

# **Ninth International Tax Planning Conference**

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**Tax Treaty Interpretations in the  
United Kingdom**

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# Tax Treaty Interpretations in the UK

## Background

- UK prolific negotiator of Tax Treaties
- Currently in excess of 100
  - Oldest Antigua and Barbuda – 1947
  - Latest USA – entered into force May 2003
  - India - 1993

# Tax Treaty Interpretations in the UK

## The Making of Treaties

- Archaic – power resides with Crown
- Made by “Order in Council”
- Not part of regular process of introducing tax legislation; not part of the Finance Bill process
- Draft Order laid before House of Commons
- Ultimately becomes law in the form of a so-called “Statutory Instrument”

# Tax Treaty Interpretations in the UK

## The Making of Treaties

- Tax effect only where they become part of UK law
- Importance, therefore, of Section 788 ICTA 1988

# Tax Treaty Interpretations in the UK

## The Making of Treaties – Section 788(1)

“If Her Majesty by Order in Council declares that arrangements specified in the Order have been made with the Government of any territory outside the UK with a view to affording relief from double taxation in relation to income tax ...etc

and that it is expedient that those arrangements should have effect, then those arrangements shall have effect.....”

# Tax Treaty Interpretations in the UK

## The Effectiveness of Treaties – Section 788(3)

- Specifies the matters in respect of which Treaties have effect “in relation to income tax and corporation tax”
- Acts in effect, as a limitation on the effect that Treaties have
- Bricom Holdings v CIR

# Tax Treaty Interpretations in the UK

## The Effectiveness of Treaties

### Bricom Holdings v CIR

- Interaction – UK CFC legislation with UK/ Netherlands Treaty
- Related to interest received by DutchCo from a UK resident Co within interest article of Treaty
- UK CFC legislation charges “a sum equal to corporation tax at the appropriate rate .... shall be assessed .... as if it were an amount of corporation tax”
- Special Commissioners’ finding: CFC charge not actually corporation tax and thus not a subject of relief under s788(3)

# Tax Treaty Interpretations in the UK

## The Effectiveness of Treaties

### Regina v CIR ex parte Commerzbank AG

- Interaction UK provisions on repayment supplement with UK/ Germany Treaty
- Related to tax repayment received by Commerzbank and impact of non-discrimination Article of Treaty
- UK legislation allowed supplement on tax repayments to UK residents but not to non-residents
- High Court finding that Article did not apply because repayment supplement not a matter within s788(3)



# Tax Treaty Interpretations in the UK

## The Effectiveness of Treaties

- Bricom and Commerzbank demonstrate importance of starting with domestic legislation
- It is little avail that taxes like those under CFC rules and entitlements such as repayment supplement introduced after s788(3) enacted and relevant Treaties negotiated
- Static nature of provisions

# Tax Treaty Interpretations in the UK

## The Power of Treaties

- Can they impose a tax charge?
- Tension between:
  - “Part XVIII – Double Taxation Relief”
  - “arrangements .... with a view to affording relief from double taxation...”

AND

- “arrangements shall .... have effect .... in so far as they provide:
  - (b) for charging the income arising from sources .... in the UK to persons not resident in the UK”

# Tax Treaty Interpretations in the UK

## The Power of Treaties

- Inland Revenue practice – arguments in the transfer pricing field:-
  - “arrangements shall .... have effect .... in so far as they provide:
    - (c) for determining the income ... to be attributed:
      - (i) to persons not resident in the UK and their agencies, branches or establishments in the UK; or
      - (ii) to persons resident in the UK who have special relationships with persons not so resident”

# Tax Treaty Interpretations in the UK

## The Power of Treaties

- Board of Inland Revenue's solicitor known to have indicated Treaty can not tax where domestic provisions do not charge
- That was consistent with Inland Revenue's own internal instructions until recently
- However:-
  - “Treaties can override domestic law to provide relief from UK tax, but they cannot create a charge to tax if none exists in UK domestic law” (Primarolo, May 2003)

# Tax Treaty Interpretations in the UK

## The General Interpretation of Treaties

As if Treaties were the equivalent of domestic law?

- Read the words - literal interpretation UNLESS
- Pepper v Hart and Others
  - legislation ambiguous, obscure or leads to an absurdity
  - material relied on; one or more Ministerial statements and other Parliamentary material necessary to understand such statements
  - statements relied upon are clear
- Suggests very narrow approach to Treaty interpretation

# Tax Treaty Interpretations in the UK

## The General Interpretation of Treaties

In accordance with the Vienna Convention on the Law of Treaties?

- Entered into force January 1980
- Signatory can not invoke domestic laws as justification for failure to adhere to a Treaty (Article 27)
- Treaty to be interpreted in good faith in accordance with ordinary meaning to be given to terms of Treaty in their context and in light of object and purpose (Article 31 (1))

# Tax Treaty Interpretations in the UK

## The General Interpretation of Treaties

In accordance with the Vienna Convention on the Law of Treaties? (cont.)

- Recourse to be had to supplementary means of interpretation, including preparatory work on circumstances of its inclusion:-
  - to confirm meaning
  - to determine meaning where ambiguous/obscure or where leads to result which is manifestly absurd or unreasonable

# Tax Treaty Interpretations in the UK

## The General Interpretation of Treaties Further Principles

- Fothergill v Monarch Airlines Ltd
  - literal interpretation in English legal context not followed - “ordinary meaning” applied
  - purposive construction to be adopted if meaning unclear
  - application of travaux preparatoire accepted even though Treaty pre-dated Vienna Convention (codifying existing public international law)



# Tax Treaty Interpretations in the UK

## The General Interpretation of Treaties Further Principles (cont.)

but use is discretionary, not mandatory

- commentaries on conventions subsequent to their publication can only have persuasive value to a Court
- the decisions of foreign Courts, whilst persuasive, depend inter alia on reputation and status

# Tax Treaty Interpretations in the UK

## The General Interpretation of Treaties Further Principles

- Sun Life Assurance Co of Canada v Pearson
  - common ground that in the interpretation of Treaties the Courts are entitled to consider the commentaries to OECD's Model Tax Convention

# Tax Treaty Interpretations in the UK

## The General Interpretation of Treaties

### Further Principles

- CIR v Commerzbank AG
  - joint statements of the Revenue authorities expressing their official view do not represent aids to interpretation which can be taken into account BUT
    - “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”  
(Article 31(3)(a))

# Tax Treaty Interpretations in the UK

## The General Interpretation of Treaties

- Exchange of Notes
  - considered by UK to have legal standing equal to the Treaty

“I.....confirm that Your note and this reply shall be regarded as constituting an agreement between the two Governments.....which shall enter into force at the same time as the Convention”.

*(UK/US Convention, 2003)*

# Tax Treaty Interpretations in the UK

## The General Interpretation of Treaties

### Treaty over-ride

- “Treaties can override our domestic law in that they may give relief from tax which our domestic law does not give. On the other hand domestic law can, if it is so desired, be enacted which will override a treaty although this is not done lightly”.

*(Inland Revenue, International Tax Handbook)*

- Padmore v CIR
  - held that the UK/Jersey Treaty had effectively been overridden

# Tax Treaty Interpretations in the UK

## The General Interpretation of Treaties

### Unilateral “changes” to Treaties

- “Any reference in arrangements made before the passing of this Act....to information necessary for the carrying out of the tax laws of the UK or the territory to which the arrangements relate shall be read as including any information foreseeably relevant to the administration or enforcement of the tax laws of the UK or, as the case may be, of that territory”.

*(Section 198(3) Finance Act 2003)*

# Tax Treaty Interpretations in the UK

## The General Interpretation of Treaties Unilateral “changes” to Treaties (cont.)

- is it lawful? Retrospective?
- “The purpose of the new wording....clearly better reflects the reality of what we and our international partners do in practice”.

*(Primarolo, May 2003)*

# Tax Treaty Interpretations in the UK

## The General Interpretation of Treaties OECD Model and Commentaries

- Model basis of UK negotiating position BUT
- “UK legislation cannot be directly interpreted by reference to the commentary....”

*(Primarolo, May 2003)*

- Reflects Sun Life approach
  - supplementary means of interpretation



# Tax Treaty Interpretations in the UK

## The General Interpretation of Treaties

### OECD Model and Commentaries (cont.)

- Which commentary?
  - time at which Treaty was negotiated?
  - time at which Treaty is being interpreted?
  - time at which relevant wording of Model Article was introduced?
  - OECD-CFA's stated position

*(Model introduction paras 33-36.1)*

# Tax Treaty Interpretations in the UK

## The General Interpretation of Treaties

### Other Double Taxation Treaties

- Padmore v CIR
  - “I think that the assistance that I can legitimately derive from other Arrangements, particularly when made later than the Jersey Arrangement, is very limited. ...Each is the product of negotiation between the UK and another territory and must reflect the particular considerations present to the minds of the negotiators in the light of the particular circumstances of their respective countries at the time”. (Gibson J.)

# Tax Treaty Interpretations in the UK

## The Hierarchy of Treaties

- European Convention on Human Rights
  - has primacy over all domestic legislation
  - Tax Treaties must comply with and be administered in accordance with the Convention
- Treaty Establishing the European Community
  - Tax Treaties may be invalid if they restrict the rights that exist under EU law, such as non-discrimination, freedom of establishment, freedom to provide services of free movement of capital and payments
    - (Lankhorst-Hohorst GmbH v FinanZant Steinfurt)*
  - Can EU Member States continue to negotiate bilateral tax treaties without EC involvement?

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