UT Neutral citation number: **[2022] UKUT 00258 (TCC)**

UT (Tax & Chancery) Case Number: UT/2021/000142

Upper Tribunal
(Tax and Chancery Chamber)

Hearing date: 13 July 2022
Rolls Building, London

Judgment given on: 23 September 2022

Before

THE HONOURABLE MRS JUSTICE FALK
UPPER TRIBUNAL JUDGE JENNIFER DEAN

Between

THE COMMISSIONERS FOR HIS MAJESTY'S REVENUE AND CUSTOMS

Appellants

and

AOZORA GMAC INVESTMENT LIMITED

Respondent

Representation:

For the Appellants: James Rivett KC and Barbara Belgrano, Counsel, instructed by the General Counsel and Solicitor for His Majesty's Revenue and Customs.

For the Respondent: David Ewart KC, Counsel instructed by Eversheds Sutherland (International) LLP

DECISION

Introduction

1. This is an appeal by HMRC against a decision of the First-Tier Tribunal ("FTT") released on 12 April 2021 (the "Decision").

2. By the Decision, the FTT allowed the appeals of the Respondent ("Aozora") against closure notices issued by HMRC following enquiries into Aozora's accounting periods ending 31 March 2007, 31 March 2008 and 31 March 2009.

3. The effect of each closure notice was to deny Aozora the unilateral double tax credit relief that would otherwise have been available to it under section 790 of the Income and Corporation Taxes Act 1988 ("ICTA") on its US source interest income. HMRC's view was that relief was not available as a result of the application of section 793A(3) of ICTA to Article 23 of the Double Tax Convention concluded between the US and the UK on 24 July 2001 (the "Tax Treaty"). The consequence was that Aozora was not able to set off the US tax which had been charged on the interest and withheld from the interest payments against its liability to UK corporation tax on that interest. The FTT concluded that section 793A(3) did not apply to deny relief under section 790.

4. The appellants appeal with the permission of the FTT. Unless otherwise specified, references in this judgment to numbers in square brackets are to paragraphs of the Decision, references to sections are to sections of ICTA, and references to Articles are to Articles of the Tax Treaty.

Double taxation relief in outline

5. In brief outline, at the relevant time Part XVIII of ICTA governed double taxation relief in respect of tax on income and chargeable gains. Chapter I of Part XVIII contained the "Principal reliefs". Within that Chapter, section 788 provided for relief to be made available in accordance with the terms of double taxation arrangements agreed with other territories, and section 790 provided for relief to be granted by the UK unilaterally under its domestic law (so-called unilateral relief). Chapter II of Part XVIII was entitled "Rules governing relief by way of credit", and contained provisions which included section 793A.

6. Double taxation arrangements agreed with other territories are not straightforwardly incorporated into domestic law. As explained by Lord Hoffmann in *NEC Semi-Conductors Ltd & other test claimants v Inland Revenue Commissioners* [2007] UKHL 25; [2007] STC 1265 at [8]:

> "… An international treaty does not give rise to any rights in English domestic law unless incorporated by legislation. The EC Treaty is so incorporated, in its entirety, by the European Communities Act 1972. But with DTCs[1] the position is more complicated. Section 788 of the 1988 Act provides that Her Majesty may by order in council declare that arrangements made by a DTC shall 'have effect'. But the result is not to make the whole DTC part of English law. By s788(3) the arrangements shall have effect 'notwithstanding anything in any enactment' –
>
> 'in relation to income tax or corporation tax in so far as they provide –
> (a) for relief from income tax, or from corporation tax in respect of income or chargeable gains; or (b) for charging the income arising from sources, or chargeable gains accruing on the disposal of assets, in the United Kingdom to persons not resident in the United Kingdom; or…(d) for conferring on persons not resident in the United Kingdom the

[1] Double taxation conventions.

right to a tax credit under section 231 in respect of qualifying distributions made to them by companies which are so resident.'"

7. Both sections 788 and 790 allowed for relief to be given by way of credit against UK tax on the relevant income or gain. Where credit was not available for foreign tax either under a double tax treaty or unilaterally, section 811 provided for that tax to be treated as a deduction, reducing the amount of the income or gain for UK tax purposes by the amount of the tax paid.

8. However, a deduction under section 811 is much less beneficial than a tax credit. For example, at a 30% UK tax rate, credit in respect of foreign tax levied at 20% on £100 of income would reduce the UK tax chargeable to (30%-20%) x 100 = £10, whereas a deduction under section 811 would reduce the UK tax to 30% x (100-20) = £24. As the FTT noted at [17], the closure notices issued to Aozora calculated the tax due on the basis that section 811 applied.

Relevant provisions of the Tax Treaty and statutory provisions

9. The Articles of the Tax Treaty of most relevance to this appeal are as follows:

Article 1 relevantly provides:

"1. Except as specifically provided herein, this Convention is applicable only to persons who are residents of one or both of the Contracting States.
2. This Convention shall not restrict in any manner any benefit now or hereafter accorded:
(a) by the laws of either Contracting State; or
(b) by any other agreement between the Contracting States.
…"

Article 11(1) states:

"Interest arising in a Contracting State and beneficially owned by a resident of the other Contracting State shall be taxable only in that other State."

Article 23(1) provides:

"**Limitation on benefits**
Except as otherwise provided in this Article, a resident of a Contracting State that derives income, profits or gains from the other Contracting State shall be entitled to all the benefits of this Convention otherwise accorded to residents of a Contracting State only if such resident is a "qualified person" as defined in paragraph 2 of this Article and satisfies any other specified conditions for the obtaining of such benefits."

The text of Article 23 is set out in more detail in the Appendix.

10. Article 24 provides for double tax relief by way of credit. Articles 24(1)-(3) deal with relief required to be granted by the US under the terms of the Tax Treaty, and Articles 24(4)-(6) address relief required to be granted by the UK. Article 24(4) is set out in the Appendix. Of particular relevance are Articles 24(4)(c) and (d). HMRC also relied on Article 4(5), which is similarly set out in the Appendix.

11. At material times, section 790 relevantly provided as follows:

“**790 – Unilateral relief**
(1) To the extent appearing from the following provisions of this section, relief from income tax and corporation tax in respect of income and chargeable gains shall be given in respect of tax payable under the law of any territory outside the United Kingdom by allowing tax as a credit against income tax or corporation tax, notwithstanding that there are not for the time being in force any arrangements under section 788 providing for such relief.

(2) Relief under sub-section (1) above is referred to in this Part as ‘unilateral relief’.

(3) Unilateral relief shall be such relief as would fall to be given under Chapter II of this Part if arrangements in relation to the territory in question containing the provisions specified in sub-sections (4) to (10C) below were in force by virtue of section 788, but subject to any provision made with respect to unilateral relief in that Chapter; and any expression in that Chapter which imports a reference to relief under arrangements for the time being having effect by virtue of that section shall be deemed to import also a reference to unilateral relief.

(4) Credit for tax paid under the law of the territory outside the United Kingdom and computed by reference to income arising or any chargeable gain accruing in that territory shall be allowed against any United Kingdom income tax or corporation tax computed by reference to that income or gain…

…”

12. Section 793A was inserted into ICTA by paragraph 5 of Schedule 30 to the Finance Act 2000. At the relevant times section 793A provided as follows:

“**793A – No double relief etc.**
(1) Where relief in respect of an amount of tax that would otherwise be payable under the law of a territory outside the United Kingdom may be allowed—
(a) under arrangements made in relation to that territory, or
(b) under the law of that territory in consequence of any such arrangements,
credit may not be allowed in respect of that tax, whether the relief has been used or not.

(2) Where, under arrangements having effect by virtue of section 788, credit may be allowed in respect of an amount of tax, credit by way of unilateral relief may not be allowed in respect of that tax.

(3) Where arrangements made in relation to a territory outside the United Kingdom contain express provision to the effect that relief by way of credit shall not be given under the arrangements in cases or circumstances specified or described in the arrangements, then neither shall credit by way of unilateral relief be allowed in those cases or circumstances.”

13. Paragraph 5(3) of Schedule 30 provided that section 793A(3) has effect in relation to arrangements made on or after 21 March 2000. Since the Tax Treaty was made on 24 July 2001 it falls within its scope.

The Decision of the FTT

14. The sole issue before the FTT was whether Aozora was prevented from claiming relief under section 790 by virtue of section 793A(3).

Findings of fact

15. There was no dispute in relation to the underlying facts. The following summary is taken from the FTT's Decision at [7]-[20]:

> (a) Aozora was incorporated in England and Wales as a limited company and is resident for tax purposes in the United Kingdom.
>
> (b) At all material times, Aozora is and was a wholly owned subsidiary of Aozora Bank Limited, a Japanese entity.
>
> (c) Aozora has two subsidiaries in the US, one of which is Aozora Investments, Inc ("Aozora US"). Aozora US has at all material times been resident for tax purposes in the US.
>
> (d) By an agreement dated 28 November 2006, Aozora US borrowed $217,770,000 from Aozora. Interest was receivable at a fixed rate of 12% per annum.
>
> (e) During the accounting periods ended 31 March 2007, 31 March 2008 and 31 March 2009, interest income of $8,710,800, $26,132,400, and $8,289,310 respectively accrued to Aozora on the loan to Aozora US. Aozora US withheld US tax from each payment, amounting to $2,613,240, $7,839,720, and $2,486,793 in US tax for the accounting periods ending 31 March 2007, 31 March 2008, and 31 March 2009 respectively.
>
> (f) By an application dated 27 March 2008 (filed on 18 April 2008) Aozora applied to the US revenue authorities (the "IRS") for access to the benefits of the Tax Treaty.
>
> (g) In a letter dated 26 October 2010, the IRS notified Aozora that it was unable to accept Aozora's request for access to the benefits of the Tax Treaty. The refusal was on the grounds that Aozora was not a "qualified person" within Article 23 of the Tax Treaty (limitation on benefits). Aozora applied to the US competent authority for discretionary treatment under Article 23(6). This was refused.
>
> (h) Aozora submitted its UK corporation tax returns for the accounting periods ending 31 March 2007, 31 March 2008 and 31 March 2009 including claims for unilateral relief by way of credit under section 790 against the UK tax due on the interest. Taking into account these unilateral credit relief claims, the corporation tax liability of the company for each of periods was self-assessed as £nil.
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> (i) Closure notices were issued by HMRC on 20 May 2016 on the basis that the effect of section 793A(3) was to prevent Aozora from obtaining unilateral relief under section 790 and Chapter II of Part XVIII ICTA. The associated amendments to Aozora's corporation tax returns gave rise to assessments to corporation tax of £900,497.40, £2,640,377.40, and £922,622.40 for the accounting periods ended 31 March 2007, 31 March 2008, and 31 March 2009 respectively.
>
> (j) On 17 November 2016, Aozora submitted a Notice of Appeal to the FTT challenging the HMRC's amendments to its corporation tax returns.

16. The FTT noted that the interest arose in the US and was beneficially owned by Aozora, a resident of the UK. By virtue of Article 11(1) the interest could only be taxed in the UK and either no US tax is withheld from interest payments, or any tax that has been withheld will be refunded. Article 24 provides for the availability of treaty tax credits. However, the benefits under Article 11 and 24 are subject to the limitation on benefits provisions found in Article 23.

17. As recorded by the FTT (at [25]-[29]) Aozora was not a qualified person, and it did not satisfy the alternative conditions in Article 23(3) and (4). Article 23(5) was also not applicable. The competent authority further refused Aozora discretionary treatment under Article 23(6). Consequently, as Aozora was denied the benefits of the Tax Treaty by Article 23, Aozora US had to withhold US tax from payments of interest. Aozora was not entitled to a refund of the US tax, nor was it entitled to claim a credit under Article 24 against its UK tax liability.

18. It is worth clarifying that the effect of the IRS's action was to deny Aozora the benefit of the exemption under Article 11, an exemption that would otherwise have resulted in no withholding tax being levied, and/or any tax previously withheld being refunded. If that exemption had been available then no claim for a UK tax credit would have been required, or indeed available either under the Tax Treaty or unilaterally (see section 793A(1)).

The FTT's interpretation of the relevant provisions

19. The FTT's Decision turned on the inclusion of the adjective "express" in section 793A(3), stating at [82]:

> "I find that the key to unlocking the construction of s793A(3) is the use of the adjective 'express' to qualify 'provision'."

20. The FTT noted that "express" must be construed in accordance with its normal English meaning. Relying on the Oxford English Dictionary definition, the FTT considered (at [83]) that the meaning "is in the sense of definitely formulated, definite, explicit, specifically designated, or specially intended", and at [84] concluded:

> "I therefore find that in order for s793A(3) to have effect in relation to the exclusion of credit relief, the terms of the relevant double tax arrangement must be explicit as to the cases and circumstances in which the credit relief is not available."

21. The FTT found (at [85]) that the Tax Treaty does not explicitly set out the cases and circumstances in which relief is not available, and Article 23 is not "an express provision to the effect that relief by way of credit shall not be given".

22. At [86], the FTT rejected HMRC's submission that the obvious purpose of section 793A(3) is to ensure that the reciprocal provisions agreed between the parties to a double tax arrangement are respected in domestic law, so that the "balance" between the parties is not upset, noting (with reference to Article 1(2)) that "double tax arrangements are not executed with a view to determining how the UK will tax its own residents", and going on to say:

> "As the Tax Treaty itself contemplates the possibility that a taxpayer may have a lower burden of taxation under domestic law than under the Tax Treaty, I find that there cannot have ever been an intention to ensure that UK domestic law reflects the "balance" in the Tax Treaty."

23. The FTT went on at [88] to disagree with HMRC that the drafting of Article 4(5) was inconsistent with Aozora's construction, and at [89] and [90] to agree with Mr Ewart's submissions on behalf of Aozora about Article 24(4)(c) and (d), also stating at [94] that it was not persuaded by Mr Rivett's explanation (for HMRC) of why Article 23 was not carved out from Article 1(2) in the same way as Article 24(4)(c). However, the FTT also noted at [91] and [92] that it would be wrong to consider that section 793A(3) was designed (solely) to give effect to Article 24. Rather, it was an enabling provision which allowed Article 24(4)(c) to be included in the Tax Treaty, and other express provisions in other treaties, and have effect in UK domestic law. At [93] the FTT expressed the view that the Explanatory Notes for Schedule 30 Finance Act 2000 were consistent with its approach.

24. At [95], the FTT stated, with reference to *R (oao Aozora GMAC) v HMRC* [2019] EWCA Civ 1643, that it was not persuaded that the funding of Aozora US through the UK rather than directly from Japan was not tax motivated. At [96] and [97] it also disagreed with Aozora's submission that HMRC's interpretation was inherently illogical, but agreed that section 793A(3) is not a broad anti-treaty abuse provision. After referring to other arguments that it did not find of assistance, the FTT determined that the appeal should be allowed.

The grounds of appeal

25. Permission to appeal was granted on the ground that this appeal raises an important point of principle of general importance that has not previously been considered by the courts.

26. As was the case before the FTT, the sole issue in this appeal is whether section 793A(3) applies to deny Aozora's claims to unilateral relief. Determination of that issue turns on whether section 793A(3) prevents Aozora from claiming credit relief in respect of the interest payments on the basis that Article 23 is an "express provision to the effect that relief by way of credit shall not be given under the arrangements in cases or circumstances specified or described in the arrangements".

27. In their grounds of appeal, HMRC maintain that the FTT wrongly gave section 793A(3) a narrow, literal construction when it should have applied a purposive construction. The FTT focused on the dictionary definition of "express" and failed to give sufficient weight to the words "to the effect that". The correct focus is on the effect or consequence of the relevant provision, bearing in mind that the statutory wording is of general application and must be capable of applying to differently worded treaties. The effect of Article 23 is that credit relief is not available under the Tax Treaty. The FTT erred in law by focusing on the mechanism by which credit relief is denied, whereas section 793A(3) is concerned with the effect rather than with the precise mechanism by which that effect is achieved. Article 23 describes the only circumstances in which credit relief is to be given, and is therefore the requisite "express" provision.

28. HMRC say, as they did before the FTT, that their analysis is supported by Article 4(5). That provision denies treaty benefits to certain dual residents in respect of whom the Contracting States cannot reach agreement about the application of the Tax Treaty, but credit relief under Article 24(4) is specifically carved out from that denial. HMRC say that this carve out was required to ensure that neither unilateral relief nor credit relief under the Tax Treaty were denied.

29. HMRC also maintain that the FTT wrongly rejected HMRC's submission that the purpose of section 793A(3) is to ensure that the balance struck between the Contracting States is respected under domestic law. Section 793A(3) is intended to ensure that there is a single route to claiming credit relief where such relief falls within the scope of the relevant treaty, so that restrictions in treaties are not circumvented.

30. Aozora had argued in the alternative that Article 1(2) of the Tax Treaty prevents Article 23 from having the effect of denying unilateral relief (see [63]-[67]). Article 24(4)(d) disapplies Article 1(2) in relation to Article 24(4)(c), but as the FTT noted at [94] there is no similar carve out in respect of Article 23.

31. On this point, HMRC say that the FTT erred in rejecting their argument that Article 24(4)(d) is simply a "belt and braces" measure in relation to Article 24(4)(c) and instead concluding that Article 24(4)(c), but not Article 23, was the sort of "express" provision to which section 793A applies. HMRC maintain that Article 1(2) of the Tax Treaty is not engaged in the present case because it is the UK domestic provision in section 793A(3) that restricts the availability of unilateral relief.

Discussion and Decision

Authorities and principles

32. Both parties agreed that the most relevant authority in relation to statutory construction was the following passage from the judgment of Lord Hodge in *R (Project for the Registration of Children as British Citizens) v Secretary of State for the Home Department* [2022] 2 WLR 343 ("*R (PRCBC) v Home Secretary*") (at [29]-[31]):

> "29. The courts in conducting statutory interpretation are 'seeking the meaning of the words which Parliament used': *Black-Clawson International Ltd v Papierwerke Waldhof-Aschaffenburg AG* [1975] AC 591, 613 per Lord Reid. More recently, Lord Nicholls of Birkenhead stated: 'Statutory interpretation is an exercise which requires the court to identify the meaning borne by the words in question in the particular context.' (*R v Secretary of State for the Environment, Transport and the Regions, Ex p Spath Holme Ltd* [2001] AC 349, 396.) Words and passages in a statute derive their meaning from their context. A phrase or passage must be read in the context of the section as a whole and in the wider context of a relevant group of sections. Other provisions in a statute and the statute as a whole may provide the relevant context. They are the words which Parliament has chosen to enact as an expression of the purpose of the legislation and are therefore the primary source by which meaning is ascertained. There is an important constitutional reason for having regard primarily to the statutory context as Lord Nicholls explained in *Spath Holme*, p 397: 'Citizens, with the assistance of their advisers, are intended to be able to understand parliamentary enactments, so that they can regulate their conduct accordingly. They should be able to rely upon what they read in an Act of Parliament.'
>
> 30. External aids to interpretation therefore must play a secondary role. Explanatory Notes, prepared under the authority of Parliament, may cast light on the meaning of particular statutory provisions. Other sources, such as Law Commission reports, reports of Royal Commissions and advisory committees, and Government White Papers may disclose the background to a statute and assist the court to identify not only the mischief which it addresses but also the purpose of the legislation, thereby assisting a purposive interpretation of a particular statutory provision. The context disclosed by such materials is relevant to assist the court to ascertain the meaning of the statute, whether or not there is ambiguity and uncertainty, and indeed may reveal ambiguity or uncertainty: *Bennion, Bailey and Norbury on Statutory Interpretation*, 8th ed (2020), para 11.2. But none of these external aids displace the meanings conveyed by the words of a statute that, after consideration of that context, are clear and unambiguous and which do not produce absurdity…
>
> 31. Statutory interpretation involves an objective assessment of the meaning which a reasonable legislature as a body would be seeking to convey in using the statutory words which are being considered. Lord Nicholls, again in *Spath Holme* [2001] 2 AC 349, 396, in an important passage stated:

> 'The task of the court is often said to be to ascertain the intention of Parliament expressed in the language under consideration. This is correct and may be helpful, so long as it is remembered that the 'intention of Parliament' is an objective concept, not subjective. The phrase is a shorthand reference to the intention which the court reasonably imputes to Parliament in respect of the language used. It is not the subjective intention of the minister or other persons who promoted the legislation. Nor is it the subjective intention of the draftsman, or of individual members or even of a majority of individual members of either House . . . Thus, when courts say that such-and-such a meaning 'cannot be what Parliament intended', they are saying only that the words under consideration cannot reasonably be taken as used by Parliament with that meaning.'"

33. An objective approach is therefore required, in which the meaning of the words used is determined in their statutory context. Explanatory Notes may cast light on that meaning and other external aids may assist in identifying the mischief addressed and the purpose of the legislation, but all such external aids play a secondary role and they will not displace a clear and unambiguous meaning which does not produce absurdity. Rather, the words used are the "primary source" by which meaning is ascertained.

34. It is also well established that the modern approach to the interpretation of legislation involves applying a purposive construction to the statute: see *Hurstwood Properties (A) Ltd and others (Respondents) v Rossendale Borough Council and another (Appellants)* [2021] 2 WLR 1125 at [9] to [16]. However, that does not detract from the need to interpret the words used.

35. The correct approach to interpretation of an international treaty was summarised by Lord Reed in *HMRC v Anson* [2015] UKSC 44; [2015] STC 1777 at [110] and [111]:

> "110. Article 31(1) of the Vienna Convention requires a treaty to be interpreted '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'. It is accordingly the ordinary (contextual) meaning which is relevant. As Robert Walker J observed at first instance in *Memec* [1996] STC 1336 at 1349, 71 TC 77 at 93, a treaty should be construed in a manner which is 'international, not exclusively English'.
>
> 111. That approach reflects the fact that a treaty is a text agreed upon by negotiation between the contracting governments..."

Interpretation of the relevant provisions

36. Aozora is not a "qualified person" for the purposes of the Tax Treaty and it did not satisfy the conditions in Article 23(3) or 23(4). The application for discretionary treatment under Article 23(6) was refused, and consequently Aozora could not obtain the treaty benefits of relief from withholding tax under Article 11.

37. Applying the principles summarised by Lord Hodge in *R (PRCBC) v Home Secretary*, the meaning of section 793A(3) has to be discerned primarily from its wording, being the words chosen to express the purpose of the legislation, in their statutory context. As a general proposition, the purpose of section 793A(3) is to prevent a claim to unilateral relief where a certain type of provision is included in double taxation arrangements. It does not, for example, prevent a claim for unilateral relief simply because there is a treaty in force between the relevant States which addresses double tax relief.

38. The interpretation of section 793A(3) cannot be directly informed by specific treaty provisions, in particular provisions agreed after enactment of the statute. Further, as explained in *R (PRCBC) v Home Secretary*, the external aids to which we were referred, although to some extent helpful in adding background and context, must have a secondary role. Adopting the purposive approach described in *Hurstwood*, we must identify the type of treaty provisions that section 793A(3) is intended to catch and assess whether Article 23 falls within that scope.

39. Section 793A(3) requires an "express provision to the effect that relief by way of credit shall not be given". In contrast, we note that Article 23 does not expressly set out the circumstances in which credit relief is not available, but rather it sets out the cases or circumstances in which the benefits of the Convention are available.

40. We consider that HMRC's interpretation puts disproportionate weight on the word "effect". The entire subsection must be construed in its wider context. In our view, there is no justification to stress one part of the subsection to the exclusion of the rest. HMRC's approach appears to accord no weight to the word "express", to the reference to "relief by way of credit", to the use of the negative (credit shall "not" be given) or to the fact that the provision in question must apply "in cases or circumstances specified or described in the arrangements". In our view, HMRC's interpretation also has the effect of treating "to the effect that" as equating to "which has the effect that" (or has the consequence that), which is not the wording that Parliament chose to employ.

41. We consider that a more natural interpretation of the words "… to the effect that relief by way of credit shall not be given…", particularly in the context of the prior reference to an "express" provision, is that section 793A(3) is intended to catch provisions in a treaty which state, in terms, that credit relief shall not be given, or which contain other wording that conveys the same message, even if the text used does not precisely correspond to the words in section 793A(3). That gives a natural meaning to each of the words used.

42. On that basis Article 23 does not fit the statutory description. It does not expressly refer to credits at all. Further, it is not written in terms of a denial of treaty benefits (whether credits or otherwise). Rather, it states that treaty benefits are (generally) only available to residents who are qualified persons, to certain other persons in the circumstances and to the extent specified in Article 23(3) and (4) (subject to the further provision in Article 23(5)), or where a determination is made by the other Contracting State under Article 23(6).

43. To expand on that point, if the natural meaning of the words in section 793A(3) is applied, the provision captures a situation where the "cases or circumstances" in which credit is denied are "specified or described" in the provision. In contrast, Article 23:

> (a) states (in Article 23(1)) that treaty benefits are, subject to exceptions, available only to qualified persons, as opposed to expressly providing that non-qualified persons cannot benefit; and
>
> (b) does not rule out treaty benefits being provided to persons who are not qualified persons. Some non-qualified persons can benefit under Article 23(3) or (4), and others can benefit through an exercise of discretion.

44. To fit within the natural meaning of the words used in section 793A(3), Article 23 would need to have contained an express provision that, or words to the effect that, credit will not be available to a non-qualified person if they do not fall within Article 23(3) or (4) and discretion is not exercised.

Whilst Article 23 does have that effect, it is not an "express provision to the effect that relief by way of credit shall not be given".

45. Further, the wording "cases or circumstances specified or described" most naturally refer to criteria set out in a treaty from which it is possible for a taxpayer to discern whether they fall within them or not, rather than to something that may depend on the exercise of discretion by another Contracting State. HMRC's interpretation has the effect on these facts that relief is denied under domestic law by a decision taken by the counterparty Contracting State in its discretion, not subject to judicial scrutiny in this jurisdiction or (potentially) in the other State. In our view, the Tribunal should be slow to adopt such an interpretation.

46. A treaty provision agreed on or after 21 March 2000 that falls within the terms of section 793A(3) has the effect, via the mechanism of section 793A(3), of increasing the UK tax burden of a UK resident by denying unilateral relief. That is so despite the fact that the relevant treaty provision would not itself have been subject to Parliamentary scrutiny in the way that, for example, a Finance Bill is, but rather would take effect by an Order in Council. We consider that this lends support to a narrower interpretation that limits section 793A(3) to treaty provisions that explicitly deny credit relief in specified circumstances, an interpretation which is, in any event, more consistent with the words used.

47. Article 24(4)(c), a provision aimed at certain sale and repurchase (repo) transactions, provides an example of the sort of text to which section 793A(3) would apply. It obviously required section 793A(3) to be in place in order to take effect as the Contracting States intended, as evidenced by the US Treasury's Technical Explanation of the Tax Treaty:

> "However, recent changes to U.K. foreign tax credit rules allow the United Kingdom to deny credits if a tax treaty specifically so provides. The United Kingdom asked for the exception in paragraph (c) in order to conform the U.K. treatment of these transactions to the U.S. tax treatment…"

48. Another example of text to which section 793A(3) would in principle apply can be found in the double taxation convention between the UK and Egypt. Article 22(1) of that treaty provides for relief by way of credit for Egyptian tax, but with the following proviso:

> "Provided that this paragraph shall not apply to a company which is a resident of the United Kingdom and is a Petroleum Company as defined for the purposes of Schedule 9 of the Oil Taxation Act 1975."

49. However, section 793A(3) does not in fact apply to this provision because the UK/Egypt treaty was entered into in 1977. As explained by HMRC in their submissions, as originally drafted section 793A(3) would have had effect in relation to claims for credit made on or after 21 March 2000, but it was altered before enactment to apply to arrangements made on or after 21 March 2000, so as not to alter the effect of provisions such as the proviso to Article 22(1) of the UK/Egypt treaty. As HMRC point out, the UK/Egypt treaty was specifically referred to in the relevant Hansard debates.

50. The Explanatory Notes to Schedule 30 to the Finance Act 2000 do not advance HMRC's case. Rather, they tend to support Aozora's interpretation. The note on paragraph 5 states:

> "Paragraph 5 inserts new section 793A, which puts beyond doubt that if, under the terms of a double taxation agreement, a taxpayer can claim either relief from foreign tax, or credit in respect of foreign tax paid, he cannot claim relief in respect of that tax under the United Kingdom's domestic law provisions at section 790. Nor will it be possible to claim unilateral credit relief under section 790 in a particular situation if the relevant double

taxation agreement itself expressly precludes relief in that situation under the agreement itself…" (Emphasis added.)

51. Schedule 30 to the Finance Act 2000 also made an amendment to section 788(5), relating to relief for "spared tax". (Spared tax is, broadly, foreign tax which is not charged due to a specific relief given with a view to promoting development, and which a treaty with the relevant territory nonetheless provides should be treated as having been paid for the purposes of credit relief in the UK.) Like section 793A(3), the amendment to section 788(5), which was made by paragraph 2 of Schedule 30, refers to "express provision". It added the following to section 778(5):

> "Relief does not fall to be given in accordance with section 801 by virtue of this sub-section unless the arrangements in question make express provision for such relief..." (Emphasis added.)

(Section 801 provided for relief for certain tax paid on profits from which foreign dividends were sourced, so-called underlying relief.)

52. The relevant commentary in the Explanatory Notes states:

> "Paragraph 2 adds a provision to section 788 that prevents the allowance of credit for tax spared under the law of a foreign country at levels beneath the immediate overseas subsidiary of a United Kingdom company unless the double taxation agreement in question specifically provides for such relief…" (Emphasis added.)

53. The use of "specifically provides", in relation to an identical reference to "express provision", should be contrasted with HMRC's criticism of the FTT's dictionary definition of "express" at [83].

54. HMRC relied on the following explanation of section 793A by Dawn Primarolo, then the Paymaster General, in the Standing Committee debate on Tuesday 20 June 2000, which Mr Rivett submitted provided relevant context:

> "Paragraph 5 enacts three provisions. First, it makes it clear that the United Kingdom will not give relief on foreign tax if the taxpayer can claim in the other country that he does not have to pay it, either because of a provision under a double taxation agreement or because that is the law in the other country. Secondly, if a taxpayer can claim credit for foreign tax under a treaty, he cannot claim credit unilaterally under domestic law. Thirdly – this was the first point made by the hon. Member for West Dorset – if a treaty contains an express provision that credit for foreign tax is not allowed in particular circumstances, relief for that tax may not be claimed unilaterally. Paragraph 5 applies only if an express provision in the treaty denies relief, not if the treaty is silent on the issue. It bears no relevance to when the laws of another country change because only a new treaty or suspension of the treaty can change the agreement…" (Emphasis added.)

55. However, it was not argued by HMRC that the conditions set out by Lord Browne-Wilkinson in *Pepper v Hart* [1993] AC 593, 640 are satisfied, and as Lord Hodge made clear in *R (PRCBC) v Home Secretary* at [32], in those circumstances Hansard references are not a legitimate aid to statutory interpretation.

56. We are therefore not persuaded that we should have regard to the Paymaster General's statement, although we would add that even if it was taken into account we cannot see how it would assist HMRC. Rather than being an "express provision" that "denies relief", the Tax Treaty simply does not extend credit relief to persons who do not fall within Article 23. The statement does not use the words such as "effect" or "consequence".

57. HMRC also relied upon commentary on what became section 793A in a document entitled *Outcome of the Review of Double Taxation Relief for Companies* (published on 21 March 2000), which recorded conclusions reached by the Government following the review of double taxation for companies which led to the legislative changes made by Finance Act 2000. Paragraphs 1.45 to 1.48 of that document state as follows:

> "**A single route to claiming credit relief**
>
> 1.45 The Government has decided to introduce a specific provision to put it beyond doubt that if, because of a double taxation agreement, a taxpayer can claim relief from another country's tax, or can claim credit relief in the United Kingdom for foreign tax under the agreement, he cannot in either case claim credit relief for the foreign tax under Section 790 ICTA 1988.
>
> 1.46 Nor will it be possible to claim credit relief under Section 790 in a particular situation if the relevant double taxation agreement itself expressly precludes such relief in that situation.
>
> 1.47 Those points will apply to all taxpayers, not just to companies; and they will apply in relation to claims for credit relief against income tax, corporation tax and capital gains tax. See paragraph 5 in Schedule 1 in Appendix 1.
>
> 1.48 Those changes will introduce greater certainty into the legislation. It is also consistent with the importance that the Government attaches to the negotiation of double taxation agreements. The United Kingdom has the largest network of such agreements (over 100) of any country in the world. Where an agreement is in place it is intended that it should provide a comprehensive solution to all matters that are within its scope. It is therefore right that relief for foreign tax should be claimed under it, and only to the extent contemplated by it."

58. To the extent that this document is relevant, we do not consider that it provides material support to HMRC. As already indicated, credit relief for non-qualified persons who do not obtain benefits as a result of the Article 23 process is simply outside the scope of the Tax Treaty, rather than "expressly precluded" as referred to in paragraph 1.46. The reference in paragraph 1.48 to a treaty providing a "comprehensive solution" needs to be read bearing in mind that that paragraph is commenting on all the changes made by what became section 793A, and not just section 793A(3). Those other changes made it clear that UK credit relief was not available if relief could have been claimed from the relevant foreign tax (section 793A(1)), and that unilateral relief was not available if credit was available under a treaty (section 793A(2)). We also note the comment at the start of that paragraph that the changes were intended to introduce "greater certainty". It does not appear to us that HMRC's broad interpretation would assist in achieving that objective. More generally, however, we do not consider that the document provides any material assistance in identifying the purpose of the legislation or the mischief at which it is aimed (per Lord Hodge in *R (PRCBC)*).

59. It appears to us that a logical consequence of HMRC's argument is that unilateral relief could arguably be denied in surprising circumstances. At the least it would introduce material uncertainty.

60. We put the following point to Mr Rivett. As a basic point, treaty benefits are typically restricted to residents of the Contracting States (see Article 1(1) of the Tax Treaty). It follows from this that a UK branch of a non-UK entity which has third country source income – for example, a UK branch of a French bank with US source income – will typically need to rely on unilateral relief to claim a credit against UK tax for tax suffered on that third country income.

61. It seems to us that it could be argued that the "effect" of the Tax Treaty restricting benefits to residents is that non-residents are denied treaty relief in respect of US source income. That in turn raises the question of why HMRC's interpretation of section 793A(3) would not apply to them.

62. Mr Rivett's argument in response to this point relied on a subtle distinction between non-residents not falling within the scope of the Tax Treaty in the first place (and thereby not being caught by section 793A(3)) and non-qualified persons who are residents, who, HMRC say, are within the scope of the Tax Treaty but are taken out by Article 23.

63. We do not accept this submission. In our view, the proper interpretation of Article 23 is that, to the extent that the Tax Treaty confers benefits on residents, it is confined to qualified persons and other persons who satisfy the conditions set out in Article 23(3) or (4) (subject to Article 23(5)), or in respect of whom discretion is exercised under Article 23(6). Others are simply not within the scope of those provisions. Further, where Article 23(6) is in point the relevant person is not within the scope of those provisions unless and until discretion is exercised in their favour.

64. Mr Rivett sought to argue that some provisions of the Tax Treaty apply to residents who fall outside the scope of Article 23. His submission was made with reference to Article 26 (the mutual agreement procedure), which is not limited to residents. However, Article 26(1) provides that the person needs to be either a resident or national of a Contracting State in order to present his case to the Competent Authority, and if the former it seems to us that Article 23 would potentially be relevant.

65. The US Technical Explanation referred to at [47] above contains an explanation of Article 23(1) which contains a useful summary of the Tax Treaty provisions to which it is relevant, and the (limited) provisions that are not restricted to residents:

> "Paragraph 1 provides that, except as otherwise provided, a resident of a Contracting State will be entitled to all the benefits of the Convention otherwise accorded to residents of a Contracting State only if the resident is a "qualified person" as defined in paragraph 2 of Article 23.
>
> The benefits otherwise accorded to residents under the Convention include all limitations on source-based taxation under Articles 6 through 22, the treaty-based relief from double taxation provided by Article 24 (Relief from Double Taxation), and the protection afforded to residents of a Contracting State under Article 25 (Non-discrimination). Some provisions do not require that a person be a resident in order to enjoy the benefits of those provisions. For example, Article 19 (Government Service) may apply to an employee of a Contracting State who is resident in neither State. Article 26 (Mutual Agreement Procedure) is not limited to residents of the Contracting States, and Article 28 (Diplomatic Agents and Consular Officers) applies to diplomatic agents or consular officials regardless of residence. Article 23 accordingly does not limit the availability of treaty benefits under these provisions."

66. In our view, HMRC's interpretation gives rise to undesirable uncertainty which it is unlikely that the "reasonable legislature" referred to by Lord Hodge would have intended.

67. We did not find HMRC's reliance on Article 4(5) (see [28] above) to be persuasive. Article 4(5) is a bilateral provision that ensures that both Contracting States will grant credits even if they cannot reach agreement about how the Tax Treaty should apply to a dual resident.

68. We also reject HMRC's argument that section 793A(3) ensures that treaty provisions cannot be circumvented. Article 23 simply has the effect that the Tax Treaty does not <u>oblige</u> either party to grant credits to a non-qualified person who does not meet the conditions in Article 23(3) or (4). As Article

1(2) indicates, neither it nor other Tax Treaty provisions are intended to preclude credit being given under domestic law. The difficulty with HMRC's argument is that it must be premised on an assumption that there is a general intention to align unilateral relief and treaty relief, such that section 793A(3) should be given a broad interpretation. But as the example referred to above about non-residents with UK branches illustrates, there is no such general alignment. Indeed, the function of unilateral relief is to provide relief where it is not available under a treaty.

69. HMRC's arguments concerning the "balance" achieved by aligning unilateral relief with treaties were not persuasive. Section 793A(3) was introduced in 2000 with prospective effect for future treaty arrangements. Unilateral relief had by then co-existed for many years with a comprehensive treaty network. The Egyptian example itself undermines any argument about balance: the UK/Egypt treaty denies credit but credit was allowed, and continued to be allowed, unilaterally.

70. Mr Rivett relied on the fact that the equivalent provision to Article 23 in the UK/Japan double tax treaty does not deny credit relief to non-qualified persons. However, that indicates no more than the parties having agreed in that particular case that they would each be obliged to grant tax credits to such persons. It does not assist in determining whether or not domestic rules allow relief when a particular treaty does not require it.

71. For completeness, we should address Aozora's alternative argument that as Article 1(2) is not disapplied in relation to Article 23, it prevents Article 23 (via section 793A(3)) from restricting the benefit of unilateral relief under section 790. Mr Ewart submitted that, read with Article 1(2), the effect of Article 23 cannot be to restrict unilateral relief. This is in contrast to Article 24(4)(d), which expressly disapplies Article 1(2) in relation to Article 24(4)(c). Mr Ewart submitted that this was supported by the US Treasury Technical Explanation of Article 24(4)(d):

> "Subparagraph (c) would not be effective without subparagraph (d). Subparagraph (c) limits benefits that are otherwise available under domestic law and therefore would be inconsistent with the rules of paragraph 2 of Article 1 (General Scope), which provide that the tax treaty cannot limit benefits that are available under domestic law. Subparagraph (d) provides an exception from paragraph 2 of Article 1 with respect to subparagraph (c)."

72. Mr Ewart submitted that if the UK had wished Article 23 to have the effect of restricting the benefit of unilateral relief, then it would have sought to include a provision similar to Article 24(4)(d) in relation to Article 23. Article 23, together with Article 1(2), could not be a provision that fell within section 793A(3), as that would result in a benefit being denied under UK law in contravention of Article 1(2).

73. This argument is not a straightforward one. HMRC's answer to it is that it fails for the simple reason that it is premised on the construction of the Tax Treaty and not domestic law, whereas we must interpret section 793A(3). On the face of it that appears to be a complete answer.

74. However, the position is not in fact that simple. That is because we must also interpret Article 23 to determine whether it is the type of provision that is caught by section 793A(3). That interpretation must have regard to the context and purpose of the Convention read as a whole, including Article 1(2) and 24(4)(d) (see the extract from *Anson* referred to at [35] above). On HMRC's interpretation there would be no need for Article 24(4)(d). To the contrary, on Aozora's approach, Article 1(2) is read in such a way as to take account of the <u>impact</u> of the Convention under domestic law (via section 793A(3)) in determining whether the Convention does in fact have the effect of restricting domestic law benefits.

75. The effect of section 793A(3) being in force, where it applies, is that a treaty containing a provision falling within its terms does in fact have the effect of restricting domestic law benefits contrary to Article 1(2), without any further step being needed under domestic law. That interpretation appears to be consistent with the US Treasury's reading of Article 1(2) as set out in its Technical Explanation.

76. Nonetheless, it is ultimately the operation of section 793A(3) that restricts relief, and furthermore the fact that a domestic law provision may be inconsistent with a treaty provision does not mean, without more, that it is ineffective.

77. In reaching our decision we therefore prefer to base our determination on a straightforward interpretation of section 793A(3).

Disposition

78. For the reasons that we have given the appeal is dismissed.

Signed on Original

MRS JUSTICE FALK

JUDGE JENNIFER DEAN

RELEASE DATE: 23 September 2022

APPENDIX

ARTICLE 4 – RESIDENCE

…

5. Where by reason of the provisions of paragraph 1 of this Article a person other than an individual is a resident of both Contracting States, the competent authorities of the Contracting States shall endeavour to determine by mutual agreement the mode of application of this Convention to that person. If the competent authorities do not reach such an agreement, that person shall not be entitled to claim any benefit provided by this Convention, except those provided by paragraph 4 of Article 24 (Relief from Double Taxation), Article 25 (Non-discrimination) and Article 26 (Mutual Agreement Procedure).

…

ARTICLE 23 - LIMITATION ON BENEFITS

1. Except as otherwise provided in this Article, a resident of a Contracting State that derives income, profits or gains from the other Contracting State shall be entitled to all the benefits of this Convention otherwise accorded to residents of a Contracting State only if such resident is a "qualified person" as defined in paragraph 2 of this Article and satisfies any other specified conditions for the obtaining of such benefits.

2. A resident of a Contracting State is a qualified person for a taxable or chargeable period only if such resident is either:

a) an individual;
b) a qualified governmental entity;
c) a company, if
(i) the principal class of its shares is listed or admitted to dealings on a recognised stock exchange specified in clauses (i) or (ii) of sub-paragraph a) of paragraph 7 of this Article and is regularly traded on one or more recognized stock exchanges, or
(ii) shares representing at least 50 per cent. of the aggregate voting power and value of the company are owned directly or indirectly by five or fewer companies entitled to benefits under clause (i) of this sub-paragraph, provided that, in the case of indirect ownership, each intermediate owner is a resident of either Contracting State;
d) a person other than an individual or a company, if…
e) …
f) a person other than an individual, if:
(i) on at least half the days of the taxable or chargeable period persons that are qualified persons by reason of sub-paragraphs a), b), clause (i) of subparagraph c), clause (i) of sub-paragraph d), or sub-paragraph e) of this paragraph own, directly or indirectly, shares or other beneficial interests representing at least 50 per cent. of the aggregate voting power and value of the person, and
(ii) less than 50 per cent. of the person's gross income for that taxable or chargeable period is paid or accrued, directly or indirectly, to persons who are not residents of either Contracting State in the form of payments that are deductible for the purposes of the taxes covered by this Convention in the State of which the person is a resident (but not including arm's length payments in the ordinary course of business for services or tangible property and payments in respect of financial obligations to a

bank, provided that where such a bank is not a resident of a Contracting State such payment is attributable to a permanent establishment of that bank located in one of the Contracting States); or

g) …

3. Notwithstanding that a company that is a resident of a Contracting State may not be a qualified person, it shall be entitled to the benefits of this Convention otherwise accorded to residents of a Contracting State with respect to an item of income, profit or gain if it satisfies any other specified conditions for the obtaining of such benefits and:

a) shares representing at least 95 per cent. of the aggregate voting power and value of the company are owned, directly or indirectly, by seven or fewer persons who are equivalent beneficiaries; and

b) less than 50 per cent. of the company's gross income for the taxable or chargeable period in which the item of income, profit or gain arises is paid or accrued, directly or indirectly, to persons who are not equivalent beneficiaries, in the form of payments that are deductible for the purposes of the taxes covered by this Convention in the State of which the company is a resident (but not including arm's length payments in the ordinary course of business for services or tangible property and payments in respect of financial obligations to a bank, provided that where such a bank is not a resident of a Contracting State such payment is attributable to a permanent establishment of that bank located in one of the Contracting States).

4. a) Notwithstanding that a resident of a Contracting State may not be a qualified person, it shall be entitled to the benefits of this Convention with respect to an item of income, profit or gain derived from the other Contracting State, if the resident is engaged in the active conduct of a trade or business in the first-mentioned State (other than the business of making or managing investments for the resident's own account, unless these activities are banking, insurance or securities activities carried on by a bank, insurance company or registered securities dealer), the income, profit or gain derived from the other Contracting State is derived in connection with, or is incidental to, that trade or business and that resident satisfies any other specified conditions for the obtaining of such benefits.

b) If a resident of a Contracting State or any of its associated enterprises carries on a trade or business activity in the other Contracting State which gives rise to an item of income, profit or gain, sub-paragraph a) of this paragraph shall apply to such item only if the trade or business activity in the first-mentioned State is substantial in relation to the trade or business activity in the other State. Whether a trade or business activity is substantial for the purposes of this paragraph shall be determined on the basis of all the facts and circumstances.

c) …

5. Notwithstanding the preceding provisions of this Article, if a company that is a resident of a Contracting State, or a company that controls such a company, has outstanding a class of shares:

a) which is subject to terms or other arrangements which entitle its holders to a portion of the income, profit or gain of the company derived from the other Contracting State that is larger than the portion such holders would receive in the absence of such terms or arrangements; and

b) 50 per cent. or more of the voting power and value of which is owned by persons who are not equivalent beneficiaries,

the benefits of this Convention shall apply only to that proportion of the income which those holders would have received in the absence of those terms or arrangements.

6. A resident of a Contracting State that is neither a qualified person nor entitled to benefits with respect to an item of income, profit or gain under paragraph 3 or 4 of this Article shall, nevertheless, be granted benefits of this Convention with respect to such item if the competent authority of the other Contracting State determines that the establishment, acquisition or maintenance of such resident and the conduct of its operations did not have as one of its principal purposes the obtaining of benefits under this Convention. The competent authority of the other Contracting State shall consult with the competent authority of the first-mentioned State before refusing to grant benefits of this Convention under this paragraph.

7. For the purposes of this Article the following rules and definitions shall apply:

a) the term "recognized stock exchange" means…

b) (i) the term "principal class of shares" means the ordinary or common shares of the company, provided that such class of shares represents the majority of the voting power and value of the company. If no single class of ordinary or common shares represents the majority of the aggregate voting power and value of the company, the "principal class of shares" is that class or those classes that in the aggregate represent a majority of the aggregate voting power and value of the company;

(ii) the term "shares" shall include depository receipts thereof or trust certificates thereof;

c) …

d) an equivalent beneficiary is a resident of a Member State of the European Community or of a European Economic Area state or of a party to the North American Free Trade Agreement but only if …

e) For the purposes of paragraph 2. of this Article, the shares in a class of shares or the units in a class of units are considered to be regularly traded on one or more recognized stock exchanges in a chargeable or taxable period if the aggregate number of shares or units of that class traded on such stock exchange or exchanges during the twelve months ending on the day before the beginning of that taxable or chargeable period is at least six per cent. of the average number of shares or units outstanding in that class during that twelve-month period.

f) ...

ARTICLE 24 - RELIEF FROM DOUBLE TAXATION

…

4. Subject to the provisions of the law of the United Kingdom regarding the allowance as a credit against United Kingdom tax of tax payable in a territory outside the United Kingdom (which shall not affect the general principle hereof):

a) United States tax payable under the laws of the United States and in accordance with this Convention, whether directly or by deduction, on profits, income or chargeable gains from sources within the United States (excluding, in the case of a dividend, United States tax in respect of the profits out of which the dividend is paid) shall be allowed as a credit against

any United Kingdom tax computed by reference to the same profits, income or chargeable gains by reference to which the United States tax is computed;
b) in the case of a dividend paid by a company which is a resident of the United States to a company which is a resident of the United Kingdom and which controls directly or indirectly at least 10 per cent. of the voting power in the company paying the dividend, the credit shall take into account (in addition to any United States tax for which credit may be allowed under the provisions of sub-paragraph a) of this paragraph) the United States tax payable by the company in respect of the profits out of which such dividend is paid;
c) United States tax shall not be taken into account under subparagraph b) of this paragraph for the purpose of allowing credit against United Kingdom tax in the case of a dividend paid by a company which is a resident of the United States if and to the extent that

(i) the United Kingdom treats the dividend as beneficially owned by a resident of the United Kingdom; and
(ii) the United States treats the dividend as beneficially owned by a resident of the United States; and
(iii) the United States has allowed a deduction to a resident of the United States in respect of an amount determined by reference to that dividend;

(d) the provisions of paragraph 2 of Article 1 (General Scope) of this Convention shall not apply to sub-paragraph c) of this paragraph.
…