Neutral Citation: **[2023] UKUT 00146 (TCC)**

Case Number: UT/2021/000165

UPPER TRIBUNAL
(Tax and Chancery Chamber)

The Royal Courts of Justice, Rolls Building,
Fetter Lane, London EC4A 1NL

CORPORATION TAX – UK/USA double tax convention – meaning of a "resident of Contracting State" for purposes of convention – whether UK resident company with shares stapled to those of US company treated as domestic corporation for purposes of US federal tax law also resident for purposes of convention – yes – whether First-tier Tribunal erred in deciding that appellant was not carrying on business in USA – no – appeal allowed

Heard on: 28 February, 1 and 2 March 2023
Judgment date: 29 June 2023

Before

MR JUSTICE RICHARD SMITH
JUDGE ANDREW SCOTT

Between

GE FINANCIAL INVESTMENTS

Appellant

and

THE COMMISSIONERS FOR HIS MAJESTY'S REVENUE AND CUSTOMS

Respondents

Representation:

For the Appellant: Philip Baker KC and John Brinsmead-Stockham KC, instructed by Slaughter and May

For the Respondents: Hui Ling McCarthy KC and Barbara Belgrano, instructed by the General Counsel and Solicitor to His Majesty's Revenue and Customs

DECISION

INTRODUCTION

1. This appeal concerns the interpretation of the UK/USA double tax convention and its application to GE Financial Investments ("GEFI Ltd") for its accounting periods ending 31 December 2003 to 31 December 2008.

2. GEFI Ltd filed company tax returns for each of those periods in which it claimed a credit for US federal income tax paid on interest income it was beneficially entitled to as a limited partner in a Delaware limited partnership. The credit in question was against UK corporation tax paid by GEFI Ltd on the same income. HMRC refused the claims.

3. It was not in dispute that GEFI Ltd was resident in the United Kingdom for the relevant period and that it was consequently liable to corporation tax on its worldwide income.

4. The total amount of the relief denied was £124,913,161.86. The tax assessed in the UK was paid by the appellant in November 2021 in order to stop the accrual of further interest. The interest accrued up to that time was £63,717,137. GEFI Ltd has, therefore, paid just under £189 million in total in respect of the disputed claims to double taxation relief.

5. GEFI Ltd appealed to the First-tier Tribunal ("the FTT") against the denial by HMRC of the relief. The FTT dismissed the appeal in a decision dated 8 June 2021. GEFI Ltd appeals to this Tribunal against that decision with the permission of the FTT.

6. There were two principal issues before the FTT.

7. The first ("issue 1") was whether GEFI Ltd was a resident of the USA for the purposes of Article 4 of the UK/USA double tax convention. If it was, it would be entitled to the double taxation relief it had claimed.

8. GEFI Ltd had amended its articles of association restricting the transfer of its ordinary dollar shares unless all the common stock in an affiliate company incorporated in Delaware (GE Financial Investments, Inc ("GEFI Inc")) was transferred to the transferee at the same time. A similar amendment was made to the certificate of incorporation of GEFI Inc. In consequence of these amendments, the shares of GEFI Ltd were "stapled" to the stock of GEFI Inc. One effect of this stapling was that, for US federal income tax purposes, GEFI Ltd was treated as a domestic corporation and was liable to tax there on its worldwide income.

9. The FTT held that, despite the fact that GEFI Ltd was liable to federal tax in the US in that way, it was not resident in the USA for treaty purposes.

10. Having found against the appellant on that issue, the FTT then considered a second issue, whether GEFI Ltd carried on business in the USA through a permanent establishment there for the purposes of Article 7 of the UK/USA double tax convention ("issue 2(a)"). If it did, it would be entitled to double taxation relief in the UK in respect of the US tax payable if (but only if) the UK was required, pursuant to Article 24(4)(a) of the convention, to give relief against US tax ("issue 2(b)").

11. The FTT decided issue 2(a) against GEFI Ltd and, having also held against the appellant on issue 1, consequently dismissed the appeal. However, in the event that its conclusion on issue 2(a) was wrong, the FTT went on to consider issue 2(b) and found in favour of the appellant.

12. GEFI Ltd appeals against the FTT decision in respect of both issues 1 and 2(a). HMRC challenges the FTT decision in respect of issue 2(b) by way of a respondents' notice. It was common ground that if GEFI Ltd succeeds on issue 1, the appeal must be determined in its

favour. If it does not succeed on issue 1, it needs to be successful on both aspects of issue 2 in order for its claims to double taxation relief to be made out.

13. For the reasons given below, we consider that the FTT was wrong to conclude that GEFI Ltd was not resident in the USA for the purposes of the UK/USA double tax convention (and hence the appeal is determined in favour of GEFI Ltd on issue 1). Nonetheless, we go on to consider issue 2(a) as we heard very detailed argument on it occupying a substantial portion of the hearing and in the event of an appeal against our decision.

14. However, we have not considered it appropriate to make findings in relation to issue 2(b). This was a complex issue, which was dealt with relatively briefly by both parties. It would be relevant only if we are wrong on both issue 1 and issue 2(a). It would, in our view, be better for that issue to be considered in a case where it is determinative. For that reason, we say no more about issue 2(b) in the remainder of this decision.

SUMMARY OF THE RELEVANT FACTS

Relevant group structure

15. The relevant transactions giving rise to the income taxed in the UK and USA involved a number of General Electric group companies.

16. GEFI Ltd was a private limited company incorporated under the Companies Act 1985. It was a subsidiary of GE Capital Investments ("GECI"), which was a UK resident private unlimited company. GEFI Inc, a Delaware corporation, was also a subsidiary of GECI.

17. In turn GECI was a subsidiary of General Electric Capital Corporation ("GECC"), a company incorporated in the USA and a wholly-owned member of the group of companies headed by the General Electric Company, also incorporated in the US.

18. A simplified diagrammatic representation of the group structure is included in an Annex to this judgment, which also includes reference to loans made by the limited partnership that are central to this appeal and are summarised below.

19. GEFI Ltd was dormant from 31 August 1997 to June 2003. On 27 June 2003 it adopted a new memorandum and articles of association by special resolution. The objects included:

(1) the objects, at (A), "to carry on business as a general commercial company and to carry on any trade or business whatsoever;

(2) the object, at (B), to hold "directly or indirectly financial receivables and other assets including (but not limited to) shares or stock in any company carrying on a financial trade";

(3) the objects, at (D), "to advance, deposit or lend money";

(4) the object, at (E), "to carry on any other trade or business whatever"; and

(5) the objects, at (L), to "lend and advance money or give credit … and to receive money on deposit or loan …".

20. The articles of association also provided at Article 8.3A that:

> "no Ordinary Dollar Shares in the capital of the Company shall be transferred unless there are transferred to the transferee at the same time all of such Ordinary Dollar Shares for the time being in issue and all of the Common Stock in [GEFI Inc] for the time being outstanding."

21. GEFI Inc had (on the previous day – 26 June 2003) amended its certificate of incorporation so as to provide a similar restriction on the transfer of its shares.

22. These changes to GEFI Ltd's articles of association and GEFI Inc's certificate of incorporation constituted the share staple, which is, as noted above, relevant to the operation of US federal tax law.

The formation of a limited partnership

23. A limited partnership, GE Financial Investments (USA) LP, was formed on 27 June 2003 pursuant to an agreement between GEFI Inc as general partner and GEFI Ltd as limited partner. The formation was in accordance with the Delaware Revised Uniform Limited Partnership Act.

24. Under that Act, the general partner is an agent of the partnership for the purposes of its business or activities and is liable for all its obligations, and a limited partner is not liable for the obligations of the partnership unless it is also a general partner or, in addition to the exercise of the rights and powers of a limited partner, it participates in the control of the business. Unlike a limited partnership formed in the UK, there is no requirement under Delaware law for the limited partnership to carry on a business.

25. The provisions of the limited partnership agreement recited, at [2], its purposes as "to (i) hold directly or indirectly financial receivables and other assets, and companies carrying on a financial trade, and engage in activities related or incidental thereto, and (ii) engage in any and all lawful activities to which the General Partner and the Limited Partner agree".

26. The partners made contributions to the limited partnership by way of promissory notes. The relevant promissory notes were acquired by the partners as follows. On 26 June 2003 GECC received two promissory notes from another corporation incorporated in the US, GELCO Corporation ("GELCO"). The first promissory note (loan 1) was for approximately US $1.5 billion and the other (loan 2) was for approximately US $15million. Both notes were then transferred to GECI on the following day (27 June 2003). On the same day GECI contributed the loan 1 promissory note to GEFI Ltd in exchange for shares and contributed the loan 2 promissory note to GEFI Inc in exchange for shares.

27. This enabled GEFI Ltd to contribute the loan 1 promissory note to the limited partnership in return for a 99% interest and enabled GEFI Inc to contribute the loan 2 promissory note to the limited partnership in return for a 1% interest.

28. Further contributions were made to the limited partnership in 2004 and 2006 as follows:

(1) in July 2004 GEFI Ltd contributed approximately US $1.1 billion to the limited partnership and made a loan of approximately US $11 million to GEFI Inc, which in turn contributed it to the limited partnership; and

(2) in July 2006 GEFI Ltd contributed approximately US $204m to the limited partnership and GEFI Inc made a contribution of approximately US $2 million.

The loans made by the limited partnership

29. The contributions to the limited partnership were then lent by the limited partnership to affiliates of the GE group. On 1 July 2004 the limited partnership lent GELCO approximately US $ 1.1 billion (loan 3). On 31 July 2006 the limited partnership extended to GECC a revolving credit facility of up to approximately US $14 million, which was then increased to approximately US $206 million in September 2006 (loan 4). On 7 December 2006 the limited partnership made a loan of approximately US $210 million to GELCO (loan 5). This loan followed a restructuring of existing loans. It did not involve the lending of further sums beyond those already lent.

30. In summary, the limited partnership received various contributions to it (including loans 1 and 2) and made three loans to affiliate companies one of which did not result in 'new' money.

The rationale for using the limited partnership to make loans

31. The limited partnership structure was originally set up to obtain a US tax advantage. In the event a change in US federal tax law meant that this advantage never materialised.

32. But the existence of the limited partnership also had a potential UK tax advantage in relation to the UK's so-called "thin capitalisation" rules. A company whose equity capital is low compared to the amount of its debt is "thinly capitalised" and UK tax rules restrict the amount of interest deductions in those circumstances. The additional income arising to GEFI Ltd through the limited partnership structure was beneficial for the operation of those rules through an increased capacity to deduct interest. As it turned out, that extra capacity was not in fact needed.

The way in which the loans were made: findings by the FTT

33. It is convenient to consider here the further findings of fact, or inferences of fact drawn from primary facts, made by the FTT. Mr Baker KC (on behalf of the appellant) made no challenge to the findings of fact made by the FTT.

34. The FTT commented at [9] that "the extent of the participation in the loan transactions by the various entities and the individuals involved can be identified by the email exchanges between them".

35. The FTT referred to a number of those emails in its discussion at [85] to [87] on whether GEFI Ltd was carrying on a business. At [84] the FTT recorded its agreement with Ms McCarthy KC (on behalf of HMRC) that "all that appears to have happened was that monies were directed straight to GELCO without negotiating terms or the consideration at a director level as would have been expected from a company carrying on commercial activities on sound business principles." It referred at [85] to the fact that the director of GEFI Inc was content to sign a loan agreement for a substantial sum and "only then, seemingly as an afterthought and "out of curiosity", ask for the reason for the transaction". At [86] the FTT said that contemporaneous emails indicated it was individuals in the General Electric tax department that were concerned with the documentation and rationale for the particular transactions. And, in that connection, the FTT also noted at [87] that a member of the General Electric tax department (Mr Tomasetti) was not aware of any business purpose for the refinancing.

36. In its discussion of issue 2(a) the FTT then went on to make further factual findings at [88] to [90] or summarised findings already recorded earlier in its judgement:

> (1) the only activities of the LP in 2003 were its formation and the capital contributions of the partners;
>
> (2) in subsequent years the activities included payment instructions originated by management personnel from elsewhere within the General Electric group and subsequently approved by the directors of GEFI Inc; and
>
> (3) the purpose of the board meetings of GEFI Inc was to review, approve and ratify the company's past activity rather than make strategic decisions in relation to its current and subsequent dealings and the board had "a very limited involvement" in the activities of the company.

WAS GEFI LTD RESIDENT IN THE USA FOR THE PURPOSES OF THE UK/USA DOUBLE TAX CONVENTION (ISSUE 1)?

The FTT decision

37. The FTT held that GEFI Ltd was not resident in the USA for the purposes of Article 4(1) of the UK/USA double tax convention. Article 4(1) of that convention was in these terms:

> "… the term "resident of a Contracting State" means, for the purposes of this Convention, any person who, under the laws of that State, is liable to tax therein by reason of his domicile, residence, citizenship, place of management, place of incorporation, or any other criterion of a similar nature. This term, however, does not include any person who is liable to tax in that State in respect only of income from sources in that State or of profits attributable to a permanent establishment in that State."

38. The text of Article 4(1) was closely modelled on the corresponding text of the OECD model convention that was in force at the time when the UK/USA double tax convention was entered into. The most relevant difference for the purposes of this appeal was that, unlike the OECD model convention, the UK/USA double tax convention included a reference to citizenship and place of incorporation.

39. The essence of FTT's reasoning, set out at [61] to [65] of its judgment, is as follows:

(1) the FTT rejected submissions made by GEFI Ltd that the connection in the criteria following the words "by reason of" in the definition of a "resident of a Contracting State" was simply the imposition of 'full' taxation: if the words from "by reason" to the end of the sentence were omitted, it would be clear from the second sentence in Article 4(1) that it covered only a resident who was liable to 'full' taxation (and this interpretation held good for the OECD model convention as well);

(2) HMRC's analysis (which the FTT accepted as correct) required <u>both</u> 'full' taxation and a direct connection to the contracting state concerned;

(3) this interpretation was consistent with academic commentary and the Canadian Supreme Court decision in *Crown Forest Industries v Canada* [1995] 2 SCR 802, which was authority for the proposition that 'full' taxation was a necessary but insufficient requirement; and

(4) in the present case, there was no connection to the USA (as a result of the share stapling) because the share stapling demonstrated a connection between the relevant shareholders but did not result in the creation of legal rights or obligations in the USA (other than those relating to tax): consequently, it was not a "criterion of a similar nature" to the other criteria mentioned in Article 4(1) of the convention.

40. There are three components to HMRC's case the first two of which are framed by reference to the OECD model convention.

41. First, HMRC adopted a linguistic analysis of Article 4(1) of the OECD model convention as explained in {39}(1) above. This analysis also drew support from a further textual analysis of the expression "any criterion of a similar nature".

42. Second, it logically followed from this that the connecting criteria in Article 4(1) of the OECD model convention could not simply be <u>any</u> reason adopted by a state for imposing 'full' taxation. There needed to be a personal connection between the state and the taxpayer. HMRC therefore endorsed the view of academic commentators (*Vogel on Double Taxation Conventions* and Marcel Widrig, in the chapter "*The Expression 'by reason of His Domicile, Residence, Place of Management ….' As Applied to Companies*" in Guglielmo Maisto's *Residence* of *Companies under Tax Treaties and EC Law* (IBFD, 2009)) that a <u>territorial</u> connection was required in the case of the OECD model convention and this meant that incorporation was not (as a legal or formal connection) a criterion of a similar nature.

43. Third, in the case of the UK/USA double tax convention (which, as mentioned above, includes a reference to place of incorporation and citizenship as connecting factors but which was in other respects based on the OECD model convention), a personal connection between

the state and the taxpayer was still required. Evidently, a 'territorial' connection was not the only means to establish treaty residence: legal and formal connections with the state are also included. In HMRC's view, the further non-territorial connection must be a direct connection between the taxpayer and the state. It cannot arise simply as a result of the relationship with another company where it is the other company that has a direct connection to the state. It is for this reason that HMRC place considerable emphasis on the fact that, in the case of the share stapling rule, there were – and this was common ground – no legal consequences in the US for GEFI Ltd other than federal tax consequences.

44. For the reasons given in more detail below, we are unable to accept any of those components of HMRC's case.

45. The proper approach to construing the terms of the UK/USA double tax convention includes consideration of its context, object and purpose, which, among other things, requires an understanding of the background against which the UK and the USA entered into the convention. The contextual background includes the relevant provisions of both UK corporation tax and US federal income tax at the material time. It requires an understanding of the OECD model convention, read in the light of the OECD commentary on the convention, and why the US has adopted its own version of the model. Once full account is taken of those matters, the meaning of Article 4(1) of the UK/USA double tax convention is, in our view, clear.

Relevant legal principles for construing double tax conventions

46. At [15] to [17] in *Irish Bank Resolution v HMRC* [2020] EWCA Civ 1128 the Court of Appeal set out the following principles of construction in relation to double tax conventions:

> "15. […] Article 31 of the 1969 Vienna Convention on the Law of Treaties provides:
>
> > 1. A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose.
> >
> > [...]
>
> 16. It was common ground that a convenient summary of these principles and the way in which they have been applied by the English courts is to be found in the judgment of Mummery J (as he then was) in *Inland Revenue Commissioners v Commerzbank AG* [1990] STC 285 at page 297 where the judge said:
>
> > "[…] The parties are agreed that the correct approach is that laid down by the House of Lords in *Fothergill v Monarch Airlines Ltd* [1981] AC 251. […] that decision makes clear the approach which should be adopted by the court.
> >
> > > (1) It is necessary to look first for a clear meaning of the words used in the relevant article of the convention. […].
> > >
> > > (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 281–282) 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 […]

(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' […]

(5) Subsequent commentaries on a convention or treaty have persuasive value only, depending on the cogency of their reasoning. Similarly, decisions of foreign courts on the interpretation of a convention or treaty text depend for their authority on the reputation and status of the court in question: per Lord Diplock (at 283–284) and per Lord Scarman (at 295).

(6) Aids to the interpretation of 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)."

[...]

17. […]. Although the views expressed in [textbooks and other articles] are of some interest, they are of course no more than the views of their authors (however distinguished) on the issues discussed and are not in any sense authoritative in relation to the legal issues of construction which we have to decide."

47. This approach has been endorsed by the Supreme Court in *Fowler v HMRC* [2020] UKSC 22: see [16], [18] and [19]. In particular, at [16] the court confirmed that guidance as to how a double tax treaty is to be interpreted is to be found in, among other things, OECD commentaries on the OECD model convention on which the treaty is based.

48. The Supreme Court made some further observations about context in its decision in *HMRC v Anson* [2015] UKSC 44, noting at [58] that:

"The contemporary background of a treaty, including the legal position preceding its conclusion, can legitimately be taken into account as part of the context relevant to the interpretation of its terms".

49. The Supreme Court noted in that case at [110] the terms of article 31(1) of the Vienna Convention and quoted (with approval) the observation of Robert Walker J at first instance in *Memec* [1996] STC 1336 at 1349 that a treaty should be construed in a manner which is "international, not exclusively English" before continuing at [111]:

"[111] That approach reflects the fact that a treaty is a text agreed upon by negotiation between the contracting governments. The terms of the 1975 Convention reflect the intentions of the US as much as those of the UK. […] In that context, one would be predisposed to favour an interpretation which reflected the ordinary meaning of the words used and the object of the

> Convention. This is indeed a point which has been repeatedly made, in other cases concerned with the construction of the UK/US double taxation conventions, in the face of narrow and technical constructions […].”

50. The importance of the negotiation between the contracting parties is well brought out in the recent Canadian Supreme Court decision in *Canada v Alta Energy Luxembourg SARL* 2021 SCC 49 (decided after the FTT made its decision in this case) where the Canadian Supreme Court said this at [34] and [59]:

> “[34] … Reciprocity is a fundamental principle underlying tax treaties …. Hogan J. observed that “[p]arties to a tax treaty are presumed to know the other country’s tax system when they negotiate a tax treaty; they are presumed to know the tax consequences of a tax treaty when they negotiate amendments to that treaty” (para. 84). This only makes sense.
>
> [59] […] treaty partners do not have the unfettered liberty to alter or redefine residence as they wish for the purposes of a tax treaty. […] Pursuant to the principle of *pacta sunt servanda*, parties to a treaty must keep their sides of the bargain and perform their obligations in good faith (art. 26 of the Vienna Convention). Domestic law definitions of residence should therefore broadly correspond to international norms and not have the effect of redefining residence in a way ‘that takes the words unmistakably past their accepted usage’ (*Couzin*, at p. 136), including the definitions of residence that were in effect in the two states at the time the Treaty was drafted.”

51. In the light of the above authorities, we start with the tax background when the UK/USA double tax convention was entered into before considering the text of the OECD model convention, and the OECD commentary on the convention, applicable at that time. In the light of that contextual background, we then consider the UK/USA double tax convention and how it differed from the OECD model.

Relevant UK and USA tax rules

UK corporation tax rules on residence

52. As for the relevant UK corporation tax rules applicable at the time the UK/USA double tax convention was entered into, we refer for convenience to the rules currently contained in the Corporation Tax Act 2009 (“CTA 2009”) even though at the material time it was the predecessor provisions to that Act that were in force. There is no difference in meaning and effect between CTA 2009 and those provisions.

53. The territorial scope of the charge to corporation tax is set out in s.5 of CTA 2009. A company resident in the UK is chargeable to corporation tax on all its profits “wherever arising”: see subsection (1). A non-UK resident company is within the charge to corporation tax only if it is carrying on a trade in the UK through a permanent establishment here and is liable to corporation tax on income connected to the permanent establishment (and is also liable to income tax, subject to the operation of the UK’s double tax conventions, on other UK-source income). A distinction is, therefore, made (which is common in corporate tax systems) between a case where, by reason of its residence in the UK, a company is taxed on its worldwide income and a case where a non-UK company is taxed only on its sources of income in the UK.

54. What then does “residence” mean in the case of a company? The leading authority on that issue remains the House of Lords decision in *De Beers Consolidated Mines v Howe* (1906), 5 TC 198 HC. The applicable rules at the time related to income tax and provided that any person residing in the UK was liable to income tax on annual profits or gains from any kind of property (wherever situated) and from any trade (wherever carried on).

55. After noting that it was easy to ascertain where an individual resides, the Lord Chancellor noted at [212] and [213] that, in the case of a company, "some artificial test must be applied" before going on to say:

> "Mr. Cohen [Counsel for the taxpayer] propounded a test which had the merits of simplicity and certitude. He maintained that a Company resides where it is registered and nowhere else. […].
>
> I cannot adopt Mr. Cohen's contention. […]. An individual may be of foreign nationality, and yet reside in the United Kingdom. So may a Company. Otherwise, it might have its chief seat of management and its centre of trading in England, under the protection of English law, and yet escape the appropriate taxation by the simple expedient of being registered abroad and distributing its dividends abroad. The decision of Chief Baron Kelly and Baron Huddleston, in the *Calcutta Jute Mills v Nicholson* and the *Cesena Sulphur Company v Nicholson*, now thirty years ago, involved the principle that a Company resides, for purposes of Income Tax, where its real business is carried on. […] I regard that as the true rule; and the real business is carried on where the central management and control actually abides."

56. That decision as to the meaning of "residence" for companies (the central management and control test) remained the only applicable UK test until 1988. Section 66(1) of the Finance Act 1988 ("FA 1988") provided that:

> "[…], a company which is incorporated in the United Kingdom shall be regarded for the purposes of the Taxes Acts as resident there; and accordingly, if a different place of residence is given by any rule of law, that place shall no longer be taken into account for those purposes."

57. It is clear from the terminology used ("shall be regarded") that this was, in substance, a type of deeming provision. Absent s.66(1) of FA 1988, the mere fact of UK incorporation was not, as per *De Beers*, sufficient to constitute residence. Following its enactment, the UK subjected companies incorporated in the UK to tax on their worldwide income even though the tie to the UK was merely of a formal or legal kind.

58. The current rules for determining company residence for corporation tax purposes are contained in Chapter 3 of Part 2 of CTA 2009 and adopt a more direct definitional route. Section 14(1) of that Act provides that "a company which is incorporated in the United Kingdom is UK resident for the purposes of the Corporation Tax Acts".

59. CTA 2009 also has provisions (as did FA 1988) dealing with cases where companies incorporated in the UK (and hence resident here) are regarded as resident in another territory for the purposes of a double tax convention. In that case s.18 of CTA 2009 provides that the company is not to be regarded as resident in the UK even if it would otherwise be so regarded as a result of the application of s.14. A simple example of the operation of this rule would be where a company incorporated in the UK has its central and management control in another territory and a double tax convention with the other territory provides in that case for the company to be treated as resident only in that other territory.

60. In other words, Parliament has recognised that determining residence by reference to incorporation would, at least in some cases, result in the UK taxing the worldwide income of a company in circumstances where another territory has a better claim to 'full' taxing rights.

61. So far as income tax is concerned, the UK charges its residents to tax on a worldwide basis and charges non-UK residents only on income arising from sources of income in the UK. That is the effect of Chapters 4 and 5 of Part 2 of the Income Tax (Earnings and Pensions) Act 2003 and ss. 6, 269, 368 and 577 of the Income Tax (Trading and Other Income) Act 2005. It

is worth noting that the concept of domicile for individuals is not relevant to the imposition of the charge to tax. Domicile has a part to play by way of an exception to the charge: non-UK domiciles who are resident in the UK are not taxed on their foreign income not remitted to the UK.

62. It follows from this that, for the purposes of UK corporation tax and income tax, the distinction between taxation on a worldwide basis and on a source basis rests solely on residence. Place of management is an aspect of the definition of residence, and domicile is not relevant at all.

US federal tax law

63. Both parties adduced expert evidence on US federal income tax law: Mr Shashy (on behalf of GEFI Ltd) and Mr Miller (on behalf of HMRC). They prepared a joint memorandum observing that there were "no points of material disagreement" with the content or conclusions in either report. In the light of that joint memorandum, we consider that we can safely have regard to either of those reports in reaching a view, as a matter of fact, as to the relevant features of US federal income tax law for the purposes of this appeal. The FTT referred to some (but not all) of those features that we consider are relevant to this appeal.

64. US federal income tax law distinguishes between "domestic" and "foreign" corporations. A "domestic" corporation is one created or organised under the laws of the US or in any one of the fifty states or the District of Columbia (s.7701(a)(4) of the US Internal Revenue Code of 1986). There is no other test: in particular, neither place of management nor domicile are relevant. A "foreign" corporation is one which is not a domestic corporation. It is generally subject to US federal income tax on classes of income with a connection to the US.

65. Section 269B(a) of the Code provides that, if a domestic corporation and a foreign corporation are stapled entities, the foreign corporation "shall be treated as" a domestic corporation – a form of wording which is similar to that adopted by s.66(1) of FA 1988 in defining corporate residence for UK tax purposes. It appears that the US rules on stapling have been in effect since at least 1984: see footnote [9] to Mr Shashy's report.

66. The share stapling is not sufficient in itself to constitute an entity as a domestic corporation. Section 269B of the Code sets out (at paragraph (e)) an exception if the entities are "foreign owned". Broadly speaking a corporation is "foreign owned" if less than 50% of the total voting power and less than 50% of the total value of its stock is held directly or indirectly by US persons (a concept which includes domestic corporations).

67. It follows that the reason a foreign stapled entity is treated as a domestic corporation is because of a direct link (through the share stapling) to the place of incorporation of the actual domestic corporation and an indirect link (through its ownership by US persons) to the actual place of incorporation of those US persons.

68. In his report Mr Shashy stated that:

> "… there is no material difference between a corporation that is actually domestic (and viewed as a resident in the U.S., that is, subject to taxation on worldwide income) and one that is deemed to be domestic for purposes of U.S. tax law (and similarly viewed as a resident of the U.S., in the sense that it is subject to taxation on worldwide income)."

69. Mr Miller, in his report, confirmed that, for US tax purposes, the share staple had "an analogous effect to incorporation in the U.S.". At [9] of his report, Mr Miller said that "[the stapled foreign corporation] is subject to U.S. federal income tax in precisely the same manner as if it were a "regular" domestic corporation".

70. Neither expert said that there were no differences for the purposes of US federal income tax between an actual domestic corporation and a stapled foreign corporation treated as a domestic corporation. The FTT referred at [29] to three differences: (1) a stapled foreign corporation is treated as a foreign corporation for the purposes of the US branch profits tax; (2) it is unable to join in the filing of a consolidated return; and (3) it is unable to claim an exemption from US federal income tax by reason of any treaty obligation of the US. For completeness, it is worth noting that special collection procedures also apply to the foreign stapled entity.

71. In fact, as Mr Baker KC noted in his submissions before us, the inability of a stapled foreign corporation to claim a treaty exemption puts it in the same position as a corporation that is actually domestic. This appears to be nothing more than an explicit recognition of how the deeming set out by s.269B of the Code was to work: it made clear that the foreign corporation was to take on the characteristics of a domestic corporation for domestic tax purposes. Indeed, in his report, Mr Shashy referred to how the US Congress had "clarified" that a stapled foreign corporation could not rely on a treaty exemption "to ensure the U.S. taxation" of the corporation.

72. A similar point can be made about a stapled foreign corporation retaining its nature as a foreign corporation for the purposes of the US branch profits tax. Mr Shashy explained that "the effect […] is to enable the U.S. to continue to collect branch profits tax in respect of stapled foreign corporations". And, in the case of the filing of a consolidated return, Mr Shashy noted "that treatment for foreign tax credit purposes, however, combined with the general taxation of a stapled foreign corporation as a deemed domestic corporation, accomplishes the primary purpose of section 269B".

73. As to the purpose of the share stapling rules, it seems clear that the primary reason for their enactment was to protect the US tax base from avoidance. At footnote [8] to his report, Mr Shashy noted that the US Congress Joint Committee on Taxation had explained that Congress believed the stapling of foreign corporate stock to the stock of a publicly traded US corporation was a simple means of attempting to avoid US federal tax. Of course, and as noted at that footnote, s.269B, when enacted, was not limited to publicly traded corporations.

74. Stapling is not the only circumstance in which a foreign corporation is treated as a domestic corporation for the purposes of US federal income tax. Other examples include: (1) cases where there has been a relevant "inversion"; (2) electing to be treated as a domestic corporation (so that the corporation is not subject to the rules on controlled foreign companies (the subpart F rules)); and (3) corporations organised in Canada or Mexico.

75. It is convenient to note here that there is no suggestion that share stapling had any consequences other than tax consequences for the purposes of US law at federal or state level.

76. In summary:

(1) companies are subject to US federal income tax on their worldwide income by reference only to their place of incorporation via the concept of a domestic corporation;

(2) share stapling is an example of a case where a foreign corporation is treated as a domestic corporation but there are other examples;

(3) the share stapling rule has been part of the US tax code since at least 1984 and was introduced as an anti-avoidance measure;

(4) GEFI Ltd was treated as a domestic corporation because of its direct and indirect links to other corporations incorporated in the USA; and

(5) there is no material difference in tax treatment between a 'real' domestic corporation and a stapled foreign one and, in particular, stapled foreign corporations are treated, despite what the FTT thought, in the same way as 'real' domestic corporations for treaty purposes.

OECD model tax convention and commentary and UK/USA double tax convention

OECD model convention and commentary

77. The concept of a "resident of a Contracting State" plays a defining role in the application of double tax conventions. In the current version of the OECD model convention, the definition appears as Article 4 (under the heading 'Resident'). The drafting of the Article has evolved over time but the core of the definition has remained stable.

78. In the 1963 version of the OECD model tax convention, the definition was (under the heading 'Fiscal domicile') in these terms:

> "For the purposes of this Convention, the term "resident of a Contracting State" means any person who, under the law of that State, is liable to taxation therein by reason of his domicile, residence, place of management or any other criterion of a similar nature."

79. There are two things that are notable in this definition. The first is that it looks to the tax laws of the contracting state in question to determine residence: hence the reference to "under the law of that State". The second is that it is seeking to identify the <u>reason</u> for the liability to tax. As we have explained above, it has been a long-standing feature of the UK tax system and indeed other tax systems of OECD countries that there are generally two ways in which tax is imposed. A state might choose to impose taxation on a 'full' (typically worldwide) basis in respect of persons by reason of some identifiable connection to the territory. Or a territory might impose tax on persons who do not have such a connection in respect only of their sources of income in the territory.

80. It strikes us as evident that, in the 1963 version of the OECD model convention, the "by reason" criteria are playing a defining role in capturing the first of those ideas. The type of liability to tax with which Article 4(1) is concerned is 'full' taxation. There was no qualification in the 1963 version similar to the second sentence in later versions of the OECD model tax convention (which we set out at {87} below).

81. Clearly, it was difficult to be confident that all territories would use the same concepts. Some might, like the UK, be framed solely by reference to residence. Others might take their cue from domicile. In others still, it could be said that the key connection (in the case of companies) might be place of management. For equally obvious reasons, the test could not sensibly be expected to identify, in simple form, all the different bases that a state might conceivably choose to impose 'full' taxation: hence, the inclusion of "or any other criterion of a similar nature". Ms McCarthy KC submitted that, if the link was simply a requirement for 'full' taxation, the convention should have referred to a criterion of "the same nature". It is true that it could have said "the same" rather than "a similar" but the latter, self-evidently, admits of greater flexibility. One might reasonably expect flexibility to be a desirable feature of a standard-form international treaty intended to be adopted by different states at different times. Among other things, this flexibility would allow a contracting state to alter its law to counteract attempts by taxpayers to avoid taxation without being required to amend their domestic law to use <u>only</u> the concepts expressly referred to in the convention when the new case did not easily fit within the natural meaning of any of those concepts. If the tax effect is intended to be the same, it is hard to see why a state should not have the freedom to use a different (but similar) concept to capture the new case.

82. Ms McCarthy KC also submitted that 'nature' is a reference to the inherent quality or character of the criteria and is different from 'effect'. It would, as a matter of ordinary English, have been wrong, in our view, to refer to 'similar effect'. There is no 'effect' expressed in the opening words and, consequently, there would be nothing to link back to. But it does not, in our view, follow that the drafter was intending to ignore 'effect' in using the word 'nature'. Reading a reference to 'nature' as apt to include 'effect' is consistent with the intended aim of the expression in capturing the large penumbra of cases in which a state might assume 'full' taxing rights.

83. In any event, it seems to us difficult to regard, for example, the concept of "domicile" (which is a legal term of art) and the concept of "place of management" (which requires a factual evaluation) as being of the same nature. Rather, it seems more natural to regard the concepts expressly referred to in Article 4(1) as being of a similar nature where the function performed by each concept is to identify the circumstances in which a state imposes 'full' taxation. The word "criterion" naturally presents itself as an apt word to cover other matters not expressly referred to.

84. Article 4(1) was amended when the 1977 OECD model convention was adopted on 11 April 1977 to add the (current) second sentence ("This term, however, does not include any person who is liable to tax in that State in respect only of income from sources in that State or capital situated therein").

85. It is convenient here to note what was said about the change to the OECD model convention in 1977 in the Canadian Supreme Court case of *Crown Forest* discussed further below. At [59] of that decision the Supreme Court referred to footnote [19] in B. P. Dwyer and J. C. Ross, *Canada - Recent Cases Concerning Withholding Tax*(1992), 19 Tax Plan. Int'l Rev. 29 (a comment on the Federal Court Trial Division decision), which said:

> "[…] There is no indication in the commentary to the 1977 OECD Model Treaty that the addition of the second sentence, which was not found in the 1963 OECD Model, was intended to affect the position of a person not viewed as a resident by the domestic law of the taxing state .... The 1977 Commentary and later OECD Reports make it clear that the change was intended to address the position of a person viewed as a resident by the domestic law of the taxing state (e.g., by reason of an attachment such as residence or place of management), but who, by reason of special privileges (diplomatic personnel, base companies, etc.) was not subject to worldwide taxation by the state ..."

86. In our view, that is clearly a correct statement of the purpose of the change made in 1977.

87. Article 4 of the 2000 version of the OECD model convention, which applied when the UK/USA double tax convention was signed in 2001, was in these terms:

> "1. For the purposes of this Convention, the term "resident of a Contracting State" means any person who, under the laws of that State, is liable to tax therein by reason of his domicile, residence, place of management or any other criterion of a similar nature, and also includes that State and any political subdivision or local authority thereof. This term, however, does not include any person who is liable to tax in that State in respect only of income from sources in that State or capital situated therein.
>
> 2. […]
>
> 3. Where by reason of the provisions of paragraph 1 a person other than an individual is a resident of both Contracting States, then it shall be deemed to be a resident only of the State in which its place of effective management is situated."

88. It is readily apparent that Article 4(1) uses a number of expressions without further definition such as "domicile" and "residence". So far as this is not already the effect of the reference to "under the laws of that State", Article 3(2) of the 2000 OECD model convention determines how those expressions should be interpreted. It says this:

> "As regards the application of the Convention at any time by a Contracting State, any term not defined therein shall, unless the context otherwise requires, have the meaning that it has at that time under the law of that State for the purposes of the taxes to which the Convention applies, any meaning under the applicable tax laws of that State prevailing over a meaning given to the term under other laws of that State."

89. One inevitable consequence of this is that persons can be resident in more than one territory for the purposes of the treaty as a result of different interpretations under the different domestic laws of the same concept or because the states use different concepts that overlap in their effect. In the case of companies, it is then the function of Article 4(3) to determine in which state the taxpayer is resident. The fact that a state might exercise its tax sovereignty in a particular way (for example, taking a broad view on what counts as being resident for the purposes of its domestic law) is not problematic and is, indeed, anticipated by other provisions of the Article.

90. We now turn to the OECD commentary on the 2000 OECD model convention. The commentary begins by pointing out that the concept of a "resident of a Contracting State" is important: (1) in determining a convention's personal scope of application; (2) in solving cases where double taxation arises in consequence of double residence; and (3) in solving cases where double taxation arises as a consequence of taxation in the state of residence and in the state of source or situs. It then continues:

> "3. Generally the domestic laws of the various States impose a comprehensive liability to tax - "full tax liability" - based on the taxpayers' personal attachment to the State concerned (the "State of residence"). This liability to tax is not imposed only on persons who are "domiciled" in a State in the sense in which "domicile" is usually taken in the legislations (private law). […]
>
> 4. Conventions for the avoidance of double taxation do not normally concern themselves with the domestic laws of the Contracting States laying down the conditions under which a person is to be treated fiscally as "resident" and, consequently, is fully liable to tax in that State. They do not lay down standards which the provisions of the domestic laws on "residence" have to fulfil in order that claims for full tax liability can be accepted between the Contracting States. In this respect the States take their stand entirely on the domestic laws.
>
> 5. This manifests itself quite clearly in the cases where there is no conflict at all between two residences, but where the conflict exists only between residence and source or situs. But the same view applies in conflicts between two residences. The special point in these cases is only that no solution of the conflict can be arrived at by reference to the concept of residence adopted in the domestic laws of the States concerned. In these cases special provisions must be established in the Convention to determine which of the two concepts of residence is to be given preference.
>
> […]
>
> 8 Paragraph 1 provides a definition of the expression "resident of a Contracting State" for the purposes of the Convention. The definition refers to the concept of residence adopted in the domestic laws (cf Preliminary remarks). As criteria for the taxation as a resident the definition mentions:

> domicile, residence, place of management or any other criterion of a similar nature. As far as individuals are concerned, the definition aims at covering the various forms of personal attachment to a State which, in the domestic taxation laws, form the basis of a comprehensive taxation (full liability to tax). It also covers cases where a person is deemed, according to the taxation laws of a State, to be a resident of that State and on account thereof is fully liable to tax therein (eg diplomats or other persons in government service). In accordance with the provisions of the second sentence of paragraph 1, however, a person is not to be considered a "resident of a Contracting State" in the sense of the Convention if, although not domiciled in that State, he is considered to be a resident according to the domestic laws but is subject only to a taxation limited to the income from sources in that State or to capital situated in that State. That situation exists in some States in relation to individuals, eg in the case of foreign diplomatic and consular staff serving in their territory. According to its wording and spirit the provision would also exclude from the definition of a resident of a Contracting State foreign-held companies exempted from tax on their foreign income by privileges tailored to attract conduit companies. This, however, has inherent difficulties and limitations. Thus it has to be interpreted restrictively because it might otherwise exclude from the scope of the Convention all residents of countries adopting a territorial principle in their taxation, a result which is clearly not intended.
>
> […]
>
> 21. [Paragraph 3] concerns companies […]. It may be rare in practice for a company, etc. to be subject to tax as a resident in more than one State, but it is, of course, possible if, for instance, one State attaches importance to the registration and the other State to the place of effective management. […]
>
> 22. It would not be an adequate solution to attach importance to a purely formal criterion like registration. Therefore paragraph 3 attaches importance to the place where the company, etc. is actually managed."

91. We take five points from this commentary.

92. **First**, it is apparent that Article 4(1) is concerned with cases where states assume 'full' taxing rights. Para. 3 of the commentary refers in both of its sentences to 'full' liability and notes that in practice the applicable attachment extends beyond 'domicile'. And, in paragraph 4, the commentary makes an <u>explicit</u> link between the concept of residence under domestic law and full taxation: see the use of the word "consequently" in the first sentence.

93. **Second**, double tax conventions "do not lay down standards" in determining who is resident for the purpose of imposing 'full' taxation and "take their stand <u>entirely</u> on the domestic laws" (our emphasis): see paras. 4 and 5.

94. The importance of standing entirely on domestic law was starkly revealed in the hearing itself. When asked by the Tribunal, neither party could come up with a single example of a case where, in negotiating a treaty, it had been expressly accepted by a state that a particular ground on which it was imposing 'full' taxation was not to count as residence for treaty purposes.

95. In our view, there is an evident need for flexibility where the conceptual framework might differ from one state to another in the way in which it defines 'residence'. As we have explained above, place of management is, in a UK context, merely an aspect of residence; but, if the House of Lords had accepted the taxpayer's submission in *De Beers*, place of incorporation would have performed precisely the same function. And nor is this a binary choice: as a matter of interpretation, there is nothing peculiar in holding that, in the case of a company, residence could be established by either place of incorporation or where its

management took place (which is, of course, how the current definition of residence works in the UK for corporation tax purposes). An international treaty is most unlikely to be concerned with the particular method adopted by a state (whether by a definition or by use of a separate concept) if the substantive tax effect is the same.

96. According to *Widrig* in the chapter "*The Expression 'by reason of His Domicile, Residence, Place of Management ....' As Applied to Companies*" in Guglielmo Maisto's *Residence* of *Companies under Tax Treaties and EC Law* (BFD, 2009), there are some countries, particularly in South and Central America, which use "domicile" as a criterion for fiscal residence for companies as well as individuals. But he goes on to note, citing Germany and Switzerland as examples, that, if the domestic law does not use the term "domicile" but instead uses "seat", that would qualify as a criterion of a similar nature within the meaning of Article 4(1) of the OECD model convention.

97. We think that must be right. But, if that is true of a case where a state uses a <u>different</u> concept, it is difficult to understand why a state could not produce the same effect by expanding an existing concept to cover a new circumstance in which the state imposes full taxing rights.

98. This is, in our view, what the UK has, since 1988, done in defining residence for companies to include place of incorporation. HMRC revealed at the hearing that, since 1993, the UK has sought to include an express reference to place of incorporation in Article 4(1) of the treaties to which it is a party. We can readily see why that might be helpful as a 'belt and braces' approach although we note that, as mentioned below, the UK has, unlike the US, <u>not</u> made a reservation to Article 4(1) of the OECD model convention in those terms.

99. As Mr Baker KC pointed out at the hearing, a large number of double tax conventions – more than 50 – to which the UK is a party do not have a reference to a place of incorporation. He described it – rightly in our view – as "astonishing" if, absent a specific reference to place of incorporation, the UK's treaties were considered not to cover corporate residence by reference to place of incorporation despite the terms of the UK's domestic law. It was of note that, when asked the question directly by the Tribunal, Ms McCarthy KC was not drawn into a response on this issue, merely commenting that it was not helpful to speculate as to what may, or may not, have been in the signatories' minds in relation to pre-1993 treaties. In the context of this particular case, that is no surprise as HMRC's case is premised on an analysis that "criterion of a similar nature" requires a personal connection to a state beyond a requirement that the state has imposed 'full' taxation. It was, no doubt, for this reason that HMRC expressly adopted the analysis of both *Widrig* and *Vogel* that, in the case of the OECD model convention, the relevant connection needed to be a territorial one and, on that basis, place of incorporation, as a purely formal or legal connection, was not sufficient.

100. In *Widrig's* view (in the work mentioned above) "all these three connecting criteria [in Article 4(1)] have to a certain extent a local connection, meaning that the term 'other criteria of similar nature' has to have a certain local character of a factual nature". *Vogel* has fuller reasoning for his analysis that, rather than a functional interpretation under which the connecting criteria are linked simply by the fact that they are ways in which a state asserts 'full' taxing rights, "the territorial interpretation is preferable". It is clear that what Vogel means by this is a factual presence in the state concerned rather than a connection by reference to legal or formal criteria. He argues that: (1) the other connecting factors contain a "territorial link" between the taxpayer and the state; (2) the functional interpretation would reduce the listed factors to "mere" examples of "liable to tax" without any additional merit; and (3) not requiring a territorial connection of any kind between the taxpayer and state would "blur the line" between the source state and the residence state. It follows from this that he considers that

nationality and place of incorporation would both be insufficient to establish treaty residence in the case of the OECD model tax convention.

101. In the case of *Vogel's* first point, there obviously needs to be a connecting factor of some kind to the territory (the state would hardly be asserting 'full' taxing rights otherwise) but it is difficult to see why, in the case of companies, this has to be a "territorial link": this is really no more than a statement of the conclusion rather than a reason for it. The second reason offered does not suffer from this fault but we find it without merit for the reasons already given above. As to the third, we do not understand how, say, taxing on a 'full' basis by reference to place of incorporation can, in any meaningful sense, blur the line with source taxation.

102. In our view, the text of the OECD model convention (including the way in which the drafting has evolved over time) and the OECD commentaries on the convention provide no support for the 'territorial' interpretation.

103. **Third**, the cases in which a state defines residence include cases of 'deemed' residence (see para. 8). It is true that, as HMRC point out, the examples given are those applying to individuals but, despite HMRC's submissions to the contrary, it is in our view too literal a reading of the relevant sentence to conclude that it was intended only to apply to individuals. It is impossible to discern any policy reason why it should be so confined. In any event, the relevant sentence begins by referring to a "person" not an individual. As we have set above, a state can impose 'full' taxation by way of a definition or a separate concept, and it is consistent with taking a stand entirely on domestic law for the treaty to be agnostic as to the precise method chosen (whether that is by way of definition, separate concept or deeming).

104. We also note that, in his skeleton argument, Mr Baker KC set out a number of examples of jurisdictions (apart from the USA) containing rules for deeming a company to be resident in their territory:

(1) Spain has a rule that a company established in a tax haven is resident in Spain if its main assets are in Spain;

(2) Italy has a rule that a non-Italian holding company is resident in Italy if it is directly or indirectly controlled by Italian resident persons or its board is mainly composed of Italian residents; and

(3) Australia has a rule that a foreign company is resident in Australia if it is carrying on business in Australia and is controlled by residents of Australia.

105. We did not take Ms McCarthy KC to dispute any of those examples (as a matter of fact).

106. All of these deemed residence rules appear to be anti-avoidance measures or measures otherwise designed to protect the erosion of a state's tax base. We note that the Australian rule for deemed residence is concerned with shareholder control and the Italian rule is, in part, referable to shareholder relationships. As we have noted above, the US stapling rule is also an anti-avoidance rule and also makes the attachment to the USA through relationships to corporations that are, as domestic corporations, connected to the US.

107. It is difficult to understand why, in the light of the object and purpose of a double tax treaty, a company which is, according to the domestic law of a state, resident in the state and, consequently, liable to 'full' taxation there would, if the connection to the state is a more indirect but nevertheless substantive one, be considered not to be resident in the state concerned for treaty purposes. The nature of a 'deeming' is that it can come in various guises and that is particularly the case where a state is seeking to protect itself from avoidance. We also note that the commentary fails to point out, or even hint at, such a relevant limitation (apart from unqualified references to personal attachment or connection).

108. **Fourth**, the second sentence in Article 4(1) is concerned with an exception to 'full' liability (see the second half of para. 8). The reference to "however" reads naturally as a qualification to the commentary on the first sentence. There is nothing in the commentary suggesting that the second sentence is performing a more fundamental role in significantly limiting the reach of the first sentence.

109. **Fifth**, a clear purpose of Article 4 is to solve cases where double taxation arises in consequence of double residence (see para. 5) and it is explicitly recognised that a purely formal criterion like registration would not be an adequate solution for this purpose (see para. 22). That in itself strongly suggests that purely formal criteria are, at least, relevant in determining residence; and that is, in our view, further support for the view that the connecting factor in Article 4(1) does not require a 'territorial' connection in the *Vogel* sense.

110. In addition, the 2000 OECD commentary set out reservations on Article 4 (see paras. 27 to 32). The FTT referred to those reservations at [42] of its judgment without further comment but did record, at [59], Ms McCarthy KC's submission that these reservations would be otiose if nothing more than 'full' taxation was required by the connecting criteria in Article 4(1) (without indicating whether it accepted that submission).

111. In fact, the only reservations made in the 2000 commentary relating to paragraph 1 of Article 4 were those made by Mexico and the USA; and the FTT and *Widrig* in the extract quoted by the FTT in its judgment were wrong to say that Canada had made a reservation in relation to paragraph 1: it had, in fact, made a reservation only in relation to paragraph 3. Despite the UK's change of approach in 1993 in seeking to include incorporation in the text of treaties that it negotiates, the UK has not placed a reservation in the OECD commentary. The sole examples in the case of the 2017 OECD model convention (which is the latest model) are, in addition to the USA, Estonia and Latvia both of which appear to adopt a test similar to that adopted by the USA.

112. Although the terms of paragraph 1 of Article 4 of the 2017 OECD model convention are in materially the same form as the 2000 version, paragraph 3 is different. It provides for a mutual agreement process to determine in which state a company is resident "having regard to its place of effective management, the place where it is incorporated or otherwise constituted and any other relevant factors" (emphasis added). Again, it is difficult to understand the current form of para. 3 of Article 4 unless the place where a company is incorporated or otherwise constituted could be a relevant factor in determining residence. And the reference to "any other relevant factors" is plainly anticipating that, in addition to place of effective management and place of incorporation, there are other relevant factors. Although the 2017 OECD model convention postdates the UK/USA double tax convention, there is nothing in the commentary to the newer version suggesting that the change in para. 3 of Article 4 was made as a result of a change in approach to, or understanding of, para. 1 of that Article.

113. Finally, we consider that no significance can be placed on the references to personal attachment in the commentary. It is of the essence of the first sentence in Article 4(1) that there must be some attachment to the territory justifying 'full' taxation rights. The relevant attachment is determined by reference to the way in which the state defines residence. Read as a whole (including the commentary on Article 4(3)), there is, in our view, no support for the view that only particular types of attachment are sufficient for the purposes of paragraph 1 of Article 4 of the convention. Indeed, what is striking is that nowhere in the Convention or the commentary is this possibility mentioned.

The UK/USA double tax convention

114. We now turn to the terms of the UK/USA double tax convention itself. Article 4 says:

> **“4. Residence**
>
> 1. Except as provided in paragraphs 2 and 3 of this Article, the term “resident of a Contracting State” means, for the purposes of this Convention, any person who, under the laws of that State, is liable to tax therein by reason of his domicile, residence, citizenship, place of management, place of incorporation, or any other criterion of a similar nature. This term, however, does not include any person who is liable to tax in that State in respect only of income from sources in that State or of profits attributable to a permanent establishment in that State.
>
> […]
>
> 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).”

115. Although there is a significant deal of common ground between the UK/USA convention and the 2000 OECD model convention, there are two material differences:

(1) Article 4(1) of the 2000 OECD model convention does not refer to “citizenship” or “place of incorporation” as relevant criteria for establishing residence; and

(2) Article 4(3) of the 2000 OECD model convention provides, in the case of companies, a tie-breaker by reference to a company’s place of effective management.

116. As we explain above, (1) reflects the fact that the USA imposes a charge to federal income tax on a person’s worldwide income by reference to “citizenship” and “place of incorporation”. In the case of (2), the effect of Article 4(5) of the UK/USA double tax convention is that, unless HMRC and the IRS, as competent authorities, agree in which state a company is resident, a company otherwise resident in both the UK and USA is entitled to a tax credit only for US tax against UK tax.

117. Despite those differences, there is a great deal of similarity between the UK/USA double tax convention and the 2000 OECD model convention. It is, in our view, of note that, apart from the inclusion of “citizenship” and “place of incorporation”, neither state sought to tailor the provisions of Article 4(1) to the applicable terms of their domestic law. As we have seen, neither state imposes a charge to tax by reference to “domicile” or “place of management” (as a separate concept from residence). But these terms were, nonetheless, included in the text of the UK/USA double tax convention.

118. More generally, it is apparent that the US regards its rules for taxing companies via the concept of a domestic corporation as examples of corporate residence: taxing by reference to a company’s status as a domestic corporation is functionally equivalent to residence. For example, at footnote ([41]) in Mr Shashy’s report, reference is made to a number of US authorities all of which refer to the concept of residence: (1) a 2006 Conference Report describing the “determination of corporate residence” under US federal tax law as depending on whether a corporation is incorporated in the US; (2) a 2015 Joint Committee describing “corporate residence” as depending on the place of incorporation; and (3) a 2017 Joint Committee stating that, in contrast to the “place of organization” of the US, “other factors such as situs, management and control are used to determine residence” in other taxing jurisdictions.

119. It is also instructive to see the terms in which the US government itself explained its position in *Crown Forest*. The Canadian Supreme Court made the following observations at [64] in the context of submissions made by the US government as intervener:

> "[…] recognizing that "place of incorporation" is the only criterion that has any relevance to the determination of world-wide tax liability under U.S. law, the U.S. entered a reservation to Article 4, paragraph 1 for the right to use "place of incorporation" as an indicator of residence. However, in order to preserve overall conformity with the OECD Model Convention, the decision was taken not to remove the other OECD criteria from Article IV, paragraph 1. Nevertheless, the term "place of incorporation" is the only term in Article IV, paragraph 1 that governs the determination of the residence of a corporation in the United States for purposes of its tax conventions.
>
> It is for this reason that the trial judge's rhetorical conclusion, at p. 6310, ("if the negotiators of the Convention meant to exclude foreign corporations in the U.S., like Norsk, from the status of "resident of a Contracting State" (i.e., the U.S.A.) one wonders why they simply did not write into the Convention exactly what they allegedly meant to say") must be rejected. The extrinsic materials reveal that such explicit "writing-in" was simply not necessary."

120. This is an explicit recognition that the US considered there to be an advantage in using, so far as possible, an internationally accepted model even if some of the words used were otiose.

121. Among the words used in Article 4(1) of the UK/USA double tax convention are "any other criterion of a similar nature". In HMRC's view the effect of the US approach is, in *Vogel's* terminology, that a taxpayer is treaty resident if: (a) there is a territorial connection (in the sense of a physical connection) between the state and the taxpayer; or (b) there is a <u>legal</u> or <u>formal</u> connection between the state and the taxpayer. This would seem to cover a wide range of connecting criteria and the effect would be to exclude criteria chosen to impose 'full' taxation in relatively few cases, including those where, in order to deal with anti-avoidance or otherwise protect its tax base, the state operated by reference to non-physical or non-legal criteria (despite the fact that a common approach to dealing with these sort of issues is to focus on economic substance). It is hard to discern <u>any</u> policy reason why a state would wish to proceed in this way. HMRC's case is focused on the fact that share stapling is not to the same effect in the US as incorporation, which is undoubtedly true. But their submissions provide no answer as to why, in the light of the object and purpose of the treaty, that should matter. As an exercise in pure linguistics, we can see why HMRC makes the argument it does; but that is not the correct approach to treaty interpretation (which is not to say that the words do not matter).

122. Further contextual background to the entry into the UK/USA double tax convention in 2001 is arguably provided by a consideration of a memorandum of understanding accompanying the double tax convention between the US and the Netherlands signed on 18 December 1992. That memorandum commented that "it is understood that, if a company is a resident of the Netherlands under paragraph 1 of Article 4 (Resident) and, because of the application of Section 269B of the Internal Revenue Code, such company is also a resident of the United States under paragraph 1 of Article 4 (Resident), the question of its residency for the purposes of the application of this Convention shall be subject to a mutual agreement procedure as laid down in paragraph 4 of Article 4 (Resident)." This statement is clearly premised on the fact that both states regarded share stapling in the US to be sufficient to constitute residence in the US for treaty purposes.

123. However, it could equally be said (as Ms McCarthy KC submitted) that the reason that this memorandum was entered into was to remove a doubt that would otherwise have existed

and that there was nothing comparable for the UK/USA double tax convention. We consider that little weight can be placed on the existence of the US/Netherlands memorandum of understanding. It is evidence of the view of the US and Dutch authorities at the relevant time but it is little more than that.

Decisions of the Supreme Court of Canada

124. We now consider two separate decisions of the Supreme Court in Canada the reasoning of which we consider supports the analysis set out above.

125. In *Crown Forest* the court had to determine whether a company, Norsk, which was incorporated in the Bahamas with a place of management in the US, was treaty resident in the USA. Article 4 of the Canada/US double tax convention defined a "resident of a Contracting State" as "any person who, under the laws of that State, is liable to tax therein by reason of his domicile, residence, place of management, place of incorporation or any other criterion of a similar nature, but in the case of an estate or trust, only to the extent that income is derived by such estate or trust is liable to tax in that State, either in its hands or in the hands of its beneficiaries."

126. The Canadian Supreme Court held at [36] that Norsk's liability to US tax was not "by reason of" its place of management but by its engagement in a trade or business effectively connected to the US. The court then had to consider whether Norsk's engagement in a business in the US was a "criterion of a similar nature" for the purposes of Article 4(1). Iacabucci J, giving the unanimous judgment of the Court, set out his determination of that issue at [39]:

> "39 [..] Should the respondent successfully demonstrate that "engaged in a business in the U.S." is a criterion of a nature similar to the enumerated grounds, then Norsk will be deemed to be a resident under the Convention.
>
> I agree with the Appellant that the most similar element among the enumerated criteria is that, standing alone, they would each constitute a basis on which states generally impose full tax liability on world-wide income: *Klaus Vogel on Double Taxation Convention*s (1991), at pp. 154-59; Joseph Isenbergh, *International Taxation: U.S. Taxation of Foreign Taxpayers and Foreign Income*, vol. I (1990), at pp. 326-27. […] Consequently, the "engaged in a business in the U.S." criterion is not of a similar nature to the enumerated grounds since it is but a basis for source taxation."

127. The court also considered the significance of the closing words in Article 4(1) – "but in the case of an estate or trust, only to the extent that income is derived by such estate or trust is liable to tax in that State, either in its hands or in the hands of its beneficiaries" – of the definition of "resident of a Contracting State". This differed from the second sentence that appears in the 2000 model tax treaty quoted above.

128. Norsk argued that the absence of this second sentence in the same terms of the OECD model convention indicated that even those only liable to source taxation should qualify for treaty resident status (see [56]). The court rejected that submission:

> "57. The Commentaries to the OECD Model Convention as well as academic sources indicate that generally the domestic laws of the contracting states employ residence to apply on "full-tax liability" […] So, too, does the American Law Institute, *Federal Income Tax Project – International Aspects of United States Income Taxation II - Proposals on United States Income Tax Treaties* (1992), at pp. 127-28:
>
> > Under the prevailing practice, a country entering into an income tax treaty extends the benefits of the treaty to a person or entity that is a "resident of (the other) Contracting State". "Residence", in turn, is defined in terms of

> taxing jurisdiction. A person or entity is considered resident in a country if that country asserts an unlimited right to tax his or its income - that is, a right based upon the taxpayer's personal connection with the country (as opposed to the source of the income or other income- or asset-related factors). The test of residence requires that the person or entity claiming treaty benefits be "fully taxable" in the residence country, in the sense of being fully subject to its plenary taxing jurisdiction.
>
> […]
>
> The authority for the proposition that only those who are liable to tax on their world-wide income can be justifiably considered residents for the purposes of international taxation conventions is found in the first sentence in Article 4 of the OECD Model Convention and the absence of the second sentence in the *Canada-United States Income Tax Convention* (1980) does not detract therefrom. This is because the second sentence is relevant to a situation in which a person is considered a resident under domestic law but where that person, by reason of a special privilege, nevertheless is not subject to tax on the basis of world-wide income. Paragraph 8 of the Commentary on Article 4 of the OECD Model Convention addresses this point …"

129. Again, it is instructive that the American Law Institute simply noted that residence arose where a "country asserts an unlimited right to tax his or its income - that is, a right based upon the taxpayer's personal connection with the country (as opposed to the source of the income or other income- or asset-related factors)" without qualifying to any extent how the personal connection could arise. The contrast made was simply between 'full' taxation and source taxation.

130. It seems to us that the reasoning of the court is clear that 'full' taxation is <u>the</u> connecting factor for the criteria set out in Article 4(1), and, in particular, the second sentence in Article 4(1) is a qualification of the first. Moreover, nowhere in the decision is there anything suggesting that, in addition to 'full' taxation, there were separate classes of "residents" where only those with an unspecified connection to the territory counted for the purposes of the treaty.

131. Subsequent to the decision of the FTT, there was a further Supreme Court of Canada decision (*Alta Energy*), which concerned the Canada-Luxembourg double tax convention.

132. This case concerned the application of the Canadian general anti-avoidance rules in the context of a claim to exemption from tax in Canada under the convention. The treaty defined "residence" in the same way as the first sentence in Article 4(1) of the 2000 OECD model tax treaty. In other words, there was <u>no</u> reference to residence by reason of the place of incorporation. It was accepted by the Canadian revenue authorities that Alta Energy, as a company incorporated in Luxembourg, was a resident for the purposes of the treaty (see [17]), and, despite the implication of HMRC's submissions that we should not read any significance into the fact that the Canadian revenue authorities had accepted that Alta Energy was resident in Luxembourg, the concession was not something that troubled the court. At [92] the majority referred to the fact that the Minister had "rightly" conceded that Alta Luxembourg was a resident of Luxembourg for the purposes of the treaty as it had its legal seat there. Nor did the minority have any difficulty with the concession. It was clear (see [176]) that Alta Luxembourg had "complied with the words of the relevant provisions of the Treaty, but not their rationale. It is that to which the GAAR requires courts to give effect."

133. Nonetheless, the Canadian revenue authorities argued that it would be contrary to the object and purpose of the convention to grant the benefits of the convention to a company which lacked economic substance in Canada.

134. In an overview of its decision, Côtė J, giving the judgment of the majority, said:

> "[6]. … Internationally, residency typically does not depend on the existence of ["sufficient substantive economic connections"]; formal criteria for residency are just as well accepted as factual criteria."

135. The court considered the issue of "residence" at paragraphs [52] to [67] and included the following observations relevant to this case:

> "[54] In the context of corporations, the "liable to tax" requirement is met under the Treaty where the domestic law of a contracting state exposes the corporation to full tax liability on its worldwide income because it has its residence in that state (see *Crown Forest*, at paras 40 and 45). Liability to full taxation is established by the nexus between that State and the corporation's resident status….
>
> [55] Aside from the "liable to tax" requirement, the purpose of art 4(1) is not to establish specific standards for defining residence. This provision expressly states that residence is to be defined by the laws of the contracting state of which the person claims to be a resident. This provision of the Treaty is modelled almost word for word on art 4(1) of the 1998 OECD Model Treaty, whose Commentary also made it clear that the intention was to leave the core definition of residence to domestic law, not to bilateral tax treaties […]
>
> [56] Consideration of the context of the Treaty confirms this intention expressed in the Commentary. Indeed, this preference for leaving the meaning of residence to domestic law is totally consistent with the scheme of the Treaty. Most terms found in the Treaty are defined under domestic law and not by the Treaty itself. […] The importance of domestic law as a source of substantive content for the application of the Treaty is expressly spelled out in art. 3(2) …
>
> …
>
> [60] I pause here to observe that the definition of residence in Luxembourg law is consistent with international practice. Broadly speaking, there are two internationally recognized methods used to determine corporate residency: (1) the "place of incorporation" or "legal seat" rule, pursuant to which residence is determined by a purely formal criterion, that is, where the corporation was incorporated or has its legal seat; and (2) the "real seat" rule, pursuant to which residence depends on a combination of factual factors aimed at identifying the corporation's place of effective management …
>
> [61] … I understand the Minister's submissions as suggesting that establishing residence merely on the basis of a formal criterion is insufficient to conform to the spirit of the rules of residence under the *Treaty*. Something more would be needed: some *real* connections to the country of residence. What the Minister's submissions overlook, however, is that many of the world's most developed economies — including Canada itself — accept and apply the "place of incorporation" or "legal seat" rule (Avi-Yonah, Sartori and Marian, pp. 130 and 133-34; see s. 250(4)(a) of the *Act*). Although a formal criterion may sometimes be unable to capture the *real* location of a corporation's economic activities, it nevertheless became widespread internationally because of its certainty and simplicity…
>
> …
>
> [67] In sum, the object, spirit, and purpose of arts 1 and 4(1) are to allow all persons who are residents under the laws of one or both of the contracting states to claim benefits under the Treaty so long as their resident status could expose them to full tax liability (regardless of whether there is actual taxation). […]"

136. In our view, in addition to being authority for the propositions found at {50} above (parties to a tax treaty are presumed to know the other country's tax system and domestic law definitions of residence should not subsequently be changed so as to depart from international norms), this decision establishes the following three propositions. First, in following the decision of *Crown Forest*, the connecting criteria in Article 4(1) of the 2000 OECD model convention are all concerned with establishing 'full' tax liability. Second, the OECD definition of residence rests entirely on domestic law: "the purpose of art 4(1) is not to establish specific standards for defining residence … the intention was to leave the core definition of residence to domestic law" and it follows, therefore, that all persons who are residents under the laws of one or both of the contracting states are also resident for the purposes of the treaty so long as their resident status could expose them to full tax liability. Third, it is common international practice to treat a company as resident in a territory by reference to formal criteria (such as incorporation) as well as factual criteria (such as place of management).

137. It is of significance that the way in which the Canadian Supreme Court expressed its conclusion at [67] of its decision was that <u>all</u> persons resident for domestic purposes were also resident for treaty purposes <u>so long as</u> their resident status rendered them liable to 'full' taxation. There was no qualification made. There was no separate category where a taxpayer could be resident domestically but not resident for treaty purposes.

Conclusion

138. The meaning of Article 4(1) of the UK/USA double tax convention needs to be determined in the light of its purpose and the contextual background. The context includes the relevant OECD model convention and the commentary on it as well as the relevant laws of the UK and USA.

139. It is clear – particularly from previous versions – that Article 4(1) of the OECD model convention identified criteria commonly adopted by countries for imposing 'full' tax liability on persons who had a connection to the country concerned. The second sentence of Article 4(1) of the OECD model tax convention is a qualification of the case of 'full' liability given by the first sentence. That is made clear by the OECD commentary and *Crown Forest*.

140. The provisions of Article 4(1) of the OECD model tax convention were deliberately drawn widely. Not only does Article 4(1) refer to a person who was "resident" under the "laws of the Contracting State" but the convention also provides for words that are not otherwise defined to take their meaning from domestic law. It follows from this that, for the purposes of the convention, there is significant room for a state to determine the circumstances in which it takes 'full' taxing rights. We consider that the OECD commentary is, plainly, right in recognising that persons who are deemed to be resident under domestic law are also resident for the purposes of the convention. There is no good reason for thinking this applies only to individuals. Where a definition ends and a deeming begins is not always easy to determine. In our view, defining a company's residence to include a case where it is incorporated in a state could be seen as either.

141. The UK/USA double tax convention adopted a form of wording in its treaty that included concepts of no relevance to the domestic law of either the UK or the US. In the case of the USA, that was, as the US government's intervention in *Crown Forest* makes clear, a deliberate decision to remain, so far as possible, in line with the OECD model in circumstances where nothing turned on the inclusion of otiose concepts. It would be wrong, therefore, to take an overly literal view of the text used in Article 4(1) of the UK/USA double tax convention.

142. As is evident from the examples of both Canada and Luxembourg and, indeed, the UK, defining corporate residence by reference to place of management and incorporation is

commonplace. As the Canadian Supreme Court put it in *Alta Energy* "formal criteria for residency are just as well accepted as factual criteria".

143. The fact that a state has a wide discretion to determine tax residence for the purposes of the OECD model convention is, in our view, borne out by the remaining provisions of Article 4 of that convention. It is the function of the tie-breaker provisions (Article 4(3) in the case of companies) to determine which state has the greater claim to residency by reference to the strength of the attachment. The 2017 OECD model tax convention is clearly consistent with legal or formal criteria being relevant factors in determining corporate residence as well as other factors in addition to the place of effective management. We consider, in light of the authorities, that we can have regard to the 2017 OECD model tax convention. There is no suggestion that, in these respects, the 2017 version was breaking new ground.

144. It follows from this that we do not consider the 'territorial' interpretation (in the *Vogel* sense) of the criteria mentioned in Article 4(1) of the OECD model tax convention is correct. We consider that the treaties to which the UK is a party that do not include express reference to incorporation do, nonetheless, cover incorporation as an aspect of the basic meaning of residence. As noted above, we regard that as the obviously right answer.

145. Of course, the provisions of the UK/USA double tax convention depart from the OECD model in including a reference to citizenship and place of incorporation. The USA imposes worldwide taxation on companies by reference only to their place of incorporation. The relevant provisions operate via the concept of a domestic corporation. It seems to us that they could just as easily have operated by reference to a concept of residence. But, having chosen the route that it did, it is no surprise that the US authorities made sure that US treaties referred to the actual criteria used in their domestic law: hence the inclusion of the place of incorporation. As mentioned above, the US is very unusual in making a reservation to the OECD model convention. The fact that incorporation is widely used as a basis for establishing corporate residence and yet there are so few reservations in the OECD model convention similar to the one made by the USA suggests that the established international view is that it is unnecessary to do so – at least, where incorporation performs a function in defining when a company is resident.

146. US federal income tax treats a stapled foreign corporation as a domestic corporation; and the expert evidence is clear that there is no material difference in tax treatment between a corporation that is actually domestic and one that is treated as such. US federal tax law could have treated a stapled foreign corporation for tax purposes as if it had been incorporated in the USA: that would inevitably have resulted in its being a domestic corporation. It chose a more direct route (treating it as a domestic corporation) but the effect is the same. The place of incorporation is, clearly, the defining feature in the way in which the tax rule operates. The staple has to be to a corporation which has its place of incorporation in the USA. And the foreign corporation has to be owned by US persons, which includes corporations which are incorporated in the US.

147. Turning then to the text of the UK/USA double tax convention, there is a case for regarding the reference to residence by reason of incorporation as, by itself, apt to cover a foreign stapled corporation. The place of incorporation (albeit of other connected domestic corporations) is, after all, the very reason why the USA has sought 'full' taxing rights over the stapled foreign corporation, and, as noted above, the US could simply have provided that a stapled foreign corporation was to be treated for tax purposes as if incorporated there. The precise drafting approach adopted should, in our view, be irrelevant. Of course, a literal view might drive one to a different conclusion because the test is 'by reason of his … place of incorporation' and the 'his' is a reference to the taxpayer concerned (in this case the stapled

foreign corporation) rather than to the domestic corporation with which its stock is stapled. But a literal reading of 'his' would, in any event, itself exclude a company. And, as we have set out above, narrow constructions of treaties should be eschewed and purposive ones followed.

148. Nonetheless, we do not have to conclude that 'place of incorporation' is enough on its own. GEFI Ltd would also be resident in the USA for the purposes of the treaty if the share stapling rule is a criterion of a similar nature to the others mentioned in Article 4(1). As we have explained above, we consider that the connection between the criteria used is that the criteria are commonly accepted ways in which 'full' taxation is imposed: nothing more and nothing less. We can see no credible basis for an additional requirement for the criteria to be of a direct nature in the form of a legal connection between the corporation and the US. A corporation is undoubtedly resident in the US by reference to its incorporation there even if it carries on no activity whatever in the US. By contrast, GEFI Ltd does have substantive economic ties to the US. It is hard to see what purpose would be served by the treaty regarding only the former but not the latter as residence for the purposes of the treaty. This would create two classes of residents in the US only one of which was within the treaty. There is nothing in the OECD commentary to suggest that this is intended in the case of the OECD model tax convention. On the contrary, it is clear that residence takes its stand "entirely" on the domestic law of each contracting state. In our view, the same applies to the UK/USA double tax convention.

149. The share stapling rule is, as explained above, a rule adopted by the USA for anti-avoidance purposes and is an example of an approach adopted by other states for protecting their tax base by imposing 'full' taxation on companies with substantive ties to the state concerned but without necessarily having direct, legal links. As Mr Baker KC pointed out, the UK has, in fact, adopted its own rules for stapled entities that reflect the common ownership of the two entities. One example is section 477 of the Taxation (International and Other Provisions) Act 2010, which treats stapled entities as consolidated subsidiaries of a deemed parent for the purposes of the UK's rules restricting deductions for corporate interest. HMRC's Corporate Finance Manual explained the rationale: "the stapling of the entities effectively makes them a single enterprise, both economically and commercially."

150. Moreover, the USA's share stapling rule had been a feature of US federal income tax law for at least 17 years before the UK/USA double tax convention was entered into; and a state is presumed to know the tax law of the other state when entering into a treaty with it. The share stapling rule appeared in a key part of the US federal tax rules dealing with corporations. The UK should have been aware of those rules.

151. Our analysis is fully consistent with the Canadian Supreme Court decisions in *Crown Forest* and *Alta Energy*. Both those decisions are clear that the connection between the criteria in Article 4(1) of the OECD convention is 'full' taxation. Neither decision says that 'full' liability is necessary but not sufficient. In the case of *Alta Energy*, that would be a surprising omission: after all, the case was directly concerned with whether the treaty required a more substantive connection to a state beyond its incorporation there. The reasoning at [67] of *Alta Energy* is quite clearly not anticipating two classes of domestic residents only one of which is treaty resident.

152. Accordingly, for all the above reasons, we consider that GEFI Ltd was a resident of the US for the purposes of the UK/USA double tax convention.

WAS GEFI LTD CARRYING ON A BUSINESS IN THE USA (ISSUE 2(A))?

Introduction

153. If, contrary to our conclusion above, GEFI Ltd is not resident in the USA for the purposes of the UK/USA double tax convention, it would still be entitled to a credit against UK tax for US tax paid if it was carrying on business in the USA through a permanent establishment there.

154. Article 11(1) of the UK/USA double tax convention provides that "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". If Article 11(1) applies, the interest arising in the US and beneficially owned by GEFI Ltd (as a resident of the UK but not, for the purpose of the convention, of the USA) would be taxed only in the UK.

155. There is, however, an exception under paragraph (3) of that Article if "…the beneficial owner of the interest, being a resident of a Contracting State, carries on business in the other Contracting State, in which the interest arises, through a permanent establishment situated therein, and the interest is attributable to such permanent establishment". In such a case, Article 7 (business profits) applies instead. And that Article provides for the residence state (in this case, the UK) to tax the business profits unless "the enterprise carries on business in the other Contracting State through a permanent establishment situated therein".

156. It follows, therefore, that the UK does not give up its rights to tax the interest arising to one of its residents (GEFI Ltd) unless Article 11(3) is engaged. And that requires, among other things, "the enterprise" to be carrying on business in the other contracting state (the USA). Accordingly, a key issue is whether GEFI Ltd is carrying on business. There was no issue in this appeal concerning the permanent establishment limb of Article 11(3).

157. Article 3(1) of the UK/USA double tax convention contains the following definitions:

> "For the purposes of this Convention, unless the context otherwise requires:
>
> […]
>
> (c) the term "enterprise" applies to the carrying on of any business;
>
> (d) the term "business" includes the performance of professional services and of other activities of an independent character;".

158. Prior to 2000 the OECD model convention had not contained a definition of "business". In the pre-2000 convention, the performance of professional services and other activities of an independent character had been dealt with by Article 14. That Article was deleted from the model convention in April 2000. The decision to do so reflected the fact that there were no intended differences between the concepts of permanent establishment used in the business profits article (Article 7) and fixed base (used in Article 14) or between how profits and tax were calculated for the purposes of those Articles. In addition, it was not always clear which activities fell within which Article.

159. The OECD commentary to Article 3(1)(h) of the 2000 OECD model convention (which is in the same terms as Article 3(1)(d) of the UK/USA double tax convention) notes in relation to the term "business":

> "10.2 The Convention does not contain an exhaustive definition of the term "business", which, under paragraph 2, should generally have the meaning which it has under the domestic law of the State that applies the Convention."

160. Prior to 2000 it is clear that "business" took its domestic law meaning and we do not consider that the incorporation of Article 14 into the definition of "business" was intended to change that.

161. We consider, therefore, that we should take account of relevant domestic law in determining the meaning of business. As we set out above (see {88} for the text of the OECD model convention but the UK/USA double tax convention contains the same substantive proposition at Article 3(2)), expressions not defined in the convention have the meaning at the time at which the convention is to be applied that they have under "the law of that State for the purposes of the taxes to which this Convention applies, any meaning under the applicable tax laws of that State prevailing over a meaning given to the term under other laws of that State". This rule does not apply if the context otherwise requires but neither party has suggested that this is the case – a conclusion with which we agree.

162. It is to tax law that we must, therefore, turn to determine the meaning of "business". The tax law concerned is that relating to the "applicable" tax laws of the UK, namely income tax, corporation tax and capital gains tax. The convention also applies to petroleum revenue tax but we do not consider this tax is relevant for the purposes of this discussion.

163. There are some expressions that are given a uniform meaning for the purposes of income tax, corporation tax and capital gains tax. The meaning of "trade" is an example: see s.989 of the Income Tax Act 2007, s.1119 of the Corporation Tax Act 2010 ("CTA 2010") and s.288(1) of the Taxation of Chargeable Gains Act 1992 ("TCGA 1992").

164. But the expression "business" is not given a uniform meaning for the purposes of those taxes. Instead, there are places in the relevant provisions where the expression is used without further elucidation: s.9(2) of CTA 2009 is an example of that. There are other places where the expression is used in conjunction with another expression: s. 25(3)(a) of CTA 2010 (as enacted) is an example of a reference to a trade or business of a company without more; and s. 781(1) of CTA 2009 is an example of a reference to a trade or business as well as to other matters. And there are other places where a particular definition is used: s. 169S(1) of TCGA 1992 is an example.

165. In the absence of a single statutory definition for the taxes as a whole and the very different statutory contexts in which the expression 'business' is used, the requirement to give the expression the meaning it has for the purposes of the applicable taxes is not without difficulty. Context is critically important in construing any expression used in a legal text.

166. The only applicable context here is that given by the UK/USA double tax convention itself and the UK domestic code in relation to which the convention is intended to apply. As explained above, it is clear that there is a hierarchy of rules for determining which state has the taxing rights under the treaty. A company with interest income may, or may not, be carrying on business in one or other or both of the contracting states. The convention recognises the possibility that a company resident in one territory might be carrying on business in the other contracting state. But it is implicit that it need not necessarily be carrying on a business anywhere.

167. In our view, the UK corporation tax code is to a similar end. In his closing submissions Mr Baker KC referred to s.9(2) of CTA 2009, which, he claimed, would mean that a company would not be chargeable to corporation tax if it was not carrying on a business. We cannot accept that submission.

168. That subsection is in terms about a case where, in the context of determining only when a company's accounting period begins, a company would not otherwise be within the charge to corporation tax. Its function is, in our view, accurately described in HMRC's Company Taxation Manual (CTM01420). An investment company's only income may be dividends from other UK companies, which are excluded from the charge to corporation tax by Part 9A of CTA 2009. The effect of s.9(2) of CTA 2009 is that, in determining the company's accounting

period, the company is treated as coming within the charge to corporation tax at the time it starts to carry on business.

169. The charge to corporation tax is not, however, imposed by s.9 of CTA 2009 but by s.2 of that Act as read, in this case, with ss.5(1) and 8(3) of that Act. Corporation tax is charged by reference to accounting periods and it is s.9(1) of CTA 2009 that provides the main rule as to when an accounting period begins, namely when the company comes within the charge to corporation tax. That expression is in turn defined by s.1167 of CTA 2010 as being satisfied when a company has income on which it is chargeable to corporation tax.

170. What is contemplated by these provisions is that a UK resident company is chargeable to corporation tax if it has any income. In the case of a company not carrying on a trade, interest is dealt with by Part 5 of CTA 2009 in the form of a creditor relationship from a non-trading loan relationship. The income from such a relationship does not require the carrying on a business.

171. Having made those initial observations, we now turn to the relevant case law. The essence of Mr Baker KC's attack on the FTT's decision on this issue was that it had failed to identify or properly apply the principles correctly understood. Plainly, it is not possible to determine whether that is so without first establishing what the principles are.

172. In our view the cases fall into different categories: (1) cases that do not relate to tax, whether UK or foreign tax; (2) cases that relate to repealed UK taxes (which include cases not directly considered in the FTT's judgment but which Mr Baker KC submits are relevant); and (3) cases directly concerned with provisions of the UK tax code that were in force at the material time. In our view, category (3) is, in the light of the terms of Article 3(2) of the UK/USA double tax convention, clearly the most directly relevant category but the decisions in that category apply the relevant principles in the other categories. Accordingly, it is convenient to start with the other categories first.

Authorities relating to non-UK taxes

173. The meaning of "business" was considered by the House of Lords in *Town Investments Ltd v Department of the Environment* [1978] AC 359, which concerned the meaning of "business tenancy" in the Counter-Inflation (Business Rents) Order 1972. The question was whether premises occupied by the Secretary of State for Environment for wider governmental purposes were occupied for the purposes of a business. The House of Lords (by a majority) held that, in view of the obvious mischief at which the Counter-Inflation Acts of 1972 and 1973 was directed, a broad construction should be given to the meaning of "business" and the expression was capable of covering what, in common parlance, would be regarded as the business of government.

174. In reaching that conclusion, Lord Diplock observed at [383] that:

> "The word 'business' is an etymological chameleon; it suits its meaning to the context in which it is found. It is not a term of legal art and its dictionary meanings, as Lindley LJ pointed out in *Rolls v Miller* (1884) 27 Ch D 71, 88, embrace
>
> > 'almost anything which is an occupation, as distinguished from a pleasure – anything which is an occupation or duty which requires attention is a business.'"

175. Lord Diplock went on at [383] and [384] to note that *Rolls* was concerned with the construction of a covenant in a lease against the carrying on of any trade or business on the demised premises and how the wide interpretation of "business" in restrictive covenants of this kind was dictated by the evident object of the covenants.

176. Lord Simon of Glaisdale said this at [401]:

> "I think that the primary sense of "carrying on a business" in ordinary speech is commercial. But it was rightly common ground that this was not the appropriate linguistic register, and that "carrying on a business" extended to the office activities of, say, professional men. Statutory construction here imperatively demands consideration of the object of the legislation [...]."

177. *Town Investments Ltd* makes it clear that "['business'] suits its meaning to the context in which it is found". The statutory context relevant to that case is markedly different from that relevant to this case. In our view, it is clear that, in the case of Articles 7 and 11 of the UK/USA double tax convention, the references to business do not (in contrast to *Town Investments Ltd*) extend to the 'business of government'.

178. In *American Leaf Blending Co Sdn Bhd v Director-General of Inland Revenue* [1979] AC 676 the Privy Council considered an appeal from the Federal Court of Malaysia. In 1964, after abandoning a tobacco business in which it had incurred losses, the company let a warehouse which was a part of its business premises. In 1967 the remainder of the premises, a factory, became empty and was also let. By 1968 five successive lettings of the premises had been made. The company was assessed to income tax in respect of the rent. It claimed it was entitled to set off the tobacco business losses against the rent on the basis that the rent was derived from a business. The Privy Council agreed with the company.

179. One argument advanced by the Malaysian tax authorities to deny the claim was that the relevant paragraphs of the charging section (s. 4 of the Income Tax Act 1967) were mutually exclusive. Having considered other relevant provisions of that Act, the Privy Council held that it was clear that "rents" were capable of being income from a business. They then went on to consider whether, in the instant case, the company was carrying on a business as to which the Privy Council said this at [683] and [684]:

> "The question is one of fact ... [The special commissioners] accepted the company's submission that because the letting of its property was one of the objects set out in its memorandum of association this was in law conclusive that in making any letting of its premises it was carrying on a business.
>
> So stated this is, in their Lordships' view, too broad a proposition. It derives apparent support from an observation of Pollock M.R. in Inland Revenue *Commissioners v. Westleigh Estates Co*. [1924] 1 K.B. 390, where he said, at p. 409: "… if [a company's] objects are business objects and are in fact carried out,… the company carries on business…" This, however, was said in the context of a company which was carrying out one of the principal objects stated in its memorandum. Their Lordships would not endorse the view that every isolated act of a kind that is authorised by its memorandum if done by a company necessarily constitutes the carrying on of a business.
>
> […]
>
> In the case of a private individual it may well be that the mere receipt of rents from property that he owns raises no presumption that he is carrying on a business. In contrast, in their Lordships' view, in the case of a company incorporated for the purpose of making profits for its shareholders any gainful use to which it puts any of its assets prima facie amounts to the carrying on of a business. […]
>
> The carrying on of "business," no doubt, usually calls for some activity on the part of whoever carries it on, though, depending on the nature of the business, the activity may be intermittent with long intervals of quiescence in between."

180. We consider that the following principles can be derived from *Town Investments Ltd* and *American Leaf Blending*:

(1) the expression "business" is an "etymological chameleon" and the expression "imperatively" demands a consideration of the object of the legislation;

(2) any gainful use to which a company puts any of its assets prima facie amounts to the carrying on of a business;

(3) however, not every isolated act of a kind authorised by a company's memorandum if done by a company necessarily constitutes the carrying on of a business by it; and

(4) the carrying on of business usually calls for some activity on the part of the person carrying it on, though, depending on the nature of the business, the activity may be intermittent with long intervals of quiescence in between.

Authorities relating to repealed UK taxes

181. In *Inland Revenue Commissioners v Korean Syndicate Ltd* [1921] 3 K.B. 258 the Court of Appeal considered the meaning of s.39 of the Finance (No. 2) Act 1915 in the context of a charge to excess profits duty (long since repealed). That section made it clear that "the trades and business" to which the duty applied were those "whether continuously carried on or not" but subject to a number of specific exclusions and inclusions.

182. The company had as its principal object the acquisition and working of mining concessions and turning them to account. The company entered into an agreement to lease a concession in Korea. The lessees paid a percentage based on the profits made by them but the sums were described in the lease as "royalties". In reversing the decision of Rowlatt J, the Court of Appeal unanimously held that the company was carrying on a business.

183. In giving his judgment at [269] to [274] Lord Sterndale MR held that the agreement was a carrying out of the object mentioned in its memorandum. As the company had come into existence "for the very purpose of acquiring concessions and turning them to account, it is impossible to say that that is not such a business" as contemplated by the legislation.

184. Atkin LJ, in agreeing with that judgment, noted at [275] "that it does not necessarily follow that because a company is incorporated under the Companies (Consolidation) Act, 1908, it is carrying on a business" before going on to note that, in the instant case, the company had, as contemplated by its memorandum, acquired concessions and turned them to account and it was irrelevant how it had chosen to do that. At [276] he noted, in relation to the activities of the company, that it was "true that it may be called, if you please, a passive carrying on of a business as opposed to an active carrying on of a business" but considered that this was not sufficient to prevent it from being classified as a business.

185. Rowlatt J (whose decision was overturned in *Korean Syndicate*) considered excess profits duty again in *Commissioners of Inland Revenue v The Tyre Investment Trust Ltd* [1924] 12 TC 646 where he held that a holding company was carrying on a business. In our view, this adds little to the analysis. It confirms that, as a matter of law, the activities of a holding company are capable of constituting a business, and, on the facts in *Tyre*, that was the case.

186. The Court of Appeal considered at [1924] 1 KB 390 the charge to "corporation profits tax" (now repealed) under s.52 of the Finance Act 1920 in (among others) the cases of *Westleigh Estates Company Ltd* (which, as we have seen, was referred to in *American Leaf Blending*) and *South Behar Railway Company Ltd*. Subsection (2) of that section provided that the charge applied to: "(a) the profits of a British company carrying on any trade or business, or any undertaking of a similar character, including the holding of investments".

187. Westleigh Estates Company Ltd was formed for the purpose of more conveniently administering an estate which was vested in a large number of beneficiaries. It derived its income from leases of land and mines. As the leases expired, the company renewed them. The company never worked the land or the mines.

188. In giving his judgment in that case, Pollock MR began by setting out his conclusions as to the proper interpretation of the relevant provisions of the Finance Act 1920. He held at [406] that s.52 of that Act appeared prima facie to be "a wide, embracing section" from which it was necessary to exclude certain companies and undertakings which would otherwise be covered with further light thrown upon its "inclusive nature" by s.43 of the Finance Act 1922.

189. Pollock MR then considered, among other cases, *Korean Syndicate* in relation to which he said this:

> "every British company which is fulfilling the objects of its memorandum of association is not thereby ipso facto, and of necessity, brought within [s.52(2)(a)], yet if its objects are business objects and are in fact carried out, it follows that the company carries on business, and consequently comes within the sub-section. […] [In the *Korean Syndicate Case* Rowlatt J made] a reservation with which I agree. "It does not follow," he says, "that, whenever at some particular moment a company is doing nothing but receiving an income from its investments, it is not carrying on a business"; and he indicates that in a certain class of cases, although a company is not actively doing anything, the right conclusion would be that the company was nevertheless carrying on a business."

190. Pollock MR then turned to the facts of the case holding that the Commissioners had not applied the law to the facts found: "its business may have been quiescent, but it was still carrying it on".

191. The decision of the Court of Appeal concerning South Behar Railway Company Ltd was appealed to the House of Lords (*South Behar Railway Company Ltd v Inland Revenue Comrs* [1925] AC 476).

192. The company had in 1895 entered into a contract with the Secretary of State for India under which it was to provide funds, material and equipment for a railway to be constructed by another company and was to receive a percentage of the gross earnings of the railway (which was to be worked and managed by the Secretary of State). The railway having been constructed, the parties then entered into a supplemental contract under which the company made, as from January 1906, in effect an out-and-out sale of the railway to the Secretary of State in consideration for a perpetual annuity.

193. The House of Lords agreed with the majority in the Court of Appeal that the company was carrying on a business within the meaning of s. 52(2)(a) of the Finance Act 1920.

194. At [479] of his judgment, Viscount Cave LC held that "the net of the tax was understood and intended by Parliament to be spread wide", which was evident from the terms of s. 43 of the Finance Act 1922 referred to by Pollock MR in his judgment in the Court of Appeal. He noted at [483] that:

> "It is true that the company carries on no trade or manufacture, and that its principal and only function at the present moment is to receive and distribute the fruits of its undertaking; but that is a part, and a material part, of the purpose for which it came into existence. [...]. The company can no longer be called upon to fulfil its first purpose - namely, to make advances for the construction of the line - because all the necessary funds have been already advanced; but it is still fulfilling its second purpose, which was to receive an

> income for its shareholders while the line was running and to distribute it among them [...]."

195. Lord Sumner referred to the terms of s.52(2)(a) of the Finance Act 1920 noting at [485] that:

> "The statute does not define any of these words, but leaves them to their vernacular meaning and, where the Legislature did not think fit to tread, I certainly have no mind to rush in. Nor is much help to be got from the authorities, for the expression "carrying on a trade or business" has generally been discussed in totally different contexts."

196. Lord Sumner then noted that it was common ground that, when first incorporated and for some years afterwards, the company did carry on a business. The change in 1906 "would appear to have been less considerable than it looks at first sight" [486]. The fact that the fluctuating profits under the former agreement later became a fixed amount made no difference:

> "It is obvious that the company's objects have by no means been accomplished. It is obvious, too, that during its present period of dormant life it has very little to do. I do not attach much importance to the domestic operations of declaring and paying dividends, remunerating directors and presenting reports, but the operation of receiving and thus discharging the annuity payments goes on continuously, and, however simple, it is not a mere passive acquiescence […].
>
> […]
>
> Business is not confined to being busy; in many businesses long intervals of inactivity occur."

197. In our view, these authorities establish the following:

(1) context is critically important in construing references to a "business" (and, indeed, there is not "much help to be got from the authorities" where the expression "has generally been discussed in totally different contexts": see Lord Sumner in *South Behar*);

(2) an activity can still be a business even if it is carried on in a less direct or passive way by, for example, participating in the profits of a business by a lease or other profit share or by holding shares in an operating company; and

(3) there can be times when a company is doing nothing more than receiving income with long periods of inactivity but it does not necessarily follow that, at those times, it is not carrying on a business: the surrounding facts might be such as to lead to the conclusion that it is still carrying on a business activity, for example where it is accomplishing its principal purpose in a different way.

Authorities relating to UK taxes in force at relevant time

Cases concerning the small profits rate of corporation tax

198. We now turn to cases dealing with the application of the small profits rate of corporation tax under, at the relevant time, section 13 of the Income and Corporation Taxes Act 1988.

199. The first relevant case is the High Court decision (Park J) in *Jowett (Inspector of Taxes) v O'Neill and Brennan Construction Ltd* [1998] STC 482. The issue was whether an associated company of the appellant "carried on a trade or business" for the purposes of s.13(4) of that Act. If it did, small profits relief would be less than it would otherwise have been. Accordingly, it was in the interests of the then Inland Revenue to argue for an expansive construction of the word "business" and, as noted in the subsequent case of *Salaried Persons Postal Loans Ltd*

discussed below, to do so on the basis that the purpose of the provision was to prevent the avoidance of tax.

200. The Special Commissioner (Mr David Shirley) held at [8] of his decision that the associated company (WCL) did not carry on business. Park J dismissed an appeal brought by the Inland Revenue against that decision. Park J said this about the statutory context:

> "Nothing much turns on the small print of the statutory words, but it is perhaps worth commenting that they assume that a company can exist without carrying on a trade or business. Also they might have been expressed, but are not, in terms of whether the company has any income or other profits in the accounting period: that is that an associated company would only be disregarded if it had no income or profits in the period. By choosing instead the criterion of whether or not the company had a trade or business the legislature might be said implicitly to have recognised that a company could exist and have some income without that inevitably meaning that it was carrying on a trade or business."

201. Again, this emphasises the importance of the statutory context, and, in this case, the implicit recognition by Parliament that a company can exist without carrying on a business. As we have established above, it is, in our view, clear that the UK/USA double tax convention also makes the same implicit assumption.

202. Having then set out the relevant facts, Park J considered the reliance by the Inland Revenue on *American Leaf Blending* and the dicta of Lord Diplock that "in the case of a company incorporated for the purpose of making profits for its shareholders any gainful use to which it puts any of its assets prima facie amounts to the carrying on of a business." It was then said that when WCL put its money on deposit, it put its assets to gainful use and was hence carrying on business. As to that submission, Park J said:

> "[…] what American Leaf Blending did was a far cry from a company which was doing nothing except putting its money on deposit at the bank, Lord Diplock did not mean that whenever any company did anything which was 'gainful use of assets' it was thereby of necessity carrying on a business.
>
> […]
>
> […] although the normal conclusion when a company lays out its assets and earns an income return is that it is carrying on a business, that is not inevitably so as a matter of law. There can be exceptional cases where it is not."

203. In our view, this is simply an illustration of the principle that, prima facie, gainful use of assets by a company will constitute the carrying on of a business but that is not inevitably so as a matter of law. Whether or not cases where that is not so are described as 'exceptional' does not advance matters much.

204. The second High Court authority on the same section was *Revenue and Customs Commissioners v Salaried Persons Postal Loans Ltd* [2006] EWHC 763 (Ch), a decision of Lawrence Collins J.

205. Lawrence Collins J considered the authorities at [23] to [33] of his decision, including the cases of American Leaf Blending discussed above as well as the case of *Jowett (HM Inspector of Taxes) v O'Neill & Brennan Construction Ltd* (1988) 70 TC, which, in our view, merely applied existing principles. He also considered two reported decisions of the Special Commissioners, *John M Harris (Design Partnership) Ltd v Lee* [1997] STC (SCD) 240 (D A Shirley) and *Land Management Ltd v Fox* [2002] STC (SCD) 152 (Dr N Brice).

206. In dismissing the Revenue's appeal against a finding that the company was not carrying on a business, Lawrence Collins J set out his conclusions at [66] to [73] concluding that there was no basis to interfere with the Special Commissioner's decision. At [73] he concluded:

> "The Special Commissioner was entitled, in my judgment, to come to the view on the facts that MML did not carry on an investment (or any other) business, especially in the light of the following matters: MML did not purchase the West Regent Street premises as an investment; it did nothing in the relevant years except receive the rents from its agent, and authorise a rent review; and the premises were a small part of its assets. This was a case of a company left with former trading premises which it let out without any active participation or management."

207. In our view, no new principle emerges from this case but it is of note that, in determining whether an investment business was being carried on, the court considered it relevant that the company let out premises "without any active participation or management" and the mere receipt of income was not, on the facts of the case, sufficient to constitute the carrying on of a business.

Other cases

208. The case of *Customs and Excise Commissioners v Lord Fisher* [1981] STC 238, a decision of Gibson J, concerned the meaning of "business" for the purposes of s.2 of the Finance Act 1972 (the provisions of which are now consolidated into the Value Added Tax Act 1994). As is well known, the requirement to impose value added tax was an obligation flowing from the United Kingdom's membership of the EU (at the time of the *Lord Fisher* decision, the EEC). As such, the courts have moved away from a consideration of the statutory language of the Act to focus instead on the concept of "economic activity" used in the applicable EU/EEC directive. However, at the time of the decision, the focus of the courts was very much on the terms used in the Act itself. Indeed, there was no reference of any kind in Gibson J's decision to the EEC. In other words, and despite Mr Baker KC's submission to the contrary, the reasoning in this case is relevant more generally in considering the circumstances in which activities might constitute the carrying on of a business.

209. Gibson J began his decision by referring to the provisions of the Finance Act 1972. A definition of "business" was provided by s. 45(1) of the 1972 Act the essence of which was that "business" included any trade, profession or vocation.

210. The case was concerned with whether the sharing of the costs of a "shoot" for pleasure and social enjoyment was enough to constitute the carrying on of a business. As Gibson J noted at [243], Lord Fisher neither sought nor made any profit: "his purpose was to cover the cost of the shoot while making at least an equal contribution to that cost from his own pocket". The tribunal had found that the supply of services for which the payment of contributions was received was "in the course of arranging a shoot for pleasure and social enjoyment".

211. Gibson J discussed at [244] the reliance of the Crown on the decision of the Court of Session in *Customs and Excise Commissioners v Morrison's Academy Boarding Houses Association* [1978] STC 1 noting that their submissions were, to a large extent, advanced by reference to the principles set out in that case. Gibson J referred to the third of the Crown's submissions as follows:

> "Thirdly, the aspects of that activity which are to be considered, as being indicia or criteria for determining whether the activity is a business, are six in number and were listed by counsel for the Crown as follows: (a) whether the activity is a 'serious undertaking earnestly pursued', a phrase derived from the judgment of Widgery J in *Rael-Brook Ltd v Minister of Housing and Local Government* [1967] 1 All ER 262 at 266, [1967] 2 QB 65 at 76, or 'a serious

occupation, not necessarily confined to commercial or profit-making undertakings', a phrase derived from the speech of Lord Kilbrandon in *Town Investments Ltd v Department of the Environment* [1977] 1 All ER 813 at 835, [1978] AC 359 at 402, both of them cited to and referred to by the tribunal in their decision; (b) whether the activity is an occupation or function actively pursued with reasonable or recognisable continuity: per Lord Cameron in *Morrison's Academy* [1978] STC 1 at 8; (c) whether the activity has a certain measure of substance as measured by the quarterly or annual value of taxable supplies made: again per Lord Cameron (at 8); (d) whether the activity was conducted in a regular manner and on sound and recognised business principles: again per Lord Cameron (at 10); (e) whether the activity is predominantly concerned with the making of taxable supplies to consumers for a consideration: per the Lord President (at 6); (f) lastly, whether the taxable supplies are of a kind which, subject to differences of detail, are commonly made by those who seek to profit by them: per the Lord President (at 6) and per Lord Cameron (at 10)."

212. Gibson J set out his conclusions on these submission at pages [246] to [252]. At the outset he noted that he should follow *Morrison's Academy* as authoritative guidance unless there was some clear reason for differing from it. He then said this in the context of the indicia referred to as the third part of the Crown's submissions:

> "As I understand their judgments, the learned judges in the Court of Session did not thereafter set out to lay down principles which, if satisfied, would in all cases demonstrate that an activity must be regarded as a 'business' within those provisions. Those aspects of an activity, to which their Lordships drew attention, and on which counsel for the Crown has relied in formulating the indicia listed above, plainly describe the main attributes of any activity which will be regarded as falling within the concepts of 'business' and 'trade, profession or vocation', and clearly they are useful tools, some perhaps more useful than others, for the analysis of an activity and for the comparing of it with other activities which are unarguably 'businesses'. The courts, however, cannot, by the formulation of tests and by the expounding of indicia, substitute any test or phrase different from that set out in the statutory provision and I am sure that their Lordships had no intention of doing so."

213. He then set out how Counsel's submission for the Crown "in its final and shortest form on the primary facts of the case" was that, although the taxpayer's shoot was genuinely a private shoot, the high cost of running it had forced the taxpayer to run it as a business. The tests laid down in the listed indicia, must drive, so it was said by the Crown, the court to the conclusion that in law this shoot was a business. Gibson J rejected that submission:

> "As to the turnover being substantial, it does not seem to me that, subject to the *de minimis* rule, the amount of money received can by itself be relevant: some pleasures or sports are very expensive and expense alone cannot turn a pleasure into a business. Again the use of planning and the efficient running of the activity, or 'sound and recognised business principles', are, no doubt, both part of the pleasure of running a large shoot and necessary to make shooting enjoyable for the participants, but such matters again cannot turn a pleasure into a business. Lastly, there are very few pleasures which are not also provided somewhere by people who carry on the business of providing them; the fact that other people commonly supply facilities for such pleasures for commercial profit cannot turn a man's pleasure into a business."

214. In other words, Gibson J expressly rejected the submission that the mere fact that the activity in question could be carried on as a business by others meant, in the case of Lord Fisher, that he was carrying on a business. The indicia relied on by the Crown were clearly

considered by Gibson J not to be determinative, including the amount of money involved. The fact that there were large sums involved could not "by itself" be relevant.

215. It is also clear that, in the context of the use of 'business' in the Act concerned, Gibson J was not confining his observations only to individuals. Indeed, the Court of Session judgment in *Morrison's Academy* did not concern individuals.

216. Finally, we consider *Elisabeth Moyne Ramsay v HMRC* [2013] UKUT 0226 (TCC), which concerned the application of s.162(1) of TCGA 1992. That subsection provided relief from capital gains tax where a person who is not a company transfers a business as a going concern to a company.

217. The Upper Tribunal (Judge Roger Berner) considered at [25] to [46] a number of the cases mentioned above – *Town Investments Ltd* (and *Rolls v Miller*), *American Leaf Blending* and *Lord Fisher* – as well as a number of other authorities.

218. Having discussed a case concerning national insurance contributions and the extent to which the statutory context might have led the Special Commissioner to regard that context as providing particular colour to the meaning of "business" in determining the level of activity required (see [45]), the Upper Tribunal said this at [46]:

> "There is no such context for the purpose of s.162 TCGA. There is no statutory definition of "business" in that respect. Business is not aligned as a concept with trades or professions, and there is nothing in that respect to colour its meaning. […] The legislation is looking at business in the context of something that is or may be carried on both by, for example, an individual and by a company. In my judgment the proper approach in that context is to construe "business" broadly, according to its unvarnished ordinary meaning."

219. At [55] to [67] the Upper Tribunal explained that the FTT had adopted the wrong approach in so far as it had failed to assess the degree of activity undertaken by Mrs Ramsay as a whole. The Upper Tribunal said at [64] that regard should be had to the indicia referred to in *Lord Fisher*, which (with the exception of the specific references to taxable supplies) it considered to be of "general application to the question whether the circumstances describe a business". Having concluded at [65] that, viewed as a whole, the activities fell within the tests set out in the *Lord Fisher* case, the Upper Tribunal continued:

> "66. There remains, however, the question of degree. That is relevant to the equation because of the fact that in the context of property investment and letting the same activities are equally capable of describing a passive investment and a property investment or rental business. Although resolution of that issue will be assisted by consideration of the *Lord Fisher* factors, to those there must be added the degree of activity undertaken. There is nothing in the TCGA which can colour the extent of the activity which for the purpose of s 162 may be regarded as sufficient to constitute a business, and so this must be approached in the context of a broad meaning of that term."

220. In our view, the decision of *Ramsay* is closely tied to its particular statutory context (see [46] and [66]). We also note that the Upper Tribunal pointed out that the reference to business appeared in the context of an activity that may be carried on by an individual and a company.

Applicable principles relevant to meaning of "business" in UK/USA double tax convention

221. We consider that the following principles can be derived from the case law considered above so far as applicable to this case:

(1) any gainful use to which a company puts any of its assets prima facie amounts to the carrying on of a business: cases where this is not so are likely to be the exceptions rather than the norm;

(2) however, not every isolated act of a kind that is authorised by a company's memorandum if done by a company necessarily constitutes the carrying on of a business by it; and

(3) the carrying on of business usually calls for some activity on the part of the person carrying it on, though, depending on the nature of the business, the activity may be intermittent with long intervals of quiescence in between.

222. In relation to (3), we consider that the qualification is important: the degree of activity depends on the nature of the business and all of the surrounding circumstances. As we note above, the authorities helpfully make it clear that an activity can still be a business even if it is carried on in a less direct way and there can be times when a company doing nothing more than receiving income with long periods of inactivity may be carrying on a business.

223. The *Lord Fisher* indicia remain relevant in considering whether an activity constitutes the carrying on of a business but they should, in our view, be used with caution as indeed they were in *Lord Fisher* itself. Nonetheless, they may be useful tools. As made clear in *Lord Fisher*, it does not follow that, if the scale of activity is significant, there is necessarily a business.

224. We consider that (leaving aside its relevance to the particular statutory context concerned) *Ramsay* adds little to (3) and merely makes clear that the degree of activity should be considered as a whole; but, as noted above, it is clear that the reasoning of the decision is not confined to activities carried on only by individuals.

Was there a legal error in the FTT decision?

225. Mr Baker KC's submissions were, in essence, directed at establishing that the FTT had either made an error of principle or had failed to have regard to relevant considerations or had had regard to irrelevant considerations. And he also submitted that the only reasonable conclusion that the tribunal could have reached on the facts it had found (from which findings he did not demur) was that GEFI Ltd was carrying on a business. We do not accept those submissions.

226. The FTT cited case law without clearly identifying what the principles were and how they might be engaged. We have done that exercise above. Nonetheless, it does not follow that the FTT was unaware of the relevant principles. In our view, it was.

227. At [73] the FTT referred to Lord Diplock's endorsement in *Town Investments Ltd* of Lindley LJ's observation in *Rolls* that a business embraced "almost anything which is an occupation, as distinguished from a pleasure – anything which is an occupation or duty which requires attention is a business". It is plain at [83], under the heading 'Discussion and Conclusion', that the FTT had regard to this dictum ("although there can be little doubt that the activities of the LP fit the description of a "serious undertaking""). As we have noted above, our view is that the context relevant to *Town Investments Ltd* is markedly different from the context relevant to the UK/USA double tax convention. So far as the FTT applied the dicta of Lord Diplock in *Town Investments Ltd* to this case, we consider it was wrong to do so. But any error on the part of FTT in doing so clearly operated in favour of GEFI Ltd.

228. At [74] the FTT referred to Lord Sumner's conclusion in *South Behar* that a company receiving an annuity was carrying on a business before quoting the extract in the judgment recited above at {196} about "domestic operations" and the fact that receiving annuity payments was "not a mere passive acquiescence." This part of *South Behar* judgment was clearly in the FTT's mind at [88] and [89] of its judgment – discussed further below.

229. It seems to us to plain, from the case law cited at [75] to [78] (including cases citing most of the authorities we discuss above), that the FTT was aware of the first two principles referred to at {221} above that we consider are established by the authorities.

230. Finally, the FTT referred to the case of *Ramsay*, which, despite Mr Baker KC's submission to the contrary, was not confined in its reasoning to businesses only carried on by individuals. In so doing the FTT took account of the *Lord Fisher* indicia but, as explained above, that decision was plainly relevant to taxpayers generally (and not just individuals). In addition, the decision in *Ramsay* confirmed that it was appropriate, in determining whether an activity constituted a business, to consider, as a whole, the degree of activity. As we have explained above, that accords with the authorities.

231. At [81] the FTT referred to a business having "intermittent and quiescent periods", which is a clear reference to *American Leaf Blending*, even though it had not quoted directly from the relevant authority and referred to this under the heading 'Discussion and Conclusion'. It is also of note that there is reference in the FTT's judgment to *American Leaf Blending* in the extracts it quoted from *Salaried Persons Postal Loans Ltd* and *Jowett*.

232. In our view, on a fair reading of the FTT's judgment as a whole, it has, albeit in different parts of its judgment, considered the relevant principles as established by the authorities. The other authorities referred to by Mr Baker KC such as *Korean Syndicate*, *Westleigh* and *Tyre* do not establish additional principles relevant to this case. As the Court of Appeal emphasised in *DPP Law v Greenberg* [2021] IRLR 1016 at [58] and [59] (an appeal from the Employment Appeals Tribunal but the reasoning of which is clearly applicable more generally), it is not the function of an appellate tribunal to pick apart the words used in first instance decisions. The decisions should be read as a whole, without focusing on individual phrases or passages in isolation, and without being "hypercritical".

233. We now turn to the manner in which the FTT sought to apply those principles.

234. At [82] the FTT took account of GEFI Ltd's objects. The FTT accepted Mr Baker KC's submission that, as the company's objects included the making of loans and as the loans were made by the limited partnership, it was relevant that the company was carrying out one of its principal objects. Again, so far as relevant to the issue, its consideration of that issue in that way was in favour of GEFI Ltd.

235. However, in our view, the FTT would, in this case, have been amply entitled to regard GEFI Ltd's objects as an irrelevant factor. GEFI Ltd had wide objects, including the making of loans (expressed in different ways in its memorandum). But the actual thing that it did was to become a limited partner in a limited partnership. It is clear that the limited partnership's objects were <u>not</u> confined to business objects. They simply referred (at [2(i)] of the limited partnership agreement) to the holding of particular assets with nothing said about whether they should be business assets and (at [2(ii)] of the limited partnership agreement) to a generalised statement of engaging in lawful activities, which plainly extends to business as well as non-business activities.

236. In our view, the crux of Mr Baker KC's criticism of the FTT's judgment rests on the following three paragraphs of the FTT's judgment:

> "83. Although there can be little doubt that the activities of the LP fit the description of a "serious undertaking" it remains necessary to consider the other factors identified by Judge Berner at [64] in *Ramsay*, namely whether these were actively pursued with reasonable or recognisable continuity, whether they had a certain amount of substance in terms of turnover, whether they were was conducted in a regular manner and on sound and recognised business principles, and whether the activities were of a kind which, subject

> to differences of detail, are commonly made by those who seek to profit by them.
>
> 84. While the loans were conducted on sound and recognised business principles and the sums involved clearly substantial, holding five affiliate loans over the course of approximately six years, especially as only three of these originated with the LP is, in my judgment, more of a passive, sporadic or isolated activity than a regular and continuous series of activities. In this I agree with Ms McCarthy who submits that there is nothing to suggest that personnel or agents acting on behalf of the LP made or conducted continuous and regular commercial activities in the US. All that appears to have happened was that monies were directed straight to GELCO without negotiating terms or the consideration at a director level as would have been expected from a company carrying on commercial activities on sound business principles.
>
> […]
>
> 91. Therefore, notwithstanding its objects, and having regard to the degree of activity as a whole, particularly the lack of participation in the strategic direction of the LP by the directors of GEFI Inc, I have come to the conclusion that GEFI was not carrying on a business in the US through its participation in the LP."

237. Mr Baker KC did not criticise the FTT for considering the *Lord Fisher* indicia but he did criticise the way in which the FTT considered those indicia at [83] and [84]. The FTT had considered that three of the five indicia were met and only one had not been met (the activity was passive, sporadic and isolated). And it had failed to consider whether the activities were of a kind commonly carried out by those who seek to profit by them. We do not think that there is any merit in this submission. It was perfectly proper for the tribunal to have considered that the majority of the indicia were met but that no business was being carried on – as indeed happened in *Lord Fisher* itself.

238. It is plain that what instead critically weighed in the balance for the FTT was what GEFI Ltd had actually done. And that is why, at [85] to [90], the FTT made a number of findings of fact or inferences from primary fact in the same section of the judgment in which it set out its conclusions on the issue.

239. At [88] the FTT had in mind *South Behar* in referring to "domestic operations" as not constituting a business activity. Similarly, at [89] the FTT referred to various payment instructions as not constituting business activities. In proceeding in this way, it seems to us that the FTT was considering the matters in *South Behar* that were considered as business activities (the receipt of the annuities). In our view, it would have been preferable if the FTT had explained more clearly why, in this case, the mere receipt of the interest payments was not sufficient to constitute the carrying on of a business. However, we consider the failure to do so to be insufficient grounds to interfere with the FTT's conclusion. What GEFI Ltd did is very far removed from the facts of *South Behar*, and we think that the Privy Council was, plainly, not saying that, in all cases, the simple act of receiving a payment would always constitute a business. The FTT was, in our view, simply saying that what the general partner did on behalf of the limited partnership in terms of payment instructions was of a modest nature and was not, *in itself*, sufficient to constitute the carrying on of a business.

240. The critical paragraph is [91]. Read in context, it is only here that the FTT was actually stating its conclusion with regard to "the degree of activity as a whole", which, as we have noted above, is a relevant consideration. At [84] it came to a factual conclusion that "all that appears to have happened was that monies were directed straight to GELCO without negotiating terms or the consideration at a director level as would have been expected from a

company carrying on commercial activities on sound business principles". It is true to say that, in doing so, the FTT referred to the US test for carrying on a business in its reference to a passive, sporadic or isolated activity, but we do not think that, read fairly as a whole, the FTT was actually applying the US test. To conclude otherwise would be an example of a *Greenberg*-style hypercritical reading of the judgment.

241. In reading the decision in the round, it seems to us to be relevant to have regard to the way in which HMRC put its case. Ms McCarthy KC said at [104] of her skeleton argument before the FTT that "the LP's only relevant 'activity' was acting as a conduit to make loans … to group companies" noting that "the central question is whether the source of the interest return from those loans was an "activity" of the LP or whether the LP was a passive recipient of the interest (the source of the interest simply being the loans held by the LP)."

242. These points were made by Ms McCarthy KC against the background of her submission that the reason for using GEFI Ltd as, in her view, a conduit company was to achieve a US tax advantage (in the event not realised) or a UK tax advantage (in the event not needed). In essence, HMRC's case was that using a previously dormant company as a component in tax planning adopted by the group where the company was a passive investor in a limited partnership and the general partner was directed to do things with a limited understanding as to why was not an activity that could reasonably be regarded as the carrying on of a business. The mere fact that the transactions entered into by the limited partnership were of a kind commonly entered into by persons carrying on a business, and involved large sums of money, did not mean that this particular company performing these particular acts was carrying on a business. To hold otherwise would itself be an error of law.

243. It seems to us that, in substance, the FTT accepted this submission even though it did not say, in terms, that it regarded GEFI Ltd as a conduit company. It was, in our view, reasonably open for the FTT to do so on the evidence before it.

244. As explained above, we do not consider that the dicta of Lord Diplock in *Town Investments Ltd* can simply be read across to the UK/USA double taxation convention. We also consider that, for the reasons given above, the objects of GEFI Ltd were at most a marginal consideration. So far as the FTT made errors in considering either of those matters, those errors operated in favour of the appellant.

245. Accordingly, any errors made by the FTT were not material and, therefore, we do not interfere with the FTT's decision on this matter.

DISPOSITION OF APPEAL

246. We consider that GEFI Ltd was resident in the USA for the purposes of the UK/USA double tax convention. The appeal is, therefore, allowed.

MR JUSTICE RICHARD SMITH
JUDGE ANDREW SCOTT

Release date: 29 June 2023

ANNEX: GENERAL ELECTRIC SIMPLIFIED GROUP STRUCTURE