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The Commerzbank Litigation (1990)

UK Law, Tax Treaty Law and EU Law

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The Commerzbank litigation comprises three reported cases all involving aspects of the same dispute between the German bank Commerzbank AG and the Inland Revenue.[1] The first decision is that of Mummery J in the Chancery Division in February 1990, and contains what has become the classic starting point for any discussion of the approach to the interpretation of double taxation conventions in the United Kingdom.[2] The second case is a decision of Nolan LJ and Henry J in the High Court in respect of a judicial review application in April 1991, and concerns the approach to non-discrimination in the United Kingdom.[3] Finally, the third decision is a judgment of the European Court of Justice (ECJ) of 13 July 1993 on a reference for a preliminary ruling from the High Court, which concerns the application of European law to a tax measure which discriminates on grounds of residence.[4] The Commerzbank litigation merits selection as one of the leading cases in UK tax law, primarily because of its summary of the approach to the interpretation of double taxation conventions, but also because of its discussion of discrimination on grounds of residence in UK and EU law.

[1] There are surprisingly few articles that discuss simply the Commerzbank litigation. There are notes on the cases in the *British Tax Review*: JDB Oliver, 'Withholding Tax and Tax Credits, with some Reflections on Union Texas' [1991] *BTR* 245 and D Sandler, 'Commerzbank – Fast Track to Harmonisation?' [1993] *BTR* 517. Aside from that, the case is discussed in virtually all articles or chapters in books about the approach to tax treaty interpretation in the UK, as well as in discussions of EU law and direct taxation.

[2] *CIR v Commerzbank AG* [1990] STC 285, 63 TC 218.

[3] *R v CIR ex parte Commerzbank AG* [1991] STC 271, 68 TC 252.

[4] Judgment of 13 July 1993, *R v CIR ex parte Commerzbank AG*, C-330/91, EU:C:1993:303; [1993] STC 605. The STC report includes the report of the Juge Rapporteur at [1993] STC 607–13.

I. BACKGROUND AND HISTORY OF THE LITIGATION

The background facts to the litigation are very simple. During 1973 Commerzbank AG, a German bank, established a branch in the United Kingdom.[5] It began making loans to US corporations, on which it received interest. The interest formed part of the profits of the UK branch, and was subject to corporation tax as such. However, the branch sought exemption from UK tax under article XV of the UK–United States double taxation convention of 16 April 1945, as amended by the Supplementary Protocol of 17 March 1966 (which inserted article XV), which provided as follows:

> Article XV
>
> Dividends and interest paid by a corporation of one Contracting Party shall be exempt from tax by the other Contracting Party except where the recipient is a citizen, resident, or corporation of that other Contracting Party. This exemption shall not apply if the corporation paying such dividend or interest is a resident of the other Contracting Party.

Commerzbank's argument was disarmingly simple: the interest it received was 'interest paid by a corporation of [the United States]', the bank was not a 'citizen, resident, or corporation of [the United Kingdom]', and the 'corporation paying such … interest' was not a resident of [the United Kingdom]. Consequently, the interest was exempt from tax by [the United Kingdom]. The argument was based on a pure, straightforward, literal interpretation of the words of the convention. The words of the article were not in a standard form that one might have expected if the convention had been based on the OECD Model.[6]

Commerzbank's claim for exemption related to the four years ended 31 December 1973 through to 31 December 1976. It was not until 7 January 1985, however, that the Inland Revenue formally refused the claim for exemption. Commerzbank claimed both a repayment of the corporation tax that the branch had paid on the interest (which amounted to £4,222,234), as well as repayment supplement (the equivalent of interest on the repayment – which amounted to £5,199,258 by the time the judicial review commenced). The Inland Revenue denied both the exemption under the convention and the claim for repayment supplement. The specific issue relating to repayment supplement – which figures more directly in the later stages of the litigation – was that section 48(2) of the Finance (No 2) Act 1975 (which provided for repayment supplement) applied

[5] There is nothing particularly significant in the establishment of a branch rather than a subsidiary. Most banks establish branches where they can since then the branch is not subject in the country where it operates to the same capital adequacy requirements to which a subsidiary would be subject. There is nothing to suggest in any way that the choice of the form of a branch was made for any reasons other than the usual commercial ones, or that the tax treatment of interest highlighted in this case was anything other than a consequence of that normal, commercial decision.

[6] OECD, *Model Tax Convention on Income and on Capital*. The version applicable at the time of the protocol in 1966 would have been the 1963 Draft of the Model.

only to residents of the UK. The bank was not a resident of the UK, only having a branch in the UK, and so was not entitled on the face of the legislation.

Commerzbank's claim for exemption and repayment of the tax plus repayment supplement was first heard by a Special Commissioner, Mr Everett, on 11 November 1987.[7] The Special Commissioner was asked to assume jurisdiction over the question of the bank's entitlement to repayment supplement, but declined to do so because no claim to repayment supplement had yet been made and refused, there was no appeal machinery in relation to repayment supplement, and it appeared to the Special Commissioner that, if the bank should succeed and be denied repayment supplement, its remedy would be to issue proceedings for recovery of the amount. The remainder of his decision focused, consequently, on the interpretation and application of article XV of the double taxation convention.

It was common ground between the parties that on a straightforward, literal construction of article XV, the bank was entitled to the exemption and to repayment of the tax.[8] The argument of the Inland Revenue (put forward by Mr WJ Durrans of the Solicitor's Office) was that, notwithstanding the clear words of the article, there was an implied limitation that benefits under the double taxation convention were not to be conferred on persons who were not citizens or residents of either the UK or the US. The bank was a resident of Germany, and so not entitled to access the benefits of the UK–US convention.

The Special Commissioner approached the matter by asking first if there was any ambiguity in the language of article XV, and whether the courts were permitted to have regard to any *travaux préparatoires* which would lead to a different conclusion from the literal interpretation. Sadly for the Revenue's argument, nothing could be produced by way of *travaux préparatoires*. The Special Commissioner concluded that there was no presumption against benefiting third parties (that is, resident or citizens of third states) under a treaty. The Inland Revenue was unable to produce any evidence that there was a general principle applicable to double taxation conventions that branches of non-resident corporations were unable to take the advantage of the benefits of a treaty concluded by the state in which they were situated.[9] By a decision of 30 November 1987, the Special Commissioner accepted Commerzbank's claim for exemption under the tax treaty, but rejected the claim for repayment supplement. Both parties requested a case stated: the bank against the refusal to consider the repayment supplement claim, and the Revenue against the decision in favour of exemption for the bank.

[7] *CIR v Commerzbank* (above n 2) 286 j.

[8] ibid, between f and g.

[9] One might regard this as a general problem of the application of tax treaties to permanent establishments (branches or agencies) situated in a contracting state. The PE is not a resident of its host state, even though for some tax purposes it is treated as if it were a local enterprise. One might contrast this position under international tax law with the position under EU law – see Judgment of 21 September 1999, *Compagnie de Saint-Gobain*, C-307/97, EU:C:1999:438.

It should be mentioned that, two days before the hearing of the Commerzbank application, a similar claim under the same article of the UK–US convention had also been made by the Banco Do Brasil SA, which was similarly rejected by the Special Commissioner and a case stated signed on 15 August 1988.[10] The two cases, raising the same point, went to the Chancery Division together (but the focus of this chapter is on the Commerzbank litigation, which included also the two other proceedings).[11]

The appeal by way of case stated was heard by Mummery J on 17 to 19 January 1990. At the time, he had been a judge of the Chancery Division for less than a year. It appears that he had never previously decided a case involving a double taxation convention, and it is not even clear if he had ever seen a double taxation convention previously.[12] In some respects, therefore, it is remarkable that his decision has become the accepted starting point for any discussion of the approach to tax treaty interpretation in the UK. He issued his decision only three weeks after the hearing, on 9 February 1990. He decided in favour of the bank on the exemption under article XV. (His judgment does not deal at all with repayment supplement, so it appears that the bank had abandoned its appeal against the Special Commissioner's decision on this issue and had decided by this stage that separate proceedings would be necessary in respect of that issue.) No appeal was brought against Mummery J's decision, and it is assumed that, sometime after the judgment, HMRC repaid £4,222,234 to the bank by way of corporation tax which had been wrongly paid.

That concluded the claim for exemption and repayment of the corporation tax, but it left the issue of repayment supplement.

Separate proceedings were brought in the Queen's Bench Division by way of judicial review of the Inland Revenue's refusal to pay repayment supplement. The case was heard by Nolan LJ (who wrote the judgment) and Henry J on 26 to 28 February 1991. On 12 April 1991 they issued a judgment concluding that the bank's claim for repayment supplement in accordance with UK law or the non-discrimination article of the UK–Germany double taxation convention failed.[13] However, they referred a single question for a preliminary ruling to the ECJ.[14] That question asked whether the failure of UK law to grant

[10] Which suggests that the possibility for branches of foreign banks in the UK to make a claim for exemption on interest derived from the US was relatively well known to the advisers to foreign banks, and not simply to Commerzbank.

[11] Commerzbank was represented before the Special Commissioners by Stephen Oliver QC, while Banco Do Brasil was represented by Stewart Bates QC; the Inland Revenue was represented by Mr WJ Durrans of the Solicitor's Office in both hearings.

[12] Though it is clear that Sir John Mummery had some experience with revenue matters. He had been instructed by the Inland Revenue in a number of tax cases while in practice as a barrister. So far as one can tell from the reported cases, none of those matters had involved tax treaties.

[13] Note: the non-discrimination claim was based on the UK–Germany treaty (Commerzbank being a national and resident of Germany), and not under the UK–US convention under which the exemption was claimed.

[14] This was not the first reference to the ECJ in a direct tax case from the UK (that honour belongs to *R v HM Treasury and CIR ex parte Daily Mail and General Trust plc*: Judgment of 27 September 1988, C-81/87, EU:C:1988:456), but it does appear to be the second.

repayment supplement to non-residents constituted a restriction of the freedom of establishment and indirect discrimination on grounds of nationality, contrary to what were then articles 5, 7, 52 and 58 of the EEC Treaty.

There was a hearing before the ECJ on 20 January 1993.[15] The opinion of Advocate General Darmon was issued on 17 March 1993, advising the Court that it should answer the question in favour of the bank. The Opinion concluded that the freedom of establishment precluded legislation which limited the payment of repayment supplement only to resident companies and refused it for non-resident companies.

On 13 July 1993 the ECJ issued its judgment in favour of the bank, confirming that the freedom of establishment prevented legislation from granting repayment supplement only to companies resident in the United Kingdom. The Court was made up of seven judges including the UK judge, David Edward.

A note at the end of the Tax Cases report of the litigation records that a consent order was issued in the Queen's Bench Division dated 31 March 1995 declaring that the Inland Revenue was not entitled to apply the requirement of UK residence as a condition for eligibility for repayment supplement, and that Commerzbank was entitled to repayment supplement accordingly.[16]

By way of summary, therefore, it took some 22 years (assuming that the dispute stretched back to the first year of operation of the branch in the UK) for Commerzbank to obtain repayment of the tax (to the tune of a little over £4 million.) and repayment supplement (to an amount of a little over £5 million), and four full hearings to do so: before the Special Commissioners, the Chancery Division, the Queen's Bench Division, and finally the European Court of Justice.

The remainder of this chapter focuses on the three main issues in the litigation: the UK approach to the interpretation of double taxation conventions (the decision of Mummery J); the domestic approach to non-discrimination (the decision written by Nolan LJ); and the European Union law approach to discrimination on grounds of residence (the judgment of the ECJ).

II. THE UK APPROACH TO TAX TREATY INTERPRETATION: THE DECISION OF MUMMERY J

The part of the decision of Mummery J which is most frequently quoted in subsequent cases is his six-bullet-point summary of the approach to interpretation, which merits being quoted in full as follows:[17]

> (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

[15] Commerzbank was now represented by Gerald Barling QC and David Anderson, and the UK government by Alan Moses QC and Derrick Wyatt.

[16] *R v CIR ex parte Commerzbank* (above n 3) 68 TC 252, 278.

[17] *CIR v Commerzbank* (above n 2) 297.

of an enactment is always a legitimate part of the process of interpretation': per Lord Wilberforce (at 272) and Lord Scarman (at 294).[18] A strictly literal approach to interpretation is not appropriate in construing legislation which gives effect to or incorporates an international treaty: per Lord Fraser (at 285) and Lord Scarman (at 290). A literal interpretation may be obviously inconsistent with the purposes of the particular article or of the treaty as a whole. If the provisions of a particular article are ambiguous, it may be possible to resolve that ambiguity by giving a purposive construction to the convention looking at it as a whole by reference to its language as set out in the relevant United Kingdom legislative instrument: per Lord Diplock (at 279).

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

> 'The language of an international convention has not been chosen by an English parliamentary draftsman. It is neither couched in the conventional English legislative idiom nor designed to be construed exclusively by English judges. It is addressed to a much wider and more varied judicial audience than is an Act of Parliament which deals with purely domestic law. It should be interpreted, as Lord Wilberforce put it in *James Buchanan & Co. Ltd v. Babco Forwarding & Shipping (UK) Limited*, [[1978] AC 141 at 152], 'unconstrained by technical rules of English law, or by English legal precedent, but on broad principles of general acceptation': per Lord Diplock (at 281–82) and Lord Scarman (at 293).

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

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

[18] These are references to the speeches in the House of Lords in *Fothergill v Monarch Airlines Ltd* [1981] AC 251 on which Mummery J drew heavily for his approach to treaty interpretation in general.

> (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 283–84) and per Lord Scarman (at 295).
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> (6) Aids to the interpretation of a treaty such as travaux préparatoires, international case law and the writings of jurists are not a substitute for study of the terms of the convention. Their use is discretionary, not mandatory, depending, for example, on the relevance of such material and the weight to be attached to it: per Lord Scarman' (at 294).

Commerzbank was not the first reported case to consider the application or interpretation of tax treaties in the UK.[19] However, it was the first case to treat the issue of tax treaty interpretation as a distinct topic for discussion, and the first to attempt to summarise the approach to the interpretation of double taxation conventions in bullet points. It is this formulation of a summary of the correct approach which has made it so easy for subsequent judges in subsequent cases to quote from this judgment. It is not possible to determine whether the summary was developed from submissions by counsel[20] or by the judge himself.

The six-point summary has been cited with approval by judges at various levels in subsequent cases,[21] and has become the classical starting point for any discussion of tax treaty interpretation in the UK. In many respects this illustrates what one might refer to as 'tax treaty interpretation meets the doctrine of *stare decisis*'. It is a process one can observe in a number of common law countries: a judgment is issued (not necessarily of the highest court) in which a judge summarises the approach to tax treaty interpretation. That summary is then quoted with approval by later courts, including higher courts, and eventually receives the approval of the highest court in that jurisdiction. The doctrine of precedent then coalesces around that summary, and, to a certain extent, ossifies that approach, which, by definition, is an approach unique to that particular jurisdiction.[22]

[19] In fact, four earlier cases involving tax treaties were cited in Commerzbank: *Avery Jones v CIR* [1976] STC 290; *CIR v Exxon Corp* [1982] STC 356; *Lord Strathalmond v CIR* [1972] 1WLR 1511; and *Sun Life Assurance Company of Canada v Pearson* [1986] STC 335.

[20] Before Mummery J the Revenue was represented by Alan Moses, and Commerzbank by Stephen Oliver QC and David Ewart, and Banco Do Brasil by Graham Aaronson QC. Any one of these gentlemen would have been capable of formulating the approach to interpretation in a series of bullet points. However, the judgment does not record that the judge was basing his summary on submissions of counsel.

[21] This includes the First-tier Tribunal in *FCE Bank Plc v Revenue & Customs* [2010] UKFTT 136 (TC), and *Felixstowe Dock & Railway Company Ltd v Revenue & Customs* [2011] UKFTT 838 (TC); the Court of Appeal in *HMRC v UBS AG* [2007] EWCA Civ 119, and *Ben Nevis (Holdings) Ltd v HMRC* [2013] EWCA Civ 578; and most recently the decision has been referred to in the Supreme Court in *Anson v Revenue & Customs* [2015] UKSC 44.

[22] One can see the same process at work in Canada, for example, around the decision of the Supreme Court in *R v Crown Forest Industries* (1995) DTC 5389, and in Australia around the decision in *McDermott Industries v CoT* (2005) 7 ITLR 800.

This process raises a number of issues of significance, which can be illustrated by *Commerzbank* and Mummery J's judgment. First, how to ensure that the approach adopted in each country and formalised through the doctrine of precedent is broadly the same as in other countries? Secondly, what to do if the summary is 'wrong', in the sense that it does not reflect an international consensus on the approach to the interpretation of double taxation conventions? Both these issues can be illustrated by Mummery J's summary of the approach to tax treaty interpretation.

First, the summary is not comprehensive. The most significant omission is any discussion of the role of the Commentaries to the OECD Model[23] as an aid to interpretation. These Commentaries are, in most cases, one of the first items anyone would turn to as an aid to interpretation. It is not entirely surprising, however, that Mummery J's summary does not make any reference to the Commentaries. The 1945 UK–US double taxation convention pre-dated and was, therefore, not based on the OECD Model. The OECD Model contained no provision equivalent to article XV of that convention, and, most significantly, the 1945 convention did not contain a provision equivalent to article 1 of the OECD Model, which states: 'Persons Covered: This Convention shall apply to persons who are residents of one or both of the Contracting States'.[24] The Commentaries did not feature as part of the issue in the Chancery Division.[25] Mummery J's summary does not, therefore, provide any guidance on the use of the Commentaries, including particularly the question of the use of subsequent Commentaries. It has been left to later cases to elaborate on this point.[26]

To be clear on the issue, the reference in Mummery J's summary at paragraph (5) to 'subsequent commentaries' is a reference to works written by academic commentators and not to official commentaries such as the Commentaries to the OECD Model. This becomes clear if one looks back at the paragraphs in the decision of the House of Lords in *Fothergill v Monarch Airlines Ltd*[27] which are cited by Mummery J as the basis for each of his six points in the summary. It would be an obvious error for anyone to think that Mummery J was making any reference whatsoever to subsequent Commentaries to the OECD Model.

[23] OECD, *Model Tax Convention on Income and on Capital* (the current version is that adopted in November 2017).

[24] One can entirely understand the position of the Inland Revenue as proceeding on the assumption that *all* double taxation conventions have an implied limitation equivalent to article 1 of the OECD Model; the decision of Mummery J reflects the fact that no such wording was found in the UK–US 1945 convention, and there was inadequate evidence to suggest that this reflected a general principle. Perhaps one might say that it was only by the 1960s, and the adoption of the OECD Draft of the Model, that this came to be recognised as a general principle applicable to all tax treaties. By the time the case was argued in 1987, this had become a general principle, but not in respect of a convention originally concluded in 1945.

[25] Before the Special Commissioners, the Revenue had cited from the Commentaries in support of the argument that there was an implied limitation that only residents of one of the two states could take a benefit from the treaty: no reference to this appears in the Chancery Division judgment.

[26] See, in particular, *Smallwood v HMRC* (2008) 10 ITLR 574.

[27] *Fothergill* (above n 18).

The second issue that arises (and in many respects the more interesting issue) is where summaries of this kind on the approach to treaty interpretation contain items that may be seen to be inaccurate in part, or simply wrong. In one sense, the judge presenting the summary cannot be inaccurate or wrong; the judge sets out his or her summary, and subsequent cases adopt that summary. However, what he or she explains in the summary may conflict with the views expressed in other countries, or possibly with the international consensus on the approach to interpretation, if one assumes that such consensus exists.[28] This can be illustrated by two points in Mummery J's judgment.

It is very hard to take issue with any of the six points in Mummery J's summary. However, outside that summary there are two other issues relating to treaty interpretation in the case with which one might justifiably take issue.

First, the Inland Revenue relied in argument on a joint statement issued by the US Internal Revenue Service and the Inland Revenue in 1977. This reflected a competent authority agreement and completely supported the Inland Revenue's position in the case.[29] As to the competent authority agreement, Mummery J says this:

> I should add, however, that this joint statement has no authority in the English courts. It expresses the official view of the Revenue authorities of the two countries. That view may be right or wrong. Although article XXA authorises the competent authorities to communicate with each other directly to implement the provisions of the convention and 'to assure its consistent interpretation and application' it does not confer any binding or authoritative effect on the views or statements of the competent authorities in the English courts.

The issue of the status of the competent authority agreement merited, perhaps, a more detailed and nuanced treatment. As Mummery J explains, the convention itself provided for competent authority agreements and, as such, any agreement reached merited more than a relatively abrupt dismissal.[30] It may be correct that the final arbiter on the meaning of the convention would be the English court, but the competent authority agreement might well be a matter to

[28] The existence of such a consensus is a contentious issue in itself (if one examines, for example, the widely divergent views on the legal status of the OECD Commentaries and particularly subsequent changes to the Commentaries). One may assume, however, that there are certain points that are non-contentious and widely accepted – this would include, for example, the applicability of the approach to treaty interpretation outlined in the Vienna Convention on the Law of Treaties 1969.

[29] This issue is dealt with at *CIR v Commerzbank* (above n 2) 301j–302d, and the competent authority agreement is quoted at the top of p 302.

[30] The provision in the 1945 UK–US convention was Art XXVIA(2) which provides: 'The competent authorities of the Contracting Parties may communicate with each other directly to implement the provisions of the present Convention and to assure its consistent interpretation and application'. This is perhaps not quite as clear a statement of authority to enter into binding interpretations as Art 25(3) of the OECD Model which provides: 'The competent authorities of the Contracting States shall endeavour to resolve by mutual agreement any difficulties or doubts arising as to the interpretation or application of the Convention'.

take into account, for example under article 31 of the Vienna Convention on the Law of Treaties.

The issue has been visited subsequently in the *Ben Nevis* litigation.[31] The Court of Appeal there reached a different conclusion on the significance of a competent authority agreement, referring to article 31 of the Vienna Convention and implying (wrongly, perhaps) that Mummery J had taken a different view because the provisions of the Vienna Convention had not been considered in respect to the status of the competent authority agreement.[32] If one looks at Mummery J's summary, however, there is explicit reference to the Vienna Convention (at paragraphs 3 and 4), so he was clearly aware of the provisions of the Vienna Convention. One might conclude that the issue of the status of competent authority agreements remains to be resolved by the Supreme Court in the UK.

The second point on which one might take issue with the judgment of Mummery J concerns the treatment of decisions of foreign courts. A decision of the US Court of Claims was cited by the Inland Revenue, *The Great West Life Assurance Company v United States*[33] which, while considering the US–Canada convention and a slightly different scenario, nevertheless discussed the rationale behind a provision similar to article XV of the UK–US convention. This discussion of the rationale supported the argument presented by the Inland Revenue. Nevertheless, Mummery J concluded that the decision was of little assistance, partly because the US Court had been heavily influenced in its decision by statements issued by the US Department of State and the US Treasury.

It will often be the case that courts in other countries have relied on material, or have adopted an approach, which would not have been relied upon or taken in the United Kingdom. Nevertheless, the principle of common interpretation would suggest that these foreign authorities are at least given consideration and treated as potentially persuasive authorities. It would, perhaps, be going too far to blame Mummery J for the dearth of cases in the United Kingdom where foreign judgments have been cited on the interpretation of equivalent provisions in the UK's treaties. Nevertheless, a more accommodating approach to foreign case law might have done more to further the principle of common interpretation.

Mummery J's decision is, of course, that of a judge sitting in the High Court. As one can see from the issue of competent authority agreements, higher courts are able to depart from or add to the approach taken by Mummery J. The issues raised by the doctrine of precedent formalising and rigidifying an erroneous approach to treaty interpretation are much greater where the decisions are those of the highest court in a country.

[31] *Ben Nevis* (above n 21).

[32] ibid, para 39.

[33] *The Great West Life Assurance Company v United States* 678 F 2d 180 (1982), (1982) 49 AFTR 2D, 82-1316.

Overall, one may say that Mummery J's six-point summary provided a good starting point for the development of an approach to the interpretation of tax treaties in the United Kingdom. The significance is proved by the number of subsequent cases in which the summary has been cited with approval.[34]

Before leaving Mummery J's judgment, one final point might be made. Despite the reference in point 1 of the summary to a purposive approach to interpretation, and the explicit rejection of a strictly literal approach, as well as references to article 31(1) of the Vienna Convention and the 'object and purpose' of the convention, in the final analysis the decision accepts a purely literal approach to the interpretation of article XV. As explained above, the Inland Revenue had accepted that on a literal interpretation the bank was entitled to the exemption. The task of the Revenue was to displace that by showing that the object and purpose led to a different conclusion. One may say that the Revenue simply failed to discharge that burden. Alternatively, one may say that, faced with little evidence that the purpose of article XV was not to grant an exemption in the circumstances, the judgment did, in the final analysis, revert to a strict, literal approach. Despite lip service paid in the six-point summary to a purposive approach to the interpretation of tax treaties, Mummery J ultimately reverts to the literal approach to interpretation, which was common in the interpretation of tax legislation at that time. This is a point which is returned to at the end of this chapter.

III. NON-DISCRIMINATION UNDER UK LAW AND THE UK–GERMANY DOUBLE TAXATION CONVENTION: THE DECISION OF NOLAN LJ

As explained above, the Inland Revenue did not appeal the decision of Mummery J, and paid the corporation tax back to the bank. That, however, left the issue of repayment supplement, and specifically the fact that under UK legislation it was available only to residents and not to non-residents such as the bank. The issue of discrimination on grounds of residence was, therefore, taken up in an application for judicial review of the Revenue's refusal to pay repayment supplement, heard by Nolan LJ and Henry J. The judgment was given by Nolan LJ.

Several arguments were advanced on behalf of the bank in support of its claim for repayment supplement.

First, the bank argued that, since it was paying corporation tax assessed on it in the same manner as a resident company, it should be treated as a resident company for the purposes of repayment supplement. This relied heavily on section 78 of the Taxes Management Act 1970 which provided that non-residents would be assessed to corporation tax 'in like manner and to the like amount' as a resident person. On that point, however, Nolan LJ concluded that

[34] See n 21 above.

too much weight was being placed on section 78. The bank was a non-resident company with a UK branch, and section 48(2) of the Finance (No 2) Act 1975 only provided for repayment supplement to be paid to residents.

Secondly, the bank relied upon the non-discrimination article in the UK–Germany double taxation convention of 1967. It cited both article XX(1), which dealt with discrimination on grounds of nationality, and also article XX(3) which provided that 'The taxation on a permanent establishment … shall not be less favourably levied … than the taxation levied on enterprises of that other territory carrying on the same activities'.

On the non-discrimination article, Nolan LJ first concluded that the refusal to extend repayment supplement constituted more burdensome taxation on the bank than was imposed on a UK-resident. However, there were three more general arguments which prevented the bank from relying on the non-discrimination article.

The first of these, and perhaps the most significant element of the decision on this point by the High Court, was that double taxation conventions are given effect in UK domestic law by what was then section 788(3) of the Income and Corporation Taxes Act 1988. That paragraph provides that double taxation conventions are to have effect in domestic law for a number of purposes specified in the subsection. None of those purposes referred to or covered repayment supplement. This was, therefore, a classic example – and perhaps the first instance identified by the UK courts – of 'tax treaty under-ride' by the United Kingdom. That is, the provision in the Taxes Act giving effect to the double taxation convention did not give full effect to the convention and, in particular, did not give effect to the non-discrimination article with regard to repayment supplement.

While the term 'treaty under-ride' is not used, and was not in fact invented until many years later, this is a clear identification of an example of treaty under-ride. In principle, the failure to extend repayment supplement to permanent establishments of German residents might well have contravened at least article XX(3) of the UK–Germany convention.[35] However, the contravention of the convention rested only at the level of public international law. The United Kingdom is a dualist country, and international treaties need to be given effect in domestic legislation in order to create rights on persons that can be enforced by them. The essence of treaty under-ride is that the United Kingdom, while undertaking the international obligation vis-a-vis the foreign country, has not given full effect in domestic law so that a person cannot rely upon breach of the convention to bring a claim and obtain relief. This remains the position today, and the Commerzbank litigation appears to be the first recorded example of a

[35] There is an argument that, if the non-discrimination article had been given effect in domestic law, the bank would still have failed because, if compared with a UK-resident company, such a company would not have been entitled to the exemption under the UK–US convention in the first place. I am grateful to Dr Avery Jones for this comment on the issue of the correct comparator.

judgment in the United Kingdom in the tax context identifying a case of treaty under-ride.

The second ground which prevented the bank from relying on the non-discrimination article, at least in terms of article XX(1), was that this paragraph prohibited discrimination on grounds of nationality. However, the refusal to grant repayment supplement was based upon the non-resident status of the bank, and not its German nationality. A UK-incorporated bank (incorporation being the equivalent of nationality for a company) which was resident in Germany for tax purposes[36] would equally have been refused repayment supplement. Unlike the European Court (as can be seen below), the High Court could not consider whether discrimination on grounds of residence amounted to indirect discrimination on grounds of nationality. Article XX(1) explicitly targeted only discrimination on grounds of nationality and not on grounds of residence. The German bank could not, therefore, argue that it had been discriminated against on grounds of nationality.

The final difficulty in relying upon the non-discrimination article raised the same issue as that raised by the application of European Union law: in determining whether there had been discrimination, should a broad or a narrow view be taken of the factual circumstances that led to the alleged discrimination? This was one of the points that the Queen's Bench Division decided should be left to the European Court.

Having rejected the claim to repayment supplement either under UK domestic law or under the non-discrimination article of the UK–Germany double taxation convention, Nolan LJ concluded that it was appropriate to refer the issue of application of European law to the ECJ. The issues raised concerned both discrimination under the general prohibition of discrimination of nationality, and also the application of the freedom of establishment. These issues were not *acte claire*, were necessary for the final determination of the claim to repayment supplement, and were appropriate for referral to the ECJ.

It is perhaps rather easy to regard the judgment of Nolan LJ as being of primary importance because it paved the way for the reference to the European Court. However, the judgment has significance in its own right. In particular, it is a clear example of treaty under-ride in the United Kingdom, an issue which has not been resolved to the present day.

IV. NON-DISCRIMINATION UNDER EU LAW: THE DECISION OF THE EUROPEAN COURT OF JUSTICE

There were essentially two issues before the ECJ which were raised by the single question referred by the High Court.

[36] Because its central management and control was in Germany, which was the sole test of residence at the time that the issue arose.

First, whether in determining if there was discrimination or an infringement of the freedom of establishment, should a broad view of the factual circumstances be taken, or a narrow view? The argument for the United Kingdom government was that a broad view should be taken: had Commerzbank been a UK-resident bank, it would not have been entitled to the exemption from tax under article XV of the UK–US treaty. It was only because it was *not resident* in the UK that it could take advantage of that exemption. Factoring this element in, Commerzbank was treated no worse overall than a UK-resident company in similar circumstances; to the contrary, it was treated better in that it was entitled to exemption and repayment of the tax, even if it was not entitled to the repayment supplement. By contrast, on a narrow view, Commerzbank – as a German resident – having become entitled to a repayment of tax was denied repayment supplement, while a UK-resident company being entitled to a tax repayment (for whatever reason) was entitled to the supplement. This raised very neatly the general question whether in determining the question of discrimination one should look broadly at the issue or take a narrower approach.

The second issue is an even more general question. The prohibition on discrimination in what was then articles 5 and 7 of the EC Treaty[37] prohibited discrimination on grounds of nationality. Similarly, the freedom of establishment in articles 52 and 58 of the Treaty[38] referred not to a resident but (in this case) to a company having its seat in a Member State. The condition attached to repayment supplement, which prevented Commerzbank from claiming it, was, by contrast, a condition attaching to residence. As a very general question, which had not at that time been resolved by the European Court, could discrimination on grounds of residence be equated to, or be an indirect form of, discrimination on grounds of nationality?

This latter point is, of course, of general importance. Tax systems often apply different rules to residents and non-residents, and less commonly apply different rules on grounds of nationality. If the prohibition of nationality discrimination in the EC Treaty also encompassed rules that discriminated on grounds of residence, then the impact on the direct tax systems of the Member States would be far more significant. Since the principles of international taxation, in accordance with the doctrine of territoriality, generally accept that a resident and a non-resident are not in a comparable position, an approach taken by European law that generally prohibited discrimination on grounds of residence (subject, of course, to justification and proportionality) would mean that, in the direct tax field, EU tax law and the general principles of international taxation would begin to diverge along different paths. On this second general issue, therefore, the decision of the ECJ would have far-reaching consequences.

[37] Now Arts 18 and 20 of the Treaty on the Functioning of the European Union (2007).
[38] Now Arts 49 and 54 of the Treaty on the Functioning of the European Union.

The Advocate General, Darmon, advised the Court to determine both issues in favour of Commerzbank. On the issue of broad or narrow approach, a narrow approach should be taken. Once a German company became entitled to repayment of tax, it would breach the freedom of establishment if it was denied repayment supplement while a UK-resident company was entitled to that supplement. It was not appropriate to go further and consider the reasons why the tax was repayable: the simple, and narrow, comparator was between a UK-resident company entitled to a repayment of tax and a German company entitled to a repayment of tax. To refuse the repayment supplement infringed the freedom of establishment exercised by the German company when it formed a branch in the United Kingdom.

On the second issue, the Advocate General asked whether discrimination on grounds of residence can be analysed as indirect discrimination on grounds of nationality.[39] He concluded that a residence condition may constitute disguised discrimination on grounds of nationality in as much as, in practice, such a condition principally affects nationals of other Member States. Put quite simply, resident persons were likely to have the nationality of the state of residence, while non-residents were more likely to have the nationality of another Member State. This applied equally to residence as a connecting factor for tax purposes.

Having examined the UK test of central management and control, the Advocate General stated that the criteria of residence and nationality overlapped to a large extent. The Advocate General seemed well aware of the potentially far-reaching implications of the view he was expressing. Nevertheless, a condition based upon residence in a Member State could, very clearly, result in an unjustifiable difference of treatment which interfered with the enjoyment of the freedom of establishment of companies having their seat in another Member State.

The ECJ dealt with the entire issue in a remarkably concise fashion. The entire decision on the right of establishment is contained in eight paragraphs which may be quoted in full.

The right of establishment

13. As the Court held in its judgment in Case C-270/83 *Commission v France* [1986] ECR 273, at paragraph 18, the freedom of establishment which Article 52 grants to nationals of a Member State, and which entails the right for them to take up and pursue activities as self-employed persons under the conditions laid down for its own nationals by the law of the Member State where such establishment is effected, includes, pursuant to Article 58 of the EEC Treaty, the right of companies or firms formed in accordance with the law of a Member State and having their registered office, central administration or principal place of business within the Community to pursue their activities in the Member State concerned through a branch or agency.

[39] See paras 28–53 of the Advocate General's Opinion: AG's Opinion of 17 March 1993, *R v CIR ex parte Commerzbank AG*, C-330/91, EU:C:1993:101.

> With regard to companies, it should be noted in this context that it is their seat in the abovementioned sense that serves as the connecting factor within the legal system of a particular State, like nationality in the case of natural persons. In the same judgment the Court held that acceptance of the proposition that the Member State in which a company seeks to establish itself may freely apply to it different treatment solely by reason of the fact that its seat is situated in another Member State would deprive the provision of all meaning.
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> 14. Moreover, it follows from the Court's judgment in Case 152/73 *Sotgiu v Deutsche Bundespost* [1974] ECR 153 (at paragraph 11) that the rules regarding equality of treatment forbid not only overt discrimination by reason of nationality or, in the case of a company, its seat, but all covert forms of discrimination which, by the application of other criteria of differentiation, lead in fact to the same result.
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> 15. Although it applies independently of a company's seat, the use of the criterion of fiscal residence within national territory for the purpose of granting repayment supplement on overpaid tax is liable to work more particularly to the disadvantage of companies having their seat in other Member States. Indeed, it is most often those companies which are resident for tax purposes outside the territory of the Member State in question.
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> 16. In order to justify the national provision at issue in the main proceedings, the United Kingdom Government argues that, far from suffering discrimination under the United Kingdom tax rules, non-resident companies which are in Commerzbank's situation enjoy privileged treatment. They are exempt from tax normally payable by resident companies. In those circumstances, there is no discrimination with respect to repayment supplement: resident companies and non-resident companies are treated differently because, for the purposes of corporation tax, they are in different situations.
>
> 17. That argument cannot be upheld.
>
> 18. A national provision such as the one in question entails unequal treatment. Where a non-resident company is deprived of the right to repayment supplement on overpaid tax to which resident companies are always entitled, it is placed at a disadvantage by comparison with the latter.
>
> 19. The fact that the exemption from tax which gave rise to the refund was available only to non-resident companies cannot justify a rule of a general nature withholding the benefit. That rule is therefore discriminatory.
>
> 20. It follows from those considerations that the reply to be given to the national court is that Articles 52 and 58 of the Treaty prevent the legislation of a Member State from granting repayment supplement on overpaid tax to companies which are resident for tax purposes in that State whilst refusing the supplement to companies which are resident for tax purposes in another Member State. The fact that the latter would not have been exempt from tax if they had been resident in that State is of no relevance in that regard.

On the second question of discrimination on grounds of residence, paragraph [15] quoted above concludes the issue by stating that 'the use of the criterion of fiscal residence within national territory for the purpose of granting repayment supplement on overpaid tax is liable to work more particularly to the disadvantage of

companies having their seat in other Member States'. This approach, which can be traced back to the *Avoir Fiscal* case,[40] set EC direct tax law on a path where it was certain to diverge from the general approach taken in international taxation. International taxation is based on a principle of territoriality that residents and non-residents are not in a comparable position with respect to the imposition of taxes; by contrast, this case confirmed that under EU law a difference in treatment on grounds of residence might well be seen as an indirect restriction of freedoms based on nationality.

On the first issue identified above, as to whether one should take a broad or a narrow approach, the ECJ clearly adopted the narrow approach. At paragraphs 16–19 quoted above, the Court considered that the only comparison was between the resident company entitled to a tax repayment and a non-resident company entitled to a tax repayment. To deny repayment supplement to the UK branch of the non-resident company interfered with the freedom of establishment.

The *Commerzbank* case is, of course, not the only decision of the ECJ to conclude that discrimination on grounds of fiscal residence might involve discrimination on grounds of nationality or infringe one of the fundamental freedoms. However, particularly having regard to the opinion of Advocate General Darmon, it is the earliest case where the distinction between fiscal residence and nationality is most clearly discussed, and the view taken that a difference of treatment on grounds of fiscal residence might involve indirect discrimination on grounds of nationality. In that respect, it represents one of the fundamental steps in the development of European Union tax law.

As explained above, when the judgment of the ECJ was reported back to the High Court in London, the litigation concluded by a consent order under which it was ordered and declared that the Inland Revenue was not entitled to apply a requirement of UK residence to deny repayment supplement to Commerzbank, and Commerzbank was entitled to the repayment supplement accordingly. In effect, the Inland Revenue accepted that the condition of residence in the UK for entitlement to repayment supplement had to be disapplied to give effect to the directly applicable EU law rights of Commerzbank.

V. CONCLUDING COMMENTS

The Commerzbank litigation justifies its inclusion in a compilation of leading cases on UK taxation on several grounds: it contains the now standard summary of the approach to tax treaty interpretation; it contains a discussion

[40] Judgment of 28 January 1986, *Commission v France*, C-270/83, EU:C:1986:37 – see para [13] quoted above.

of non-discrimination under tax treaties and, in particular, an example of treaty under-ride; and it is one of the ECJ cases that most clearly concluded that discrimination on grounds of residence could be regarded as indirect discrimination on grounds of nationality and be challenged as an infringement of the freedom of establishment or the general prohibition of nationality under the EC Treaties.

All that being said, it is reasonable to conclude by asking whether the case was rightly decided at the outset. It is difficult not to have a degree of sympathy with the position of the Inland Revenue from the beginning. Anyone steeped in double taxation convention practice would automatically assume that provisions in a double taxation convention are intended to apply only to persons who are residents of one or both of the two countries that are parties to the convention. The UK–US convention should, in principle, apply only to persons who are resident in the US or the UK. A German bank should, in principle, have never been entitled to access the benefits of that convention. Conventions based upon the OECD Model state this explicitly in article 1; the fundamental approach of the Inland Revenue (rejected by Mummery J) was to seek to imply that principle into an earlier convention of 1945 which did not have the explicit wording of article 1 of the Model. Had Mummery J perhaps been more steeped in the principles of international taxation, he might have had less difficulty in recognising such an implied, general principle.

Even if one were unwilling to imply that as a general limitation, an examination of the object and purpose of article XV might well have led to the conclusion that the purpose was to deal with a particular issue related to the deemed US source rule for interest paid by a foreign corporation.[41] A claim for exemption by the UK branch of a German bank was never within the object and purpose of the article.

The UK branch of Commerzbank enjoyed an exemption from tax which, one may assume, was never within the contemplation of the negotiators of the UK–US double taxation convention of 1945 (or the supplementary protocol of 1966):[42] the branch enjoyed an unintended windfall, and got both repayment of tax and repayment supplement as well.

All that being said, the litigation forms the canvas for the development of some fundamental principles which go well beyond the particular circumstances: these include the approach to the interpretation of double taxation conventions, and the application of EU tax law to provisions discriminating on grounds of residence. Litigation is like armed conflict: once begun, one can never predict

[41] That explanation for the purpose of the article comes from the joint statement of the revenue authorities and from *Great West Life* (above n 33) which Mummery J was averse to following.

[42] The enactment of a specific provision on losses of branches in receipt of exempt interest in s 50(1), FA 1976 suggests that the possible ramifications of Art XV were seen relatively early. I am indebted to Dr Avery Jones for pointing out this provision.

the outcome or its consequences. When Commerzbank was advised that it might make a claim for exemption and repayment supplement, only the most far-sighted of legal advisers might have appreciated that this would give rise to a leading case on treaty interpretation and on the application of EU law in the direct tax context. That, however, is where the case ended up, and the Commerzbank litigation deserves its place in a collection of leading cases on UK taxation for those reasons.