US court would not have jurisdiction to exercise primary supervision over the administration of the SRP by virtue of the 'safe harbor' provisions or otherwise.

[109] Comparison of the language of the DTA which we are called upon to construe with the language of another double taxation convention (that between Canada and the UK) would be a very unsure basis to reach a conclusion contrary to the one we have reached by reference to directly related materials (particularly the exchange of notes) and we reject it.

[110] We do not accept that the purpose of the exemption under art 17(1)(b) of the DTA is to provide equal treatment for pensioners resident in either contracting state with regard to the taxation of pension income. It is, as we discern it, to give exemption in both contracting states to pension income which the parties to the DTA have chosen to exempt from income taxation under their respective domestic laws because they are schemes operated principally to administer or provide pension or retirement benefits, etc.

[111] We accept Mr Yates's submissions on the DTA issue for the reasons he advanced and decide in consequence that the SRP falls outside the definition of 'pension scheme' in art 3(1)(o) of the DTA, and that Mr Macklin is not entitled to rely on art 17(1)(b) of the DTA in relation to pension income derived by him from the SRP. We dismiss his appeal on this basis accordingly."

Construing the DTA

32. As Mr Schwarz stressed, article 31 of the Vienna Convention (which, as already mentioned, embodies customary international law) provides for a treaty to be interpreted in accordance with the "ordinary meaning" of its terms, albeit "in their context and in the light of [the treaty's] object and purpose".

33. In the present case, the DTA does not, of course, state expressly that, for the purposes of the DTA, a "pension scheme" must be established "under or in conformity with the relevant contracting state's tax legislation relating to pension schemes" or be generally exempt from income taxation "as a pension scheme". Further, it seems to me that, taken in isolation, the words "established in" would ordinarily indicate "setting up", especially with a degree of permanence. That view receives support from the Oxford English

Dictionary, whose definitions of "establish" include "To set up on a secure or permanent basis; to found (a government, an institution; in mod. use often, a house of business)" and "To place in a secure or permanent position; to install and secure in a possession, office, dignity, etc.; to 'set up' (a person, oneself) in business; to settle (a person) in or at a place; *refl*. to obtain a secure footing; also in weaker sense, to take up one's quarters".

34. Had "established in" had a settled meaning under United Kingdom law for the purposes of the taxes to which the DTA applies, article 3(2) of the DTA would have been in point. Before me, however, neither counsel contended that "established in" could be said to have a meaning under the law of the United Kingdom or the United States "for the purposes of the taxes to which [the DTA] applies". As regards United States law, the FTT explained in paragraph 64 of the Decision that the experts agreed that the term "established" is "widely used in US legal enactments" but has "no uniform or technical meaning" and no "relevant definition". Article 3(2) is thus of no help.

35. I was referred during submissions to a number of cases in which the meaning of expressions including the word "established" (or a variant of it) has been considered. These included *Lord Advocate v Huron and Erie Loan and Savings Co* 1911 SC 612 (where the Court of Session had to interpret "establishes a place of business within the United Kingdom"), *The Camille and Henry Dreyfus Foundation Inc v Commissioners of Inland Revenue* (1955) 36 TC 126 (where the relevant wording was "any body of persons or trust established for charitable purposes only") and *Re Oriel Ltd* [1985] 3 All ER 216 (in which the Court of Appeal was concerned with "has an established place of business in England"). Each of these cases dealt with a specific wording and context different from that with which I am concerned, and they do not seem to me to be of significant assistance. Nor, in my view, does it help much to look at how the word "established" has been used in section 150 of the Finance Act 2004 or the IRC.

36. I was taken, too, to a provision in a double tax agreement concluded between the United Kingdom and Canada in 1980. The FTT said that comparison of the language of the DTA with that of another double tax agreement "would be a very unsure basis to reach a conclusion contrary to the one we have reached by reference to directly related materials" (see paragraph 109 of the Decision). In my view, nothing useful can be gleaned from the UK-Canada agreement, which predates the DTA by more than 20 years and most of which I have not seen.

37. It will be seen from the passage from the Decision that I have set out above that the FTT saw as relevant, though not determinative, a finding it made that the SRP would "not be considered, as a matter of US law, to be 'established in' the USA for the purposes of the DTA" (see paragraphs 103 and 104 of the Decision). The relevant finding was based on evidence given by Ms Marla J. Aspinwall, whom HMRC called to give expert evidence. To my mind,

however, Ms Aspinwall's evidence was in this respect neither relevant nor even admissible. Since a treaty provision has an "autonomous meaning", Ms Aspinwall was in effect being asked to express an opinion on the very point of interpretation that the FTT had to decide. As, however, was remarked by Lloyd Jones LJ in the *Ben Nevis* case, "Questions of interpretation are for the court" (or, here, the tribunal) (see paragraph 19 above). To my mind, this part of Ms Aspinwall's evidence was no more admissible than the expert evidence rejected in *Ben Nevis*. To make matters worse, Ms Aspinwall based her conclusions in part on a report prepared for the Senate Foreign Relations Committee in advance of the DTA's ratification. Under English law, however, such a report cannot be taken into account (compare paragraph 18 above). It is perhaps worth adding that Mr Yates accepted that *Revenue and Customs Comrs v Megantic Services Ltd* [2010] UKUT 464 (TCC), [2011] STC 1000, which the FTT mentioned in paragraph 74 of the Decision, is not in point. As Mr Yates commented, the DTA must mean the same in the tribunal as it would in a court.

38. Each counsel suggested that another part of the DTA supports his case. Mr Schwarz pointed out that article 3(1)(k) defines "qualified governmental entity" in such a way as to include "a person that is wholly owned by a Contracting State or a political subdivision or local authority of a Contracting State", provided that, among other things "*it is organised under the laws of the Contracting State*" (my emphasis). The parties to the DTA would, he suggested, have used comparable wording had they intended there to be a requirement for a "pension scheme" to be "established" "under or in conformity with the relevant contracting state's tax legislation relating to pension schemes".

39. For his part, Mr Yates relied on article 18 of the DTA, which I have set out in paragraph 10 above. Mr Yates contended that it would be unsatisfactory if a scheme such as the SRP represented a "pension scheme established in that State" within the meaning of article 18(2) and, hence, a benchmark for the purposes of deciding whether reliefs exceed those that would be allowed "by the other State to residents of that State for contributions to, or benefits accrued under, a pension scheme established in that State".

40. While there is a degree of force in both of the points mentioned in the previous two paragraphs, I do not think they provide *strong* support for either side. In particular, I think it likely that article 18 can be construed in a sensible way however "established in" is interpreted.

41. Mr Yates also queried the practicality of the interpretation of "established in" for which Mr Macklin contends. A pension scheme can in reality, he argued, amount to no more than a life insurance contract. Is it apt to talk of such a scheme being "set up physically" anywhere?

42. I doubt, however, whether there is any real substance in this point. As Mr Schwarz said, a pension scheme has to be administered *somewhere*.

43. The FTT took the purpose of article 17(1)(b) of the DTA to be "to recognise the special categories of pension scheme to which the contracting states have chosen to give exemption from income taxation under their respective domestic laws because they are schemes operated principally to administer or provide pension or retirement benefits, etc" (see paragraph 106 of the Decision, and also paragraph 110). However, it is not evident to me that it would be inconsistent with the purpose of the DTA for Mr Macklin to enjoy the exemption from tax for which he contends. Mr Yates accepted during submissions that the exemption would have applied if, say, Mr Macklin had been working in the United States for an investment bank rather than the World Bank and that, on the same figures, HMRC would have been no better off than it would be if Mr Macklin's case were accepted. It is by no means clear that the framers of the DTA would have wanted someone in Mr Macklin's position to be denied the tax benefit available to employees of commercial organisations.

44. A good deal of argument was devoted to the Exchange of Notes. It was common ground that the Exchange of Notes can be taken into account when interpreting the DTA, and (as can be seen from paragraph 12 above) it stated that, in the context of article 3(1)(o), it was "understood" that "pension scheme" would include:

> "under the law of the United Kingdom, employment-related arrangements (other than a social security scheme) approved as retirement benefit schemes for the purposes of Chapter I of Part XIV of the Income and Corporation Taxes Act 1988, and personal pension schemes approved under Chapter IV of Part XIV of that Act".

As Mr Yates emphasised, such schemes do not necessarily have to be physically set up or administered in the United Kingdom. Section 632 of the Income and Corporation Taxes Act 1988 expressly provides for personal pension schemes to be "established" by firms from the European Economic Area ("EEA"), and section 270 of the Finance Act 2004 (which, however, postdates the DTA) requires a scheme administrator of a pension scheme to be "resident in the United Kingdom *or another state which is a member State [of the European Union] or a non-member EEA State*" (emphasis added).

45. Mr Yates argued that it is to be inferred that a scheme can be "established in" the United Kingdom without being physically set up or administered there. He also cited the Exchange of Notes as an example of "established" being used in the context of legislation (since the Exchange of Notes refers to "identical or substantially similar schemes which are established pursuant to legislation introduced after the date of signature of the Convention"). Mr Schwarz, on the other hand, argued that the relevant part of the Exchange of Notes was

designed to forestall discussion. It was intended, he submitted, to make it abundantly clear that the schemes listed in the Exchange of Notes are to be treated as "pension schemes" for the purpose of the DTA regardless of whether they would be under its actual terms. Given the rival explanations, the Exchange of Notes is potentially compatible with each side's case.

46. In the end, I have concluded that neither its terms nor its context sustain the construction of the DTA for which HMRC contend and which the FTT accepted. The better view, I think, is that Mr Macklin is right and (a) "established in" refers to a pension scheme's physical location and (b) a pension scheme need not necessarily be "generally exempt from taxation" *as such*. That conclusion is consistent both with the ordinary meaning of "established in" and the fact that the DTA nowhere states that a "pension scheme" must be established "under or in conformity with the relevant contracting state's tax legislation relating to pension schemes" or generally exempt from income taxation "as a pension scheme". HMRC's construction would in effect involve importing into article 3(1)(o) the words "under or in conformity with the relevant contracting state's tax legislation relating to pension schemes" and "as a pension scheme". I do not think there is any sufficient justification for doing so.

47. In the circumstances, I shall allow Mr Macklin's appeal on the substantive issue.

The costs issue

48. Mr Macklin asked the FTT to make a costs order in his favour in respect of costs he had incurred as regards:

> "two aspects of US law … , namely:
>
> 1. Under US law, the SRP is generally exempt from income taxation in the US ….
>
> 2. Under US law, benefits paid by the SRP to pensioners and other beneficiaries who are resident aliens in the United States, are exempt from tax to the extent of contributions made by the [World Bank] as employer and by the employee …."

49. Mr Schwarz summarised the basis on which Mr Macklin contended that a costs order should be made against HMRC in these terms in his skeleton argument:

> "The conduct of [HMRC] relating to US evidence on (a) whether the SRP is generally exempt from US income tax and (b) the US income tax treatment of benefits paid to US resident pensioners … was unreasonable because (a) in the event the evidence was not disputed

(b) [HMRC] could and should have agreed at any of the stages prior to the exchange of expert reports but did not do so (c) they knew that significant costs would otherwise be incurred."

During his oral submissions, Mr Schwarz explained that the costs that Mr Macklin was seeking to recover comprised the costs, so far as attributable to the points mentioned in the previous paragraph, of the report prepared by Mr Marco Blanco, Mr Macklin's expert, together with the costs of instructing Mr Blanco on the points and of associated correspondence.

50. The FTT declined to order HMRC to pay any costs. It said the following about the subject in the Decision:

"[143] Mr Schwarz applied to us to consider making an order in respect of costs against HMRC on the basis that they had acted unreasonably in defending or conducting the proceedings (r 10(1)(b), Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009 (the Rules). It is to be noted that this appeal was allocated as a Complex case under r 23 of the Rules and Mr Macklin had made a timeous written request to the tribunal that the proceedings be excluded from potential liability for costs under r 10(1)(c).

[144] The basis on which Mr Schwarz's application was made was that HMRC had acted unreasonably in requiring extensive expert evidence of US law to be adduced in the appeal. Mr Schwarz submitted that this had been a disproportionate approach, having regard to the relatively modest amounts of tax at issue.

[145] We dismiss the application. We have regard to the overriding objective of the Rules, which require us to deal with cases fairly and justly and, in particular, to deal with cases in ways which are proportionate to the importance of the case, the complexity of the issues, the anticipated costs, and the resources of the parties (r 2(1) and (2)(a)).

[146] Although relatively modest amounts of tax are at issue in this appeal, we were informed that there were other cases where the same or similar issues were raised. Apart from this, the interpretation of the expression 'established in' a contracting state for the purposes of the DTA seems to us to be a point of general importance for HMRC, which they may reasonably require to litigate with the advantage of full expert evidence on US law. We have seen no reason to conclude that HMRC have acted unreasonably in defending or conducting these proceedings."

51. Before me, Mr Schwarz argued that the FTT had not addressed its mind to the right question. Paragraph 144 of the Decision did not, he said, accurately

describe the application that Mr Macklin had made. The matter should accordingly, it was submitted, be remitted to the FTT.

52. For his part, Mr Yates contended that the first sentence of paragraph 144 of the Decision was not an inaccurate way of characterising Mr Macklin's application for costs and that the FTT was entitled to arrive at the conclusion it did. In fact, Mr Yates suggested, the FTT could not properly have made a costs order in Mr Macklin's favour.

53. In my view, there is no good reason to think that the FTT did not have in mind the application for costs that Mr Macklin had made. I agree with Mr Yates that the first sentence of paragraph 144 of the Decision identified the relevant issue adequately, albeit briefly.

54. With regard to whether the FTT was entitled to consider that it had "seen no reason to conclude that HMRC have acted unreasonably in defending or conducting these proceedings", I was taken through the relevant history in a little detail by Mr Yates and Mr Schwarz. It is apparent from the materials to which I was referred that:

(a) By a letter dated 20 March 2012, HMRC were asked to agree relatively bald assertions as to American law;

(b) At this stage, HMRC were not represented by solicitors or counsel;

(c) On 12 April 2012, HMRC told Mr Macklin's representatives that they were unable to agree the points "at this time" but that a meeting with counsel had been arranged "with the aim of clarifying the exact points that need to be addressed to the Tribunal, including whether or not interpretation of US law is an issue";

(d) In a further letter of 17 May 2012, HMRC said:

"In simple terms, we are unable to agree your proposed facts on US law for no other reason than we simply do not understand how you see US law operating in respect of the pension scheme. This is why Mr Stuart would appreciate a further discussion with you. If he can gain an understanding on this point, he may then be in a position to agree your facts on US law or explain in detail why HMRC can not agree them";

(e) On 8 June 2012, Mr Macklin's representatives repeated their "invitation to agree" "points of law which, in our view, are incontestable";

(f) At a hearing on 26 July 2012, the FTT gave directions for HMRC to serve expert evidence by 28 September and for the questions put to HMRC's expert to relate to, among other matters, the points that

HMRC had been asked to agree. The directions also referred to HMRC informing Mr Macklin of "the consequences and results of its discussion with the IRS". As to this, Mr Yates told me that a telephone discussion with the IRS took place but nothing useful emerged from it;

(g) Ms Aspinwall's report was signed on 27 September 2012 and served on the following day;

(h) That same day, HMRC said that, in the light of Ms Aspinwall's report, it "no longer intends to pursue the argument that the SRP is not generally exempt from tax in the US";

(i) Also on 28 September 2012, Mr Macklin's representatives served the expert report they had obtained from Mr Blanco. By then, therefore, Mr Macklin will have incurred the costs that he says HMRC should be ordered to bear.

55. Taking this history in the context of the fact that "there were other cases where the same or similar issues were raised" and the wider significance to HMRC of the interpretation of "established in" (as noted by the FTT in paragraph 146 of the Decision), it seems to me that the FTT was amply entitled to take the view that HMRC had not acted unreasonably. In the circumstances, I shall dismiss Mr Macklin's challenge to the Decision in so far as it relates to costs.

Overall conclusion

56. The appeal is allowed in part. In my view, article 17(1)(b) of the DTA entitles Mr Macklin to claim partial exemption from income tax on his pension from the World Bank. In so far, however, as the appeal relates to the FTT's conclusions on costs, I shall dismiss it.

Mr Justice Newey

RELEASE DATE: 4 February 2015