[2017] UKUT 0219 (TCC)

Appeal number: UT/2016/0122

INCOME TAX – preliminary issue – section 15 ITTOIA 2005 – performance of duties of employed diver in UK waters treated as the carrying on of a trade in the UK – respondent resident in South Africa – whether income taxable as employment income under Article 14 or as business profits under Article 7 of the South Africa/UK Double Tax Treaty 2002 – interpretation of the Double Tax Treaty in accordance with the Vienna Convention on the Law of Treaties – application of Article 3(2) of the Double Tax Treaty

UPPER TRIBUNAL
TAX AND CHANCERY CHAMBER

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE AND CUSTOMS

Appellants

- and -

MARTIN FREDERICK FOWLER

Respondent

TRIBUNAL: The Honourable Mr. Justice Marcus Smith

Sitting in public at The Rolls Building, Fetter Lane, London EC4A 1NL on 18 and 19 May 2017

Akash Nawbatt, Q.C., instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Appellants
Jonathan Schwarz, instructed by Norton Rose Fulbright, for the Respondent

© CROWN COPYRIGHT 2017

DECISION

A. INTRODUCTION

1. Mr. Fowler is a qualified diver resident in South Africa. During the 2011/2012 and 2012/2013 tax years, he undertook diving engagements in the UK Continental Shelf waters.

2. Mr. Fowler is a resident of the Republic of South Africa for the purposes of the Convention between the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of the Republic of South Africa for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and on Capital Gains (the "Double Tax Treaty").

3. The Double Tax Treaty has been incorporated into English law by the Double Taxation Relief (Taxes on Income) (South Africa) Order 2002, S.I. 2002 No. 3138.

4. By closure notices issued by the Commissioners for Her Majesty's Revenue and Customs ("HMRC") in respect of the relevant tax years, HMRC sought to tax Mr. Fowler's income from his diving activities on the ground that this income was from employment within Article 14 of the Double Tax Treaty ("Income from Employment") rather than business profit within Article 7 of the Double Tax Treaty ("Business Profits").

5. It is common ground that if Mr. Fowler was self-employed in the relevant tax years, then his diving income is not taxable as he has no permanent establishment within the UK. What is not common ground is Mr. Fowler's self-employed status. Mr. Fowler contends that he was self-employed in the relevant tax years, but that is disputed by HMRC, who contend that he was an employee.

6. Section 15 of the Income Tax (Trading and Other Income) Act 2005 ("ITTOIA 2005") provides as follows:

"**Divers and diving supervisors**

(1) This section applies if –

(a) a person performs the duties of employment as a diver or diving supervisor in the United Kingdom or in any area designated by Order in Council under section 1(7) of the Continental Shelf Act 1964,

(b) the duties consist wholly or mainly of seabed diving activities, and

(c) any employment income from the employment would otherwise be chargeable to tax under Part 2 of ITEPA 2003."

Pausing there, "ITEPA 2003" is a reference to the Income Tax (Earnings and Pensions) Act 2003, and this decision adopts this abbreviation used in ITTOIA 2005. Section 15 continues:

"(2) The performance of the duties of employment is instead treated for income tax purposes as the carrying on of a trade in the United Kingdom.

(3) For the purposes of this section the following are seabed diving activities –

(a) taking part as a diver in diving operations concerned with the exploration or exploitation of the seabed, its subsoil and their natural resources, and

(b) acting as a diving supervisor in relation to any such diving operations."

7. Mr. Fowler's primary contention was that he was self-employed and so exempt from tax.

8. Mr. Fowler's alternative case was that, even if he was an employee for the relevant tax years, section 15 of ITTOIA 2005 treated the performance of the duties of his employment for income tax purposes as the carrying on of a trade in the UK. Mr Fowler contended that the effect of section 15 was to bring his income within Article 7 of the Double Tax Treaty, even if that income was otherwise from employment within Article 14.

9. The First-tier Tribunal (Tax Chamber) ("FTT") decided that the question of the effect of section 15 of ITTOIA 2005 should be determined as a preliminary issue, framed as follows:

"Whether, as a matter of law, if section 15 of [ITTOIA] applies to the diving activities of [Mr. Fowler] during the tax years 2011-12 and 2012-13, [Mr. Fowler] cannot be liable to income tax in the UK for those years in respect of his income from those activities by reason of Article 7, or alternatively Article 20, of the [Double Tax Treaty] or whether [Mr. Fowler] may be liable to income tax for those years in respect of his income from those activities by reason of Article 14 of the Treaty."

10. Although the preliminary issue referred to Article 20 of the Double Tax Treaty, it was common ground that Article 20 was not engaged in the present case. The question, therefore, was whether Mr. Fowler's income from his diving activities was governed by Article 7 or by Article 14.

11. In a decision handed down by the FTT on 9 March 2016 (the "Decision"), Judge Guy Brannan held at [121] that the preliminary issue should be decided in favour of Mr. Fowler. He held that, for the reasons given in the Decision, Mr. Fowler's income from his diving activities in the UK or UK Continental Shelf for the years in question fell within Article 7 of the Double Tax Treaty.

12. With the permission of the Judge, HMRC appeals to the Upper Tribunal. This is the determination of that appeal.

B. THE RELEVANT PROVISIONS OF THE DOUBLE TAX TREATY

13. The main provisions of the Double Tax Treaty are as follows.

14. Article 3 is entitled "General Definitions". Article 3(1) sets out a series of specific definitions and provides so far as material:

5 "(1) For the purposes of this [Double Tax Treaty], unless the context otherwise requires:

…

(d) the term "business" includes the performance of professional services and of other activities of an independent character;

10 …

(g) the term "enterprise" applies to the carrying on of any business;

(h) the terms "enterprise of a Contracting State" and "enterprise of the other Contracting State" mean respectively an enterprise carried on by a resident of a Contracting State and an enterprise carried on by a resident of the other
15 Contracting State…"

15. Article 3(2) sets out a general rule of interpretation for undefined terms:

"As regards the application of the provisions of this Convention at any time by a Contracting State, any term not defined therein shall, unless the context otherwise requires, have the meaning that it has at that time under the law of that State for the
20 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."

16. Article 7 is entitled "Business Profits" and provides so far as material:

"(1) The profits of an enterprise of a Contracting State shall be taxable only in that
25 State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein. If the enterprise carries 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."

17. Article 14 is entitled "Income from Employment" and provides so far as
30 material:

"(1) Subject to the provisions of Articles 15, 17 and 18 of this Convention, salaries, wages and other similar remuneration derived by a resident of a Contracting State in respect of an employment shall be taxable only in that State unless the employment is exercised in the other Contracting State. If the employment is so exercised, such
35 remuneration as is derived therefrom may be taxed in that other State."

C. THE GENERAL APPROACH TO INTERPRETATION

(1) The Vienna Convention

18. The Double Tax Treaty is to be interpreted in accordance with Articles 31 and 32 of the Vienna Convention on the Law of Treaties 1969 (the "Vienna Convention"): see *Anson v. Commissioners for HM Revenue and Customers* [2015] UKSC 44 at [54], but also *HMRC v. Smallwood* [2010] EWCA Civ 778.

19. Articles 31 and 32 of the Vienna Convention provide as follows:

"**Article 31. General Rule of Interpretation**

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 the 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. Supplementary Means of Interpretation

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."

(2) Case law

20. The Vienna Convention has been cited and expounded in the English courts many times. The parties placed reliance upon statements of the law in *Smallwood* and *Anson*, which both concerned (different) double tax treaties.

5 21. In *Smallwood*, Patten L.J. stated at [26]:

"The correct approach to the construction of the [treaty] it is not, I think, controversial. The Special Commissioners adopted the summary by Mummery J. (as he then was) in *Inland Revenue Commissioners v. Commerzbank* [1990] STC 285 at p.297 of the principles of interpretation laid down by the House of Lords in *Fothergill v. Monarch*
10 *Airlines* [1981] AC 251. This summary has subsequently been approved by the Court of Appeal in *Memec v. Inland Revenue Commissioners* [1998] STC 754 as a correct statement of the law. In his judgement, Mummery J. said that:

(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
15 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 considering 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
20 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).

25 (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 legislation 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
30 with purely domestic law. It should be interpreted, as Lord Wilberforce put it in *James Buchanan & Co. Ltd v. Babco Forwarding & Shipping (UK) Ltd* [1987] 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)."

35 (3) Among those principles is the general principle of international law, now embodied in article 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*
40 *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
45 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 article 32 of the Vienna Convention, which came into force after the conclusion of this double taxation convention, but codified an already existing principle of 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 the treaty such as *travaux préparatoires*, international case law and the writings of the 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)."

22. In *Anson*, the Supreme Court summarised these provisions as follows at [56] (*per* Lord Reed):

"Put shortly, the aim of interpretation of a treaty is therefore to establish, by objective and rational means, the common intention which can be ascribed to the parties. That intention is ascertained by considering the ordinary meaning of the terms of the treaty in their context and in the light of the treaty's object and purpose. Subsequent agreement as to the interpretation of the treaty, and subsequent practice which establishes agreement between the parties, are also to be taken into account, together with any relevant rules of international law which apply in the relations between the parties. Recourse may also be had to a broader range of references in order to confirm the meaning arrived at on that approach, or if that approach leaves the meaning ambiguous or obscure, or leads to a result which is manifestly absurd or unreasonable."

23. There was some suggestion that these two decisions, *Smallwood* and *Anson*, represented different approaches to the construction of treaties, with Mr. Nawbatt, Q.C., counsel for HMRC, favouring the claims of *Smallwood* and Mr. Schwarz, counsel for Mr. Fowler, submitting that the approach in *Anson* was to be preferred. I confess that I was not assisted by these submissions. It seems to me that the approach that I must follow is laid down in the Vienna Convention and that both *Smallwood* and *Anson* help me to understand that approach. I do not need to choose between them.

D. THE SCHEME OF THE DOUBLE TAX TREATY

(1) Overarching purpose

24. The purpose of a double taxation agreement between two states is to ensure that a person does not pay tax twice on the same income. Such agreements will, typically, and as the Double Tax Treaty does here, identify different classes of income and then allocate taxing rights to those classes of income as between the states party to the treaty.

25. Articles 6 to 20 of the Double Tax Treaty list various kinds of income (I use this term neutrally, to reference whatever the income may be, whether "income", "profits", "dividends", "interest", "royalties", to name but a few of the terms used in the Double Tax Treaty).

(2) Various classes of income

26. Whilst this case is concerned with two particular types of income, "business profits" in Article 7 and "income from employment" in Article 14, it is worth setting out the various classes of income captured by the Double Tax Treaty:

(1) Income from immovable property: Article 6;

(2) Business profits: Article 7;

(3) Shipping and air transport: Article 8;

(4) Associated enterprises: Article 9;

(5) Dividends: Article 10;

(6) Interest: Article 11;

(7) Royalties: Article 12;

(8) Capital gains: Article 13;

(9) Income from employment: Article 14;

(10) Directors fees: Article 15;

(11) Entertainers and sports persons: Article 16;

(12) Pensions and annuities: Article 17;

(13) Government service: Article 18;

(14) Students and apprentices: Article 19;

(15) Other income: Article 20.

27. The purpose of each of these Articles is:

(1) To define a particular class of income; and then

(2) To lay down a rule (or rules) saying which state has the right to tax that particular class of income.

Obviously, these two questions must be asked and answered in this order. It must be ascertained which is the operative Article, before determining which state has the right to tax pursuant to that particular Article.

28. It is this anterior question – the relevant applicable Article – that arises in these proceedings. The only candidates are Article 7 and Article 14. Before proceeding to a consideration of these specific Articles, two general points can be made regarding:

(1) The definition of terms; and

(2) The interrelationship between the Articles generally in the Double Tax Treaty.

(3) Definition of terms

29. In some cases, the income captured by a particular Article is defined in the Article itself. Thus, by way of example, Article 11(2) defines "interest" as "income from debt-claims of every kind, whether or not secured by mortgage and whether or not carrying a right to participate in the debtor's profits, and in particular, income from government securities and income from bonds or debentures. The term "interest" shall not include any item which is treated as a dividend under the provisions of Article 10 of this Convention".

30. In other cases, the income captured by an Article is not specifically defined in that Article. The term "employment", used in Article 14, is an example. There are, as we shall see, a number of terms in Article 7 and in Article 14 that are not specifically defined by the Double Tax Treaty.

31. It was common ground that the correct approach – following the provisions of the Vienna Convention and indeed the *schema* of the Double Tax Treaty itself – to construing the Double Tax Treaty was as follows:

(1) If a term was defined in the Treaty, then the Treaty definition was to be applied.

(2) If a term was undefined in the Treaty, the general rule of interpretation contained in Article 3(2) of the Treaty applied, "unless the context otherwise requires".

(3) Where "the context otherwise requires", the definition would be the autonomous treaty meaning determined in accordance with the rules of the Vienna Convention.

32. What was <u>not</u> common ground was the ambit of "the context otherwise requires" carve-out from Article 3(2). Mr. Schwarz contended that this term should bear the meaning expressed in *Hammonds v. Jones* [2009] EWCA Civ 1400, where the Court of Appeal (Lloyd L.J.) held that the phrase meant that a

definition could only be displaced if "necessary, rather than merely sensible or reasonable".

33. Whatever the merits of the *Hammond v. Jones* construction, I am satisfied that it states an approach that I am not bound to follow. *Hammond v. Jones* concerned the construction of a partnership deed governed by English law. Here, I am concerned with the construction of a treaty. As *Smallwood* makes clear, when construing a treaty, I am unconstrained by technical rules of English law and by English legal precedent. I construe the treaty on broad principles of general acceptation.

34. In my judgment, although the use of the term "requires" might be said to import a degree of necessity, I do not consider this to be consistent with my duty to construe the Double Tax Treaty as a whole. To my mind, it is necessary, when considering whether a definition ought to be supplied by Article 3(2), to have regard to the effect of that definition on the Double Tax Treaty as a whole. If the definition supplied by Article 3(2) results in an outcome that is either <u>not</u> sensible or <u>not</u> reasonable then I consider that it should be disapplied.

(4) Interrelationship between the Articles

35. In some cases, the interrelationship between some of the Articles is defined in the Articles themselves. The definition of "interest" in Article 11(2) is a case in point: the definition makes clear that it excludes "dividends", which fall within the scope of Article 10.

36. Another example is Article 14 itself. Article 14(1) states expressly that the Article is "[s]ubject to the provisions of Articles 15, 17 and 18". To this extent therefore Article 14 is subjugated to these other Articles.

37. In my judgment, there is no provision in the Double Tax Treaty specifically regulating the relationship between Article 7 and Article 14. That is because, as both parties submitted, there is a well-understood distinction, in both the Republic of South Africa and in the United Kingdom, between income derived from a contract of employment or service and income derived from a contract for services.

38. Given that this is a treaty between South Africa and the United Kingdom, and only between these states, I approach the construction of Articles 7 and 14 on the basis that they embody this distinction. One consequence of this is that Articles 7 and 14 must be mutually exclusive. Income can either derive from a contract <u>of</u> service or from a contract <u>for</u> services. It cannot derive from both, but must come from one or the other. If, as I find, Article 7 regulates the taxation of income from contracts for services and Article 14 regulates the taxation of income from contracts of service, then that must be right.

39. Mr. Nawbatt placed some reliance on the terms of Article 7(6), which provides that "[w]here profits include items of income or capital gains which are dealt with separately in other Articles of this Convention, then the

provisions of those Articles shall not be affected by the provisions of this Article". Obviously, Article 7(6) is a provision ordering priority of application between Article 7 and other Articles in the Double Tax Treaty. But that does not mean (as Mr. Nawbatt contended) that Article 7(6) has the effect of regulating priority between Article 7 and Article 14, and I find that it does not.

40. It follows from this that it does not matter with which Article I begin the construction process. Whichever Article I begin with, the opposite answer ought to pertain in relation to the other Article (i.e. what falls within Article 7 must fall outside Article 14 and *vice versa*). I will begin my consideration with Article 14, because that is the Article identified in the HMRC closure notices as the Article that is engaged in the case of Mr. Fowler.

E. ARTICLE 14

(1) Preliminary points

41. Article 14 refers to "salaries, wages and other similar remuneration derived…in respect of an employment". "Employment" is not defined in the Double Tax Treaty, nor for that matter are the terms "salaries", "wages" or "derived…in respect of".

42. It might be said that the entire phrase "salaries, wages and other similar remuneration derived…in respect of an employment" is undefined, both in its component elements and overall.

43. It is therefore necessary to have resort to Article 3(2) of the Double Tax Treaty, although an important question will be the extent of that resort.

44. Before considering the detail of the relevant United Kingdom law, it is necessary to make two, more general, points:

> (1) The law under Article 3(2) to which one must have reference is ambulatory. Article 3(2) does not compel reference to the law as it stood at the time the Double Tax Treaty was concluded. To the contrary, the express wording of Article 3(2) ("…at any time…the meaning that it has at that time under the law…") requires reference to the law as it stands at the time of the relevant tax assessment, here the law that pertained at the time of the two closure notices.
>
> (2) When considering the applicable United Kingdom law, the applicable tax laws prevail over any other meaning that might pertain under other laws of the United Kingdom.

(2) The relevant provisions of the Income Tax (Earnings and Pensions) Act 2003

45. Parts 2 to 7A of ITEPA 2003 impose charges to income tax on employment income: section 1(1) of ITEPA 2003. These parts of ITEPA 2003 are referred to in ITEPA 2003 as the "employment income Parts".

46. Section 4(1) of ITEPA 2003 defines "employment" as:

"In the employment income Parts "employment" includes in particular –

(a) any employment under a contract of service,

(b) any employment under a contract of apprenticeship, and

5 (c) any employment in the service of the Crown."

47. Section 4(2) makes clear that the terms "employed", "employee" and "employer" have corresponding meanings.

48. Section 4(1)(c) provides an extremely good example of the difficulty of meshing the Articles of the Double Tax Treaty with provisions of municipal
10 law:

> (1) As I have noted, Article 14 does not define the term "employment" and so – by virtue of Article 3(2) – reference must be had to municipal law, in this case the law of the United Kingdom.
>
> (2) That leads to section 4(1) of ITEPA 2003, which defines
> 15 "employment" as extending to "any employment in the service of the Crown".
>
> (3) This, however, is the province of Article 18 of the Double Tax Treaty, which applies to government service and which states in Article 18(1)(a) that "[s]alaries, wages and other similar remuneration, other than
> 20 a pension, paid by a Contracting State or a political subdivision or a local authority thereof to an individual in respect of services rendered to that State or subdivision or authority shall be taxable only in that State".
>
> (4) Of course, properly applying the Double Tax Treaty in the case of an employee in the service of the Crown, one would never get to section
> 25 4(1)(c) of ITEPA 2003. The relevant Article in the Double Tax Treaty would be Article 18 from the outset, and Article 14 (which in terms says it is "[s]ubject to the provisions of Articles 15, 17 and 18") would never have to be construed. Nevertheless, it does seem to me clear that one effect of the interplay between Article 18 and Article 14 is that Article 18 (at least
> 30 in this case) informs what would otherwise be the meaning of "employment" under Article 14.

49. Having defined "employment", ITEPA 2003 then goes on to describe the nature of the charge to tax on employment income. Section 6(1) states:

"The charge to tax on employment income under this Part is a charge to tax on –

35 (a) general earnings, and

(b) specific employment income.

The meaning of “employment income”, “general earnings” and “specific employment income” is given in section 7.”

50. Section 7 provides as follows:

“(1) This section gives the meaning for the purposes of the Tax Acts of “employment income”, “general earnings” and “specific employment income”.

(2) “Employment income” means –

(a) earnings within Chapter 1 of Part 3,

(b) any amount treated as earnings (see subsection (5)), or

(c) any amount which counts as employment income (see subsection (6)).

(3) “General earnings” means –

(a) Earnings within Chapter 1 of Part 3, or

(b) any amount treated as earnings (see subsection (5)),

excluding in each case any exempt income.

(4) “Specific employment income” means any amount which counts as employment income (see subsection (6)), excluding any exempt income.”

51. It is unnecessary to consider further the specific meanings attached by ITEPA 2003 to “employment income”, “general earnings” or “specific employment income”.

52. It is, however, necessary to refer to the provisions of section 6(5) of ITEPA 2003, which provides:

“Employment income is not charged to tax under this Part if it is within the charge to tax under Part 2 of ITTOIA 2005 (trading income) by virtue of section 15 of that Act (divers and diving supervisors).”

This, of course, is a reference to the section quoted in paragraph 6 above and which lies at the heart of the preliminary issue here being considered.

(3) Analysis

53. ITEPA 2003 draws a clear distinction between a status – namely “employment”, defined in section 4 –, the fruits derived from that status – namely “employment income”, “general earnings” and “specific employment income”, defined in section 7 – and the charge to tax on those fruits described in section 6.

54. Mr. Nawbatt contended that the distinction between what I am calling “status” and what I am calling the “fruits” derived from that status was a critical

one. It reflected the similar distinction drawn in Article 14 between "an employment" and the "salaries, wages and other similar remuneration derived…in respect of" that employment.

55. Mr. Nawbatt contended that the only definition that English law was supplying through Article 3(2) was that in relation to "an employment", and that Article 3(2) could not be used to have recourse to English law in order to define either the individual terms "salaries", "wages" or "remuneration" or the whole phrase "salaries, wages and other similar remuneration derived…in respect of an employment". The only term that needed to be defined was "an employment" and this meant that Article 3(2) only permitted recourse to the definition contained in section 4 of ITEPA 2003, and not the definitions contained in either section 7 or section 6(5).

56. This, according to Mr. Nawbatt, was the fundamental error committed by the FTT in its Decision. That error, according to Mr. Nawbatt, was best illustrated by reference to [110] of the Decision, which reads as follows:

> "The UK tax provisions which correspond to "salaries, wages and other similar remuneration derived…in respect of an employment" are plainly those (so far as relevant to this appeal) to be found in sections 1, 4, 6, 7, 9 and 62 ITEPA 2003. Section 1 charges to income tax "employment income". Section 4 defines "employment" to include "any employment under a contract of service." Section 6 explains that the charge to tax on employment income is a charge to tax on "general earnings" and "specific employment income". Section 7 defines the three terms referred to in section 6. Section 9 makes it (at least tolerably) clear that what is chargeable is "earnings from an employment". Finally, section 62 defines what is meant by "earnings", viz "any salary, wages or fee", gratuities and anything else that that "constitutes an emolument of the employment." Taken together, these provisions, in my view, correspond to "salaries, wages and other similar remuneration derived…in respect of employment" for the purposes of Article 14."

57. Mr. Schwarz contended that the FTT's Decision was correct, and that HMRC's approach to what Article 3(2) imported by way of definition was much too narrow. Mr. Schwarz contended that where Article 3(2) was engaged, it was the "meaning" that the term had under domestic law that has to be applied, and that "meaning" could involve reference to multiple and complex provisions of domestic law.

58. Mr. Schwarz cited the decision of the House of Lords in *Pirelli Cable Holding NV v. Her Majesty's Commissioners of Inland Revenue* [2006] UKHL 4 in support of this proposition, but really only as an illustration. This case concerned, as Lord Nicholls put it, the application of two double taxation conventions in circumstances not envisaged when they were made. The issue before the House of Lords was the construction of the term "tax credit", a term undefined in the conventions before the House of Lords. As here, the House of Lords had to have recourse to the English law definition of "tax credit". That took their Lordships into a chain of complex statutory provisions. Thus, Lord Scott stated at [71]:

“The Court of Appeal apparently did not accept that references to “tax credit” in Article 10 of the two double taxation agreements meant “tax credit under section 231” […] But the section 832(1) definition is essential in order to give meaning to “tax credit” in Article 10, for the term is nowhere else defined and Article 3(2) expressly imports domestic law definitions for terms not defined in the DTAs themselves. The Court of Appeal say […] that “the reference [in section 788 (3)(d)] to section 231 was necessary in order to cause the tax credit to be aggregated with the distribution in respect of which the tax credit is conferred and so to be rendered chargeable to tax under paragraph 2 of schedule F”. That is no doubt true but does not, in my opinion, justify writing the definition out of the DTAs. Article 10 in express terms hinged a Netherlands/Italian parent company’s right to a tax credit to the entitlement that a UK resident individual would have had to a tax credit if he had received the dividends that the foreign parent company had received. That being so I do not, for my part, find it at all surprising that specific provisions and domestic legislation restricting in specified circumstances the right to a tax credit should govern the availability of a tax credit under Article 10. Be that as it may, the only tax credit available, at least in this area of tax law, is a tax credit under section 231. There is no such thing as an Article 10(3)(c) tax credit that is not a “tax credit under section 231”.”

59. The precise details of the definition of the term “tax credit” in *Pirelli* do not matter: the important point is that Lord Scott considered it essential, when seeking to define “tax credit” in the tax treaty, to look to the entire statutory scheme.

60. Lord Walker said this:

“[103] I have found this issue much less easy. It is to my mind a short but very difficult point of statutory construction. The unanimous view of the very experienced judges in courts below commands great respect. But in the end I have come to the conclusion, differing most reluctantly from the courts below, that they reached the wrong conclusion because they did not give enough weight to two factors. One is that in applying the DTAs it is necessary to look, not only at their terms, but also at the language of section 788(3)(d), which uses a technical expression of domestic tax law, “qualifying distribution”. The other is that the clear scheme of the 1988 Act is that the payment of a dividend should be accompanied by a payment of ATC if a tax credit is to come into existence, and if exceptionally (because of a GIE) the payment of the dividend is not accompanied by payment of ACT, the dividend would not give rise to a tax credit, because of section 247(2). Section 247(2) does not directly affect the meaning of “tax credit”, but it does to my mind affect the meaning of “qualifying distribution”; a dividend paid under a GIE is in terms excluded from section 14(1), and section 231 is in terms made to take effect subject to section 247.

[104] These processes of exclusion and subjection are no doubt not strictly a matter of definition (although the types and purposes of statutory definitions are manifold: see Bennion, *Statutory Interpretation*, 4th ed., pp.479*ff*). But they are a fundamental element of how a tax credit under section 247 was intended to work under the imputation system. A thunderbolt from Luxembourg, in the form of the decision in *Hoechst*, has shown that under EU law the statutory scheme was flawed, and has been flawed since its inception in 1973. There is no answer which resolves all the difficulties. But in those circumstances your Lordships should in my opinion adopt a construction which best accords with the original scheme for the 1988 Act, flawed

though it is now seen to be, rather than abandoning the attempt to find any sort of purposive construction."

61. In effect, the contention advanced on behalf of Mr. Fowler was that the nexus between "employment" and "employment income" was so close that the two terms had to be read together, and together had to supply the meaning of the term "an employment" in Article 14.

62. In my judgment, the contentions of HMRC are to be preferred. I reach this conclusion for the following reasons:

(1) The first question is whether, in order to determine the scope of applicability of Article 14, I am to construe the term "an employment" or whether I need to consider other terms in addition – "salaries", "wages", "similar remuneration" – or whether I must consider the phrase "salaries, wages and other similar remuneration derived… in respect of an employment" as a whole.

(2) In my judgment, the term defining the scope of Article 14 is the term "employment" (i.e. the status) rather than the "salaries, wages and other similar remuneration derived…in respect of" it (i.e. the fruits of that status). That is for two reasons:

(a) When considering the taxing right as between the two Contracting States, it is "employment" that is determinative. If the <u>employment</u> is that of a resident of a Contracting State, it is <u>that</u> Contracting State which has the taxing right, <u>unless</u> the <u>employment</u> is exercised in the other Contracting State. The taxing right is allocated according to where the employee is resident and where the employment is exercised. The fruits of that employment play no role in delimiting the scope of Article 14.

(b) It is significant that the Double Tax Treaty uses the term "salaries, wages and other similar remuneration". The catch-all of "other similar remuneration" is obviously intended to ensure that all fruits derived from employment – subject to other provisions of the Double Tax Treaty – are captured and that it was not the intention of the drafters of the Double Tax Treaty that these terms be further defined. In other words, in my judgment, the phrase "salaries, wages and other similar remuneration" is actually defined by the Double Tax Treaty, and resort to Article 3(2) is not permitted.

(3) I should say that I would not have considered myself to be prevented from resorting to Article 3(2) by reason of its use of the word "term". Whilst it might be said that this expression limits Article 3(2) to supplying the definition of <u>individual</u> words, I do not consider that is the correct construction. A "term" may comprise several words or a phrase. Had I considered it appropriate – which for the reasons I give above I do not – I would have been prepared to use Article 3(2) to supply the definition of an entire phrase, such as "salaries, wages and other similar remuneration derived…in respect of an employment".

(4) The consequence is that I must have resort to English law only to construe the term "an employment", which means (subject to one qualification, considered below) that my inquiry begins at and ends with section 4(1) of ITEPA 2003. This is the meaning of the word "employment" under the tax laws of the United Kingdom.

(5) The one qualification is this: were it the case that – as in *Pirelli* – the meaning of section 4(1) could not properly be understood, and the section not properly construed, without reference to the definition of "employment income", etc, as defined in section 7 of ITEPA 2003, then I would not have stopped at section 4(1). However, in my judgment, this is not a *Pirelli* case. The terms "employment" (section 4) and "employment income" (section 7) are distinct in the statutory scheme, and it is certainly possible to understand the former without reference to the latter. Whether the converse is true is not a matter that arises for decision.

63. It follows that, for these reasons, HMRC's appeal ought to succeed. Section 15 of ITTOIA is not relevant to the definition of "employment" because it relates not to that definition, but to the definition of "employment income", which is irrelevant for the purpose of construing the term "an employment" in Article 14.

64. It is appropriate, however, to cross-check the soundness of this conclusion against the result that would pertain in the case of Article 7. If an inconsistent result pertained, then clearly that would be an indicator that my construction of Article 14 would have to be revisited, so that the inconsistency could be resolved.

F. ARTICLE 7

65. Article 7 refers to the "profits of an enterprise". "Enterprise", as noted in paragraph 14 above, is defined as "the carrying on of any business". The profits of an enterprise of a Contracting State are taxable "only in that State", unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein. In that eventuality, 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.

66. There are two other relevant definitions in Article 3(1):

(1) "enterprise of a Contracting State" and "enterprise of the other Contracting State" mean respectively an enterprise carried on by a resident of a Contracting State and an enterprise carried on by a resident of the other Contracting State.

(2) "business" includes (the definition is thus non-exclusive) the performance of professional services and of other activities of an independent character.

67. Both parties contended, and I find, that there is no overlap between Article 7 and Article 14. This is for the reason given in paragraphs 37 to 38 above: Article 7 relates to contracts for services and Article 14 to contracts of employment or service.

5 68. Just as in the case of Article 14, the question arises as to whether the relevant term to be construed is "enterprise" or "profits of an enterprise". As in the case of Article 14, I have no hesitation in concluding that it is the term "enterprise" that defines the scope of Article 7, and not the term "profits of an enterprise".

10 69. That is because the taxing right of a Contracting State under Article 7 turns on whether the enterprise is "an enterprise of a Contracting State", and the limited derogation from that taxing right arises in relation to "business" (which is what an enterprise carries on) in the other Contracting State through a permanent establishment.

15 70. Once again, therefore, there is a distinction drawn between the status and the fruits of the status: only the former is relevant to ascertaining the scope of Article 7.

G. OTHER MATTERS

71. During the course of submissions, I was referred to:

20 (1) The OECD Model Tax Convention on Income and on Capital dated 15 July 2014, and a number of OECD commentaries on various Articles of that (and earlier) OECD Model Tax Conventions. Whilst I accept that there are circumstances in which such material can assist on points of construction, I did not find these materials of any assistance in this case.

25 (2) The predecessor section of section 15 of ITTOIA 2005, section 314 of the Income and Corporation Taxes Act 1988. I am somewhat less persuaded that this could be relevant to any interpretative question (it is a little fanciful to suggest that the parties negotiating this Double Tax Treaty would have had regard to the terms of such a provision when negotiating 30 the terms of Articles 7 and 14), and I certainly did not find this predecessor provision of any assistance.

(3) Passages in Hansard explaining (or purporting to explain) the legislative thinking behind sections 314 of the Income and Corporation Taxes Act 1988 and section 15 of ITTOIA. Again, I found this 35 explanation, such as it was, of little assistance.

However, it is right that – for completeness' sake – I should record that I have noted and considered the arguments that were made in relation to these provisions.

72. Finally, I should say a word in relation to "deeming" provisions, which 40 assumed a greater significance in argument than they have done in this decision.

That is because I have determined that the relevant terms to be construed in Articles 7 and 14 are (respectively) “enterprise” and “employment”. For the reasons that I have given, this means that provisions such as section 15 of ITTOIA 2005 – which might be said to be a “deeming” provision – fall away as irrelevant to the constructions of Articles 7 and 14 for reasons that have nothing to do with their “deeming” nature.

73. I was not shown an example of a “deeming” provision relating to the definition of “employment” in section 4 of ITEPA 2003 and it may be that no such provision exists. I put to both counsel a hypothetical section 4(1)(d) of ITEPA 2003, which “deemed” any contract for services to be a “contract of service” under section 4(1)(a) of ITEPA 2003. Such a deeming provision would, of course, effectively abrogate – at least in English tax law – the distinction between contracts of service and contracts for services.

74. Mr. Nawbatt maintained that such a provision would be so fundamentally at variance with the scheme of Articles 7 and 14 of the Double Tax Treaty that this (hypothetical) definition of “employment” would have to be rejected for purposes of supplying a definition under Article 3(2) on the ground that the context otherwise required.

75. On the other hand, Mr. Schwarz contended that this (hypothetical) definition would supply the definition of “employment” in Article 14 through the Article 3(2) route.

76. I expressly do not decide this question, which does not arise given my findings in relation to the construction of Articles 7 and 14 of the Double Tax Treaty. However, I should say that I do not necessarily consider that more narrowly drawn “deeming” provisions (whether adding to or subtracting from the meaning of “employment” in section 4) would be incapable of supplying (through Article 3(2)) the meaning of “employment” for the purposes of Article 14, even if they deem something that is employment not to be or something that is not employment to be employment. It is simply that this case does not arise here.

H. DISPOSITION

77. For the reasons given in this decision, the appeal is allowed. I determine the preliminary issue as follows. On the assumption that Mr. Fowler was employed and not self-employed, I find that Mr. Fowler’s diving engagements in the UK Continental Shelf waters fell within Article 14 of the Double Tax Treaty.

The Honourable Mr. Justice Marcus Smith

Release Date: 30 May 2017