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UK: Yates v Revenue and Customs Commissioners*

Philip Baker

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* [2012] UKFTT 568 (TC); (2012) 15 ITLR 205 – First-Tier Tax Tribunal.

1. Introduction

This is a decision of the First Tier Tribunal in the United Kingdom. The case has not proceeded any higher so far. There were two main issues in the case. The first question was whether the taxpayer, Mrs Yates, was resident for domestic tax purposes in the UK. On the basis that she was, and that she had dual residence, the second question was the application of the tie-breaker under the UK-Spain DTC of 1975.

2. Facts of the Case

The facts are fairly straightforward. Mrs Yates realized certain capital gains on the sale of shares over a number of years (from 2003 to 2006). She sought to argue that she was not liable to UK tax on the basis that: first, she was not resident in the UK under domestic law, and second, if she was, she was also resident in Spain and the tie-breaker fell to Spain, and Spain had the exclusive right to tax. There wasn't any evidence as to whether Spain would actually tax the gains, but she said that the tie-breaker would have had the result that only Spain could tax.

She originated in the UK. She had been born in the UK and all her background was there, but she had a disease called Gauchers disease which is described in the case as a wasting illness which affects the bones and shortens life expectancy. She was advised to move to Spain for health reasons by moving to a better climate. Moving to a better climate would have the effect that the disease would be slowed in its effect and she would be less likely to pick up infections. So she took a flat – she initially hired a flat and then bought one in Spain – and in each of the years in question she spent significantly more than half the year in Spain. In most of them she was spending approximately 80% of her time in Spain and only 20% in the UK so she was there much more than in the UK.

However, she had a husband and they had been together for 20 plus years, and they had a son together. He remained throughout in the UK because he had business interests there. It had been mentioned that he would join her in Spain, but the business interests required that he remained in the UK. Subsequently, when the relationship became somewhat strained, she moved back to the UK to join him. She owned a half share in a house with him in the UK. The rest of her family was in the UK. She kept her major bank account in the UK and also, because the Gauchers disease was very severely disabling, she received a benefit from the UK government. So she continued to have strong links with the UK even though she was spending most of her time in Spain.

In Spain she became a director of a Spanish property company, though she received no payment for that. She started making some friends there as well.

3. The Court's decision

The first question that had to be decided was whether she was resident in the UK. Her argument was she had left the UK and had ceased to be resident there. The problem was that the UK had tightened up on its rules for people becoming non-resident as a result of the Supreme Court case of Gaines-Cooper[1] which emphasized that to leave the UK you need to make a distinct break in your pattern of life. Even going abroad for much of your time, if you do not make a complete break – if you just change your sky rather than your life – then you are still resident. This involves an enquiry into all of the factors of someone's life. The trial judge concluded, applying that case, that she had not made a distinct break. She continued to come back to the UK, she had an interest in a house there, her husband was in the UK, so she was still resident for tax purposes.

So it was necessary to turn to the second issue (which is the treaty issue that concerns us) and that is residence under the UK-Spain DTC.

It was accepted on the basis of evidence from a UK tax adviser that someone who spends 183 days a year there is resident in Spain for tax purposes. This was assumed to be correct, and so Mrs Yates was a dual resident.

It was then necessary to turn to the tie-breaker in the UK-Spain DTC of 1975, which is in standard OECD Model Convention wording.

The first test was whether the taxpayer had a permanent home in one or both states: she had a permanent home in both states. She had the half interest in the home with her husband and the flat in Spain. There was a partial argument to the effect that in Spain she had the flat but it was not a real "home" because it did not meet the French test of being a *foyer*: the French version of the OECD Model Convention talks about a *foyer,* and this was not a real *foyer*. The judge dealt with that very briefly and concluded that the flat was a permanent home.

This then led on to the second test of centre of vital interests. In the UK, Mrs Yates had an interest in a house; she had a husband. All her major financial possessions were in the UK. In Spain all she had was her directorship. In terms of her personal relationships, the court emphasised that her closest personal relationship was with her husband. She had hoped that he would join her in Spain. When he didn't and the relationship became strained, she moved back to the UK. So the personal relationship with her husband was the most important relationship of her life. Her family was in the UK. She had some friends in Spain, but they weren't as important as the family relationships. Her economic interests all pointed to the UK. She earned nothing from her work in Spain. She kept her bank accounts back in the UK. Consequently, her centre of vital interests determined the matter in favour of the United Kingdom.

The judge went on to add that, if CVI had not been determinative, then on the place of habitual abode, Spain would have won purely on a day count. It is only a

[1] [2011] UKSC 47; [2011] STC 2249.

short paragraph and the judge clearly did not focus his attention much on it, but he said habitual abode is a question of day count. Incidentally, he also cited the article from John Avery Jones on CVI and on habitual abode.[2]

As to the outcome, Mrs Yates was found to be UK resident both for domestic law and for treaty purposes. The result is that she ended up paying something short of GBP 2,000,000 of tax in the UK which she had hoped not to have been paying.

4. Comments on the Court's reasoning

Under UK domestic law applicable at the time of this case, there needed to be a clear break to cease residence. From April 2013, however, there is a statutory residence test in the UK which will replace the Gaines-Cooper case and does not have the distinct break requirement.

For treaty purposes, it is clear as a practical matter that the permanent home test may be the critical one because it is going to be hard either to decide where someone's centre of vital interests is or to lose a centre of vital interest. So, as a practical matter of advice, for people who want to ensure that they are resident for treaty purposes in one country or another, the permanent home test maybe the critical one. Once you have gone past that test, you are moving to an area of great uncertainty.

Here, Mrs Yates had homes in both places, and therefore you have to move into that element of uncertainty.

So far as her centre of vital interests was concerned, there were some indications of Spain here. Clearly much more time was spent there; she was living there for health reasons; she had a home there. But she still had strong links with the UK, and it is probably correct that her life really centred on the UK, even though she spent far less time there than she spent in Spain.

One point which is very clear is this: if the relationship with your spouse is the key relationship in your life, then it is going to be very hard to have a centre of vital interests separate from where your spouse has their home. This is only likely to occur, for example, if the spouse is required by employment or similar reasons to be present in another country, but all other economic and social factors point to a centre of vital interests in the country where the spouse is not present.

5. Conclusion

This is an interesting illustration of the application of the tie-breaker tests in a standard OECD-model style treaty, particularly the application of the centre of vital interests test. There are few examples of such cases in the UK.

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[2] Avery Jones, J.F. et.al., "Dual Residence of Individuals" [1981] BTR 15, p. 104.

UK: Weiser v Revenue and Customs Commissioners*

Philip Baker

1. **Introduction**
2. **Facts of the case**
3. **The Court's decision**
4. **Comments on the Court's reasoning**
5. **Conclusion**

* [2012] UKFTT 501 (TC); (2012) 15 ITLR 157 – First Tier Tax Tribunal.

1. Introduction

This case is a nice demonstration of the difference between "subject to tax" and "liable to tax". It is a First Tier Tax Tribunal decision (i.e. a first level court). Immediately after the judgment, Mr Weiser appeared in a couple of newspapers saying he was going to appeal. However, he may then have realized that it was a very good judgement, and it now appears unlikely that the case is going any further.

Judge Roger Berner, who decided the case, was previously a partner in one of the magic circle law firms; he has international tax experience, and sat quite often as a judge with John Avery Jones.

The case concerns a provision in the UK-Israel DTC, which is an old tax treaty going back to 1963. The treaty goes back to the days when the UK was still putting "subject to tax" clauses in our treaties.[1] The case concerned the pension article of the treaty which said:

> *"Any pension ... derived from sources within the United Kingdom by an individual who is a resident of Israel and* subject to Israel tax in respect thereof, *shall be exempt from United Kingdom tax."* (emphasis added)

The pension was exempt from tax in the UK if it was received by a resident of Israel and subject to Israel tax.

2. Facts of the case

Mr Weiser had previously lived in the UK, worked in the UK, and built up a pension entitlement. He then moved to live in Israel and became a resident there. There is no doubt he was a resident of Israel, and he had a residence certificate from the Israel Revenue Authorities.

He received a pension arising from the work that he had previously done in the UK and he argued that the pension should be exempt from UK tax under the terms of the treaty. The problem was that he was a new immigrant to Israel, and new immigrants enjoy a ten year exemption from Israel tax. He could have chosen to subject the pension to Israeli tax – you could elect against the ten year exemption – but he had not done so. So he was not paying any Israel tax, but he still wanted to get the exemption from the UK.

The question then was whether the pension was subject to tax in Israel.

3. The Court's decision

Mr Weiser was represented by an accountant; the case for the UK Revenue was presented by a barrister,[2] and she presented a great deal of material and made certain that the court was very fully informed of the issues.

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[1] It was because of the difficulties in applying such clauses that the UK ceased putting them in treaties and instead began using the beneficial ownership limitation.

[2] Ms Hui Ling McCarthy of Gray's Inn Tax Chambers.

The Tribunal was very well aware of the distinction between being liable to tax and subject to tax. Liable to tax meant that Mr Weiser was within the fiscal jurisdiction of the State, and he was within the jurisdiction of the State of Israel. Israel could have taxed him had they wanted to, but gave a specific exemption for new immigrants.

"Subject to tax" on the other hand related to the particular income. This meant that the taxpayer had to be actually paying tax on that income (subject to the possibility that he might have personal allowances or losses to set against the income). Thus the taxpayer might not have to pay any money, but would be subject to tax on that income as opposed to being simply within the fiscal jurisdiction.

Mr Weiser was within the fiscal jurisdiction. He was a resident but he was not subject to tax because of the exemption.

4. Comments on the Court's reasoning

Judge Berner set out the principles of treaty interpretation. He also cited foreign case law; the barrister appearing for HMRC cited to him an Australian High Court case and an Indian Income Tax Appellant Tribunal judgment. She also cited academic writings, including an article written by John Avery Jones and other members of the International Tax Group. The Commentary to the OECD MC was also cited. This led to a very well-constructed judgement, looking at the principles, citing relevant material, and coming to a completely correct result.

On treaty interpretation, there are some interesting points. Judge Berner cited the standard approach to treaty interpretation in UK case law. However, he added a point about double non- taxation as follows: "The starting point (of a purposive approach to interpretation) is to look for a clear meaning of the words in (the pension article) that is consistent with the purpose of the treaty. That purpose I discern to be the allocation of taxing rights as between the UK and Israel to obviate double taxation, and to prevent the evasion of tax. Its purpose is not to enable double non-taxation of the relevant income".

That is one of the first statements in the UK that the purpose of a treaty is not to enable double non-taxation (though Judge Berner cited a dictum in the Court of Appeal that pointed in the same direction).

What Judge Berner said about "subject to tax" and "liable to tax" is in a slightly longer quotation:

> *"In my view, consistent with what I regard as the purpose of the treaty in this regard, the ordinary meaning of (the pension article) is that pension income derived from UK sources is only exempt from UK tax if that income is chargeable to Israel tax such that Israel tax will ordinarily be payable in respect of that income, subject to deductions for allowances and relief. This follows from the distinction that must in my view be drawn between the use, in double tax treaties, of the expressions 'liable to tax' and 'subject to tax', and also by the*

requirement ... that the individual concerned should not only be a resident of Israel ...' but should be subject to tax in respect of *the relevant income. The reference to that income in this context clearly distinguishes this provision from one which requires the individual to fall within the scope of a state's taxation generally. This provision is not concerned with the status of the individual, but with the chargeability to tax of the specific income. Income which is exempted from taxation cannot during the currency of that exemption be income in respect of which an individual can be said to be subject to tax."*

So, this case is a nice illustration of the distinction between being liable to tax (and therefore a resident of a state under Article 4(1) of the OECD MC), and particular income being "subject to tax".

5. Conclusion

This case, in a sense, is an historical legacy. The UK has not generally put "subject to tax" clauses in treaties, and has tried to avoid it, for the last 40 years. However, the wording is still found in some older treaties, and it is useful to have this explanation of the meaning.