



**TC05009**

**Appeal number: TC/2015/03408**

*INCOME TAX –preliminary issue - section 15 ITTOIA 2005 - performance of duties of employed diver in UK waters treated as the carrying on of a trade in the UK – appellant resident in South Africa – whether income taxable as employment income under Article 14 or business profits under Article 7 South Africa/UK Double Tax Treaty 2002 – interpretation of Double Tax Treaty in accordance with the Vienna Convention on the Law of Treaties – application of Article 3 (2) South Africa/UK Double Tax Treaty*

**FIRST-TIER TRIBUNAL  
TAX CHAMBER**

**MARTIN FREDERICK FOWLER**

**Appellant**

**- and -**

**THE COMMISSIONERS FOR HER MAJESTY'S  
REVENUE & CUSTOMS**

**Respondents**

**TRIBUNAL: JUDGE GUY BRANNAN**

**Sitting in public at the Royal Courts of Justice on 9 March 2016**

**Jonathan Schwarz, Counsel, instructed by Norton Rose Fulbright for the Appellant**

**Akash Nawbatt, Counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents**

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## DECISION

### Introduction

- 5 1. This appeal raises a short but difficult point on the interpretation of the South Africa / UK Double Tax Treaty 2002 (SI 2002/3138) (“the Treaty”). The issue arises as a preliminary point in an appeal by Mr Fowler.
2. Mr Fowler appeals in respect of closure notices for the income tax years ended 5 April 2012 and 5 April 2013.
- 10 3. Mr Fowler is resident, for tax purposes, in South Africa. In the tax years in question he worked as a qualified diver undertaking diving work in the UK Continental Shelf sector of the North Sea.
4. HMRC decided that Mr Fowler’s income from his North Sea diving activities fell within Article 14 (Income from Employment) of the Treaty and were, therefore,  
15 chargeable to UK income tax. The closure notices were issued on that basis.
5. Mr Fowler, however, contends that his diving income constitutes business profits falling within Article 7 (Business Profits) of the Treaty and were, accordingly, exempt from UK income tax because he has no permanent establishment (within the meaning of Article 5 of the Treaty) in the UK.
- 20 6. The question whether Mr Fowler was for the relevant tax years an employee (as HMRC contend) or was self-employed (as Mr Fowler contends) is in dispute.
7. Even if Mr Fowler was an employee for the relevant tax years, section 15 Income Tax (Trading and Other Income) Act 2005 (“ITTOIA”) treats the performance of the duties of his employment for income tax purposes as the carrying  
25 on of a trade in the UK.
8. It was against this background that the Tribunal (Judge Poole) directed that the section 15 ITTOIA issue should be determined as a preliminary issue as follows:
- 30 “Whether, as a matter of law, if section 15 of [ITTOIA] applies to the diving activities of the Appellant during the tax years 2011 – 12 and 2012 – 13, the Appellant cannot be liable to income tax in the UK for those years in respect of his income from those activities by reason of article 7, or alternatively article 20, of the [Treaty] or whether the Appellant may be liable to income tax for those years in respect of his income from those activities by reason of article 14 of the Treaty.”
- 35 9. Although Judge Poole’s Directions referred to Article 20 of the Treaty (other income) it was common ground before me that Article 20 was not engaged in the present case.

## The facts

10. For the purposes of the hearing of this preliminary point, the parties agreed a short Statement of Facts which reads as follows:

5                   “1. The Appellant is a qualified diver resident in the Republic of South Africa.

2. During the 2011/2012 and 2012/2013 tax years, he undertook diving engagements in the UK Continental Shelf waters.

3. The Appellant is a resident of South Africa for the purposes of the South Africa-United Kingdom Tax Treaty (SI 2002/3138). . . .”

10 11. The question whether Mr Fowler was an employee or self-employed in the relevant tax years as I have said, is in dispute and will, if necessary, be determined at the full hearing of this appeal. I shall not be considering this matter further and shall proceed on the assumption that Mr Fowler falls within section 15 ITTOIA in accordance with Judge Poole’s Directions.

15 12. I should add, however, that it did not appear to be in dispute that if Mr Fowler was self-employed he would therefore be carrying on a trade within ITTOIA Part 2 and that Article 7 of the Treaty would apply to his diving income. Therefore, the preliminary issue is whether the same treatment applies if Mr Fowler is deemed to carry on a trade by section 15 ITTOIA.

20 13. It was also apparently assumed that Mr Fowler did not have a permanent establishment for the purposes of Article 7 of the Treaty. There was no evidence before me on this point, and I make no finding upon it, but my decision proceeds on this basis

25 14. Finally, I was not informed of the manner in which South Africa would tax Mr Fowler’s income, if at all.

## The legislation

30 15. Section 15 ITTOIA was originally enacted in section 28 Finance Act 1978 (and consolidated by section 314 ICTA 1988 and subsequently re-written as section 15 ITTOIA 2005). Section 15(2) ITTOIA is the statutory provision which lies at the centre of this dispute, at least as regards this preliminary point. Section 15 provides as follows:

### “15. Divers and diving supervisors

(1) This section applies if—

35 (a) a person performs the duties of employment as a diver or diving supervisor in the United Kingdom or in any area designated by Order in Council under section 1(7) of the Continental Shelf Act 1964 (c. 29),

(b) the duties consist wholly or mainly of seabed diving activities, and

(c) any employment income from the employment would otherwise be chargeable to tax under Part 2 of ITEPA 2003.

(2) The performance of the duties of employment is instead treated for income tax purposes as the carrying on of a trade in the United Kingdom.

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(3) For the purposes of this section the following are seabed diving activities—

(a) taking part as a diver in diving operations concerned with the exploration or exploitation of the seabed, its subsoil and their natural resources, and

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(b) acting as a diving supervisor in relation to any such diving operations.”

16. It is worth observing that the deeming provision (“is instead treated for income tax purposes”) contained in section 15(2) only applies if the taxpayer would otherwise be an employee and the employment income would otherwise be chargeable under Part 2 of ITEPA 2003 (section 15(1) (a) and (c)). As I have said, for the purposes solely of this preliminary issue, I shall be proceeding on the basis that Mr Fowler was an employee for the relevant tax years and that his income derived from that employment would otherwise be chargeable under Part 2 of ITEPA 2003.

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17. Furthermore, section 15 is not an isolated deeming provision. It appears in a list of deeming provisions from sections 9 – 16 ITTOIA. For example, in broad terms:

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(1) section 9 treats farming or market gardening as a trade for income tax purposes;

(2) section 10 treats the commercial occupation of land in the UK (other than woodlands) as a trade for income tax purposes;

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(3) section 11 deems the commercial occupation of woodlands in the UK not to be a trade for income tax purposes;

(4) section 12 treats the profits arising from mines and quarries etc. as chargeable to income tax as if the concern were trade carried on in the UK;

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(5) section 13 treats certain UK activities of non-UK resident performers as activities in the course of a trade profession or vocation carried on in the UK; and

(6) section 16 treats oil -related activities as a separate trade for income tax purposes.

18. Income falling within section 15 ITTOIA is not charged to tax as employment income by virtue of section 6(5) ITEPA. Section 6(5) ITEPA provides:

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“(5) Employment income is not charged to tax under this Part if it is within the charge to tax under Part 2 of ITTOIA 2005 (trading income) by virtue of section 15 of that Act (divers and diving supervisors).”

19. The Treaty has effect for UK tax purposes pursuant to section 6 Taxation (International and Other Provisions) Act 2010 (“TIOPA”) which provides:

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**“The effect given by section 2 to double taxation arrangements**

(1) Subject to this Part and Part 18 of ICTA, double taxation arrangements have effect in accordance with subsections (2) to (4) despite anything in any enactment.

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(2) Double taxation arrangements have effect in relation to income tax and corporation tax so far as the arrangements provide—

(a) for relief from income tax or corporation tax,

(b) for taxing income of non-UK resident persons that arises from sources in the United Kingdom....”

## 10 **Treaty Provisions**

20. The Preamble of the Treaty is as follows:

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“The Government of the United Kingdom of Great Britain and Northern Ireland and the Government of the Republic of South Africa desiring to promote and strengthen the economic relations between the two countries by the conclusion of a new Convention for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and on capital gains.”

21. The relevant provisions of the Treaty are as set out below.

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22. Article 3(1) (“General Definitions”) of the Treaty corresponds to Article 3 (1) of the OECD Model Convention with respect to Taxes on Income and on Capital (the “OECD Model Convention”) and contains partial definitions of “business” and “enterprise” and “enterprise of a Contracting State”. It provides as follows:

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“1. For the purposes of this Convention, unless the context otherwise requires:

...

(d) the term "business" includes the performance of professional services and of other activities of an independent character;

...

(g) the term "enterprise" applies to the carrying on of any business;

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(h) the terms "enterprise of a Contracting State" and "enterprise of the other Contracting State" mean respectively an enterprise carried on by a resident of a Contracting State and an enterprise carried on by a resident of the other Contracting State....”

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23. Article 3(2) of the Treaty corresponds to Article 3(2) of the OECD Model Convention and sets out a general rule of interpretation for undefined terms. It provides:

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“2. As regards the application of the provisions of this 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 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.”

24. Article 7 of the Treaty deals with business profits and corresponds to Article 7 of the OECD Model Convention. It provides (so far as relevant):

“1. The profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein. If the enterprise carries on business as aforesaid, the profits of the enterprise may be taxed in the other State but only so much of them as is attributable to that permanent establishment.”

25. Article 14 of the Treaty deals with employment income and corresponds to Article 15 of the OECD Model Convention. It provides (so far as relevant):

“1. Subject to the provisions of Articles 15, 17 and 18 of this Convention, salaries, wages and other similar remuneration derived by a resident of a Contracting State in respect of an employment shall be taxable only in that State unless the employment is exercised in the other Contracting State. If the employment is so exercised, such remuneration as is derived therefrom may be taxed in that other State.”

## 20 Provisions of the Vienna Convention on the Law of Treaties

26. The Treaty must be interpreted in accordance with Articles 31 and 32 of the Vienna Convention on the Law of Treaties 1969 (“the Vienna Convention”): see *Anson v Commissioners for HM Revenue & Customs* [2015] UKSC 44 at [54] (“*Anson*”).

27. Articles 31 and 32 of the Vienna Convention are in the following terms:

### "Article 31

#### *General rule of interpretation*

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.

2. The context for the purpose of the interpretation of a treaty shall comprise, in addition to the text, including its preamble and annexes:

(a) Any agreement relating to the treaty which was made between all the parties in connexion with the conclusion of the treaty;

(b) Any instrument which was made by one or more parties in connexion with the conclusion of the treaty and accepted by the other parties as an instrument related to the treaty.

3. There shall be taken into account, together with the context:

(a) Any subsequent agreement between the parties regarding the interpretation of the treaty or the application of its provisions;

(b) Any subsequent practice in the application of the treaty which establishes the agreement of the parties regarding its interpretation;

(c) Any relevant rules of international law applicable in the relations between the parties.

5 4. A special meaning shall be given to a term if it is established that the parties so intended.

**Article 32**

*Supplementary means of interpretation*

10 Recourse may be had to supplementary means of interpretation, including the preparatory work of the treaty and the circumstances of its conclusion, in order to confirm the meaning resulting from the application of article 31, or to determine the meaning when the interpretation according to article 31:

(a) leaves the meaning ambiguous or obscure; or

15 (b) leads to a result which is manifestly absurd or unreasonable."

28. In *Anson* the Supreme Court (Lord Reed delivering the judgment of the Court) summarised these provisions as follows at [56]:

20 "Put shortly, the aim of interpretation of a treaty is therefore to establish, by objective and rational means, the common intention which can be ascribed to the parties. That intention is ascertained by considering the ordinary meaning of the terms of the treaty in their context and in the light of the treaty's object and purpose. Subsequent agreement as to the interpretation of the treaty, and subsequent practice which establishes agreement between the parties, are also to be taken  
25 into account, together with any relevant rules of international law which apply in the relations between the parties. Recourse may also be had to a broader range of references in order to confirm the meaning arrived at on that approach, or if that approach leaves the meaning ambiguous or obscure, or leads to a result which is manifestly absurd  
30 or unreasonable."

**Submissions for Mr Fowler**

29. Mr Schwarz, who appeared for Mr Fowler, submitted that the correct approach to the interpretation of the Treaty in accordance with Article 31(1) and (4) of the Vienna Convention and Article 3(2) of the Treaty was:

- 35 (1) If the term is defined in the treaty, the treaty definition is to be applied;
- (2) If the term is undefined, a reference to its domestic tax law meaning is required by Article 3(2), unless the context otherwise requires;
- (3) If Article 3(2) does not lead to a reference to domestic tax law, the autonomous treaty meaning must be determined in accordance with the rules in  
40 the Vienna Convention.

30. Pausing at this point, it seemed to me that Mr Nawbatt, who appeared for HMRC, did not dispute this general approach to interpretation.

31. Reference to domestic UK tax law was, Mr Schwarz continued, required by Article 3(2) in this case – Article 3(2) was expressed in mandatory terms. Article 3(2) was an expression of the principle in Article 31(4) of the Vienna Convention, viz that a special meaning was to be given to an expression if the parties so intended.

5 32. The purpose of Article 3(2) was to ensure, Mr Schwarz said, that the provisions of the Treaty which permitted taxation or provided relief from taxation corresponded to the taxing provisions of domestic law of the Contracting State seeking to tax the income.

10 33. The meaning of an expression for the purposes of UK tax law took priority over any other meaning (“prevailing”: Article 3(2)). Only in exceptional circumstances would the domestic tax law meaning be excluded (“unless the context otherwise requires”). Mr Schwarz referred us to the decision of the Court of Appeal in *Hammonds (a firm) v David Jones* [2009] EWCA 1400 at [32] where the phrase “unless the context otherwise requires” in a partnership agreement was considered by  
15 Lloyd LJ who said that the context must make it “necessary, rather than merely sensible or reasonable.”

34. The terms defined in Article 3(1) also applied “unless the context otherwise requires”. These words of exception demanded a compelling context for excluding the reference to the domestic tax law meaning. For example, Mr Schwarz referred to *IRC v Exxon Corporation* [1982] STC 356 at 368e, where Goulding J refused to apply a  
20 domestic law definition which would have rendered a treaty provision incapable of any application at all.

35. The word “enterprise” (used in Article 7(1) of the Treaty) was only partially defined in Article 3(1)(g) and applied to “any business” which itself was only  
25 partially defined in Article 3(1)(d). The word “employment” used in Article 14(1) was not defined in the Treaty.

36. In both cases, Mr Schwarz argued, domestic UK tax law supplied the meaning that Article 3(2) required.

37. For the purposes of UK tax law, a business comprised trades, professions, vocations and investment: *Jowett (HMIT) v O’Neill & Brennan Construction Ltd* [1998] STC 482 per Park J at 489b.

38. Part 2 Chapter 2 ITTOIA (“Income taxed as trade profits”) explained the meaning of trade profits. In particular, the meaning of “trade” went beyond section 5 ITTOIA (“profits of a trade, profession or vocation”) and, in Mr Schwarz’s view,  
35 extended to activities treated as trades e.g. sections 9-12 and 15 ITTOIA. All those meanings were collectively within the ambit of the expression “under applicable law” for the purposes of Article 3(2).

39. Thus, Mr Schwarz said, the trade that a diver was deemed to carry on by section 15 ITTOIA constituted the carrying on of the business within Article 3(1)(g) and gave  
40 rise to business profits within Article 7. Furthermore, income within section 15 ITTOIA was taken out of the charge to employment income by ITEPA Section 6(5)

40. Moreover, section 15 ITTOIA formed part of the definition of “trade”. It deemed the performance of diving activities to be a trade “for income tax purposes” (section 15(2)). This deemed treatment, said Mr Schwarz, applied for all income tax purposes and was not dependent on context. It, therefore, included section 6(2) TIOPA which gave effect to the Treaty in domestic law.

41. The context, according to Mr Schwarz’s submission, supported the use of the domestic law meaning and did not, for the purposes of Article 3(2), require otherwise.

42. First, the Treaty specified several categories of income from personal activities: Article 7 (business profits), Article 14 (1) (income from employment), Article 14 (3) (employment exercised aboard a ship or aircraft operated in international traffic), Article 15 (directors’ fees), Article 16 (entertainers and sportsmen, Article 18 (salaries and similar income in respect of government service) and Article 26 (members of diplomatic or permanent missions and consular posts). Mr Schwarz contended that the treatment of income differed according to the category. The question, however, was always the same: which treaty category was relevant to an item of income taxable under domestic law.

43. Secondly, section 15 ITTOIA and section 6(5) ITEPA were long-standing provisions – originally enacted in 1978. Therefore, when the Treaty was concluded in 2002, these provisions had already been in place for nearly 25 years.

44. In this way, classification of the diving activity as the carrying on of a business in the Treaty, accorded with the scheme of the domestic tax legislation.

45. The OECD Commentary on the OECD Model Convention (“the OECD Commentary”) in relation to Article 3 (1) in paragraph 10.2 recognised that the meaning of “business” should be determined under Article 3(2). The Commentary provides:

“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.”

46. The OECD Commentary on Article 15 of the OECD Model Convention (corresponding to Article 14 of the Treaty) when the Treaty was concluded was silent on the question of employment status. However, Mr Schwarz suggested that it would be anomalous for the meaning of “business” to be determined by reference to domestic tax law while “employment” was not.

47. Mr Schwarz noted that the OECD Commentary was supplementary material within Article 32 of the Vienna Convention: *IRC v Commerzbank* [1990] STC 285 at 298 f. and g.).

48. Accordingly, Mr Schwarz submitted that, as a matter of law, if section 15 ITTOIA applied to diving activities of Mr Fowler during the tax years 2011-12 and 2012-13, his liability to UK income tax in respect of those activities fell within Article

7 (business profits) and not Article 14 (income from employment). Because Mr Fowler did not have a permanent establishment in the UK, he could not be liable to UK income tax in those years.

### Submissions for HMRC

5 49. Mr Nawbatt submitted that section 15 ITTOIA only applied to Mr Fowler's  
diving activities on the basis that he was an employee (section 15 (1) (a)). In those  
circumstances, Article 14 applied to allocate taxing rights to the UK. The fact that UK  
legislation deemed income of employed divers to be trading income did not alter the  
10 fact that the income was derived from an employment. Section 15 ITTOIA did not  
change the legal character of the relationship under which Mr Fowler performed his  
duties, which, for the purposes of this preliminary point, had to be assumed was one  
of employment. It followed, therefore, that employed divers had statutory  
employment rights and were employed earners for national insurance contributions  
purposes.

15 50. Mr Nawbatt stated that Mr Fowler received payslips from Bibby Project  
Personnel for the relevant tax years showing a deduction for Class I national  
insurance contributions. I should point out that, as far as I am aware, I was not taken  
to any evidence to substantiate this submission.

20 51. As regards the interpretation of double tax treaties, Mr Nawbatt referred to the  
decision of the Court of Appeal in *Smallwood and another v HMRC* [2010] EWCA  
Civ 778 at [15] where Patten LJ discussed the role of Article 13 (Capital gains) of the  
Mauritius – UK double tax treaty. Patten LJ said:

25 “28. Article 13 of the DTA is intended to deal with any conflicts which  
may exist between taxation of capital gains on the basis of the source  
or situs of the income or gain and taxation on the basis of the residence  
of the taxpayer. It is therefore limited to defining the relevant basis of  
taxation for each type of gain and is not concerned to determine the  
purely domestic question of where the taxpayer is resident for purposes  
30 of the DTA or when. Articles 13(1)-(3) therefore provide for gains  
from the disposal of immovable property and certain types of business  
assets to be taxed in the Contracting State in which they are situate and  
for all other gains to be taxed "only in the Contracting States of which  
the alienator is resident": see Article 13(4). Any issue as to which  
Contracting State that is falls to be determined by reference to Article  
35 4.

40 29. As explained earlier, the provisions of the DTA are given statutory  
effect in relation to the taxpayers concerned by s.788 TA 1988 as a  
form of relief against what would otherwise be the relevant tax liability  
under UK law. But the DTA is not concerned to alter the basis of  
taxation adopted in each of the Contracting States as such or to dictate  
to each Contracting State how it should tax particular forms of receipts.  
Its purpose is to set out rules for resolving issues of double taxation  
which arise from the tax treatment adopted by each country's domestic  
legislation by reference to a series of tests agreed by the Contracting

States under the DTA. The criteria adopted in these tests are not necessarily related to the test of liability under the relevant national laws and are certainly not intended to resolve these domestic issues.”

52. By analogy with the comments of Patten LJ, Mr Nawbatt argued that the purpose of Article 14 in the present case was to allocate taxation rights between the state of residence (South Africa) and the place where the employment was exercised (the UK). The role of Article 14 was simply to determine which Contracting State had the right to tax the income. Article 14 was not concerned with *how* the Contracting State taxed the income.

53. Next, Mr Nawbatt referred to the general principles of treaty interpretation referred to by Patten LJ at [26] adopting the summary by Mummery J (as he then was) in *IRC v Commerzbank* [1990] STC 285 at 297 (approved by the Court of Appeal in both *Memec v IRC* [1998] STC 754 and *Ben Nevis (Holdings) Ltd & Anor v HMRC* [2013] EWCA Civ 578). Mummery J said:

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

(2) The process of interpretation should take account of the fact that—  
"The language of an international convention has not been chosen by an English parliamentary draftsman. It is neither couched in the conventional English legislative idiom nor designed to be construed exclusively by English judges. It is addressed to a much wider and more varied judicial audience than is an Act of Parliament which deals with purely domestic law. It should be interpreted, as Lord Wilberforce put it in *James Buchanan & Co. Ltd v Babco Forwarding & Shipping (UK) Limited*, [1987] AC 141 at 152, "unconstrained by technical rules of English law, or by English legal precedent, but on broad principles of general acceptance": 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 article 31(1) of the Vienna Convention on the Law of Treaties, that 'a treaty should be interpreted in good faith and in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose'. A similar principle is expressed in slightly different terms in McNair's *The Law of Treaties* (1961) p 365, where it is stated that the

5 task of applying or construing or interpreting a treaty is 'the duty of giving effect to the expressed intention of the parties, that is, their intention as expressed in the words used by them in the light of the surrounding circumstances'. It is also stated in that work (p 366) that references to the primary necessity of giving effect to 'the plain terms' of a treaty or construing words according to their 'general and ordinary meaning' or their 'natural signification' are to be a starting point or prima facie guide and 'cannot be allowed to obstruct the essential quest in the application of treaties, namely the search for the real intention of the contracting parties in using the language employed by them'.

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

15 (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).

20 (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)."

25 54. The references to the inappropriate use of literal interpretation, the fact that expressions used were not drafted by an English parliamentary draftsman and the need to have regard to the purpose of the treaty meant, in Mr Nawbatt's submission, that one should be wary of construing words like "shall" in Article 3(2) as mandatory.

35 55. The object and purpose of Article 14, according to Mr Nawbatt, was to allocate taxing rights to the Contracting State in which the employment was exercised i.e. the source State. If Mr Schwarz's submissions were accepted it would lead to a result which was contrary to the object and purpose of the Treaty, viz that if Mr Fowler was an employee and derived income from an employment exercised in the UK, the UK would not have taxing rights. The submissions made on behalf of Mr Fowler, said Mr Nawbatt, were directed at domestic issues and not the issue of allocation of taxing rights.

40 56. As regards Article 3 of the Treaty, terms "enterprise" and "business" were defined in the Treaty. Only the word "employment", Mr Nawbatt noted, was undefined.

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57. In relation to the term “business”, Article 3(1)(d) was drawing the common law distinction between employees who were integrated into an employer’s business and those who carried on business independently i.e. as independent contractors.

58. In relation to Article 7 (business profits), Mr Nawbatt argued that Mr Schwarz’s submission was inconsistent with the purpose of the Treaty. One of the key allocation issues in relation to the taxation of business profits concerned the existence of a permanent establishment. An employee could not have a permanent establishment. The concept of a permanent establishment harked back to the definition of “business” i.e. the concept of services of an independent character. Thus the fact that an employee could not have a permanent establishment strongly indicated that Article 7 could not be the applicable Article. Moreover, the purpose of Article 7 was to avoid double taxation by allocating taxing rights: it was not intended to result in, following Mr Schwarz’s logic, no taxation by either Contracting State.

59. As regards Article 14, Mr Nawbatt drew our attention to the two conditions which had to be satisfied before the “source” Contracting State could exercise its taxation rights. First, the income had to be derived from employment (“as is derived therefrom”). Secondly, the employment had to be exercised in that other Contracting State. If those two conditions were satisfied, Mr Nawbatt continued, then that State (the UK, in the present appeal) had the right to tax the income. The fact that the source State’s domestic legislation deemed the activity to be a trade did not change the fact that the income was derived from an employment and was earned in the UK. Those were exactly the same two pre-conditions that applied to the application of section 15 ITTOIA. There was no “third” condition that the income should be taxed as employment income – that was the additional condition which Mr Schwarz sought to apply.

60. Mr Nawbatt suggested that the soundness of Mr Schwarz’s submissions should be tested by reversing the position. He posed the hypothetical case of a diver being treated as a matter of general law a self-employed person, but under domestic UK tax legislation was taxed, instead, as an employee. In such a case, Article 14 could not possibly apply.

61. In relation to section 15 ITTOIA, Mr Nawbatt disagreed with Mr Schwarz’s suggestion that it contained a definition of “trade”. It was not a definitional provision but a deeming provision. Section 15 set out the way in which the UK chose to tax income from this particular kind of employment. It created a fictional trade. If there had been a real trade, section 15 ITTOIA would have no application.

62. The difficulty with the argument put forward on behalf of Mr Fowler, according to Mr Nawbatt, was that it allowed the UK unilaterally to swap between different Articles of the Treaty, and therefore to determine the allocation of taxation rights, by creating a domestic statutory fiction.

63. Mr Nawbatt took me to *Hansard* to explain why section 15 ITTOIA had been enacted. I am, of course, aware of the usual *Pepper v Hart* constraints in looking at *Hansard*. In this case, however, the fundamental question at issue is not the meaning

of section 15 ITTOIA but rather the interpretation of the Treaty. In that context, an understanding of the public statements made in relation to section 15 ITTOIA might be helpful. The relevant extract from *Hansard* is dated 3 February 1978 and records the following answer to a Parliamentary question given by Mr Robert Sheldon MP, the Financial Secretary to the Treasury:

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“Mr Adam Hunter asked the Chancellor of the Exchequer whether he will treat divers in the North Sea as self-employed for tax purposes; and if he will make a statement.

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Mr Robert Sheldon I have given further careful consideration to this matter in the light of representations received. As I have made clear on several occasions, these divers fall to be treated as employees under the existing law. Nevertheless, after careful examination of their particular circumstances, I recognise that there are certain distinctive features about their work, such as the danger which it entails, their vulnerability to long-term health hazards, the exceptional travelling difficulties involved and the shortness of their working life. Taking into account these and other factors, my right hon. Friend is now prepared to introduce legislation in the coming Finance Bill which will provide that earnings from diving operations in connection with exploration or exploitation activities in the United Kingdom Continental Shelf will, with effect from 1978 – 79, be assessable under Schedule D rather than Schedule E.” (*HC Deb 3 February 1978 vol 943 c359 W*)

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64. This statement demonstrated, according to Mr Nawbatt, that the genesis of section 15 ITTOIA was not based on difficulties of categorisation and was introduced for reasons unrelated to employment status. It would, therefore, be surprising if a provision introduced for these special reasons would have the effect of depriving the UK taxing rights under the Treaty. The statement showed, Mr Nawbatt argued, that section 15 was a provision which concerned how the UK chose to tax income from a particular kind of employment. There was no suggestion that Parliament thought that employed divers were actually carrying on a trade (and indeed there would be no need for section 15 in such a case).

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65. Mr Nawbatt’s primary submission, therefore, was that under ordinary principles of interpretation Article 14 of the Treaty applied in this case. However, in case the Tribunal considered the provisions of the Treaty unclear or ambiguous, Mr Nawbatt submitted that the OECD Commentary supported his submissions.

66. The relevant provision of the OECD Model Convention in relation to employment income is Article 15, which corresponds with Article 14 of the Treaty.

67. Paragraph 1 of the OECD Commentary stated:

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“1. Paragraph 1 establishes the general rule as to the taxation of income from employment..., namely, that such income is taxable in the State where the employment is actually exercised. The issue of whether or not services are provided in the exercise of an employment may sometimes give rise to difficulties which are discussed in paragraphs 8.1ff.”

68. This made it clear, said Mr Nawbatt, that Article 14 was dealing with income from employment and not income from contracts for services (Article 7).

69. Mr Nawbatt then referred to paragraphs 8.4 – 8.6 of the OECD Commentary (added on 22 July 2010 i.e. after the date on which the Treaty was concluded) which read:

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“8.4 In many States, however, various legislative or jurisprudential rules and criteria (e.g. substance over form rules) have been developed for the purpose of distinguishing cases where services rendered by an individual to an enterprise should be considered to be rendered in an employment relationship (contract of service) from cases where such services should be considered to be rendered under a contract for the provision of services between two separate enterprises (contract for services). That distinction keeps its importance when applying the provisions of Article 15.... Subject to the limit described in paragraph 8.11 and unless the context of a particular convention requires otherwise, it is a matter of domestic law of the State of source to determine whether services rendered by an individual in that State are provided in an employment relationship and that determination will govern how that State applies the Convention.

8.5 In some cases, services rendered by an individual to an enterprise may be considered to be employment services for the purposes of domestic tax law even though the services are provided under a formal contract for services between, on the one hand, the enterprise that acquires the services, and, on the other hand, either the individual himself or another enterprise by which the individual is formally employed or with which the individual has concluded another formal contract for services.

8.6 In such cases, the relevant domestic law may ignore the way in which the services are characterised in the formal contracts. It may prefer to focus primarily on the nature of the services rendered by the individual and their integration into the business carried on by the enterprise that acquires the services to conclude that there is an employment relationship between the individual and that enterprise.”

70. These passages, Mr Nawbatt submitted, showed that the key issue in determining which Article of the Treaty should be applied was to determine correctly the nature of the relationship under which Mr Fowler provided his services – was it an employment relationship or was he an independent contractor?

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71. Mr Nawbatt then referred to paragraph 8.11 of the OECD Commentary and placed great weight on its terms. Paragraph 8.11 was also added on 22 July 2010 and is worth quoting in full:

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“The conclusion that, under domestic law, a formal contractual relationship should be disregarded, must however, be arrived at on the basis of objective criteria. For instance, a State could not argue that services are deemed, under its domestic law, to constitute employment services where, under the relevant facts and circumstances, it clearly appears that the services are rendered under a contract for the provision

of services concluded between two separate enterprises. The relief provided for under paragraph 2 of Article 15 would be rendered meaningless if States were allowed to deem services to constitute employment services in cases where there is clearly no employment relationship or to deny the quality of employer to an enterprise carried on by a non-resident where it is clear that the enterprise provide services, through its own personnel, to an enterprise carried on by a resident. Conversely, where services rendered by an individual may properly be regarded by a State as rendered in an employment relationship rather than as under a contract for services concluded between two enterprises, that State should logically also consider that the individual is not carrying on the business of the enterprise it constitutes that individual's formal employer; this could be relevant, for example, for purposes of determining whether that enterprise has a permanent establishment at the place where the individual performances activities."

72. In Mr Nawbatt's submission, paragraph 8.11 made it clear that deeming provisions, which were not based on the substance of the relationship, would not prevent the application of the correct treaty Article. In other words, a Contracting State cannot allocate to itself the right to tax by deeming a contract for services to be a contract of service.

73. The OECD Commentary in relation to Article 7 stated as follows:

"74. ...[I]t has... been decided to include a rule of interpretation that ensures that Articles applicable to specific categories of income will have priority over Article 7. It follows from this rule that Article 7 will be applicable to business profits which do not belong to categories of income covered by these other Articles.... This rule does not, however, govern the manner in which the income will be classified for the purposes of domestic law; thus, if a Contracting State may tax an item of income pursuant to other Articles of this Convention, that State may, for its own domestic tax purposes, characterise such income as it wishes... provided that the tax treatment of that item of income is in accordance with the provisions of the Convention."

74. Paragraph 74 of the OECD Commentary, Mr Nawbatt said, applied squarely in the present case. The fact that the UK deemed income from an employment to be income from a trade for domestic purposes did not remove the UK's right to tax it under Article 14 of the Treaty.

75. In response to Mr Schwarz's submissions, Mr Nawbatt argued that the terms "enterprise" and "business" were defined in the Treaty and that, therefore, Article 3(2) had no application in relation to those terms. "Employment" was not defined. Section 15 ITTOIA, however, did not provide a definition of "employment" and therefore did not fall within Article 3(2). In other words, section 15 did not attempt to define "employment" – it only applied if an employment relationship was already in existence.

76. As regards Article 31(4) of the Vienna Convention, there was no intention on the part of the parties to the Treaty to displace the ordinary meaning of the term “employment” and paragraph 8.11 of the OECD Commentary confirms this.

### **Reply on behalf of Mr Fowler**

5 77. Mr Schwarz commented on HMRC’s reliance upon the decision of the Court of Appeal in *Smallwood* and noted that that decision had not been endorsed by the Supreme Court in *Anson*. Instead, in *Anson* the Court had focused on the rules of interpretation in the Vienna Convention. In any event, *Smallwood* was irrelevant and of no assistance.

10 78. As regards the definitions in Article 3 of the Treaty, the term “enterprise” was not fully defined: it simply referred to “the carrying on of any business”. The term “business” was not fully defined – the definition was inclusive rather than exhaustive.

15 79. Furthermore, Mr Schwarz drew attention to the provisions of Article 14(2) which provided that employment income would remain taxable only in the jurisdiction of the state of residence in cases of a presence not exceeding 183 days. This was simply a slightly different test from the permanent establishment test employed by Article 7 (read with Article 5).

80. HMRC’s submissions, Mr Schwarz said, ignored the correct approach to questions of interpretation of the Treaty.

20 81. Moreover, the reference to *Hansard* supported Mr Fowler’s case rather than that of HMRC. The tax treatment of divers, as the ministerial statement made clear, did not depend on contractual arrangements and the status of divers as employees.

25 82. As regards Mr Nawbatt’s references to the common law distinction between a contract for services and a contract of service, Mr Schwarz pointed out that the treaty applied to the UK as a whole and the UK included Scotland, which was not a common law system; neither, for that matter, was South Africa.

30 83. The fact that Mr Fowler was liable to Class 1 national insurance contributions and secondary Class 1 contributions paid by employers was irrelevant. The deeming provisions in section 15 ITTOIA only had effect for income tax purposes. In any event, national insurance contributions were not a tax and were not covered by the Treaty.

35 84. Mr Schwarz also noted that the various passages in the OECD commentary referred to by Mr Nawbatt were only added in 2010. On this point, Mr Schwarz referred to of the Special Commissioners (Dr Brice and Dr Avery-Jones) in *Smallwood* at [99]:

“The relevance of Commentaries adopted later than the Treaty is more problematic because the parties cannot have intended the new Commentary to apply at a time of making the Treaty. However, to ignore them means that one would be shutting one’s eyes to advances

in international tax thinking, such as how to apply the treaty to payments for software that had not been considered when the Treaty was made. The safer option is to read the later Commentary and then decide in the light of its content what weight should be given to it.”

5 85. In this case, there were no recent developments. Section 15 ITTOIA dated back to 1978.

86. In addition, Mr Schwarz referred to a Canadian authority *The Queen v Prevost Car Inc* [2010] 2 FCR 65 in which the Federal Court of Appeal, considering the question of “beneficial ownership” in a double tax treaty, stated that the  
10 Commentaries on the OECD Model Convention were a widely-accepted guide to the interpretation and application of existing bilateral conventions. The court went on to say at [11]:

15 “The same may be said with respect to later Commentaries, when they represent a fair interpretation of the words of the Model Convention and do not conflict with Commentaries in existence at the time a specific treaty was entered and when, of course, neither treaty partner has registered an objection to the new Commentaries.”

87. In Mr Schwarz’s submission, the 2010 amendments to the OECD Commentary did not address the question of the meaning of the term “employment”. They merely  
20 confirmed that the domestic law meaning applied, subject to paragraph 8.11.

88. In any event, in accordance with [58] of the Supreme Court’s decision in *Anson* later commentaries did not appear to form part of the “context” against which the Treaty had to be interpreted.

89. Furthermore, references to paragraphs 8.1 and 8.11 of the OECD Commentary were, Mr Schwarz submitted, taken out of context. They related to Article 15(2) of the  
25 OECD Model Convention (Article 14(2) of the Treaty). The passages from the OECD Commentary were addressing the circumstances in which an employee was entitled to benefit from restrictions on source-based taxation.

90. In relation to section 15 ITTOIA, this was a deeming provision which treated  
30 certain activities to be a trade. It was not a computational provision. The purpose was to treat employed divers in the same way as self-employed divers.

91. As regards the question whether section 15 ITTOIA provided a definition, Part 2 of ITTOIA defined the meaning of “trade”. Even if it was not a definition, that was  
35 not what was required by Article 3(2), which required that the term have a “meaning”. It was only necessary to determine the “meaning” of a term under the applicable domestic tax law. On that basis, section 15 ITTOIA met the requirement of Article 3(2).

92. Mr Schwarz submitted that HMRC’s arguments went against the grain of the legislation and the Treaty. HMRC were arguing that Mr Fowler’s activities  
40 constituted a trade for domestic tax law but an employment for the purposes of the

Treaty. A more logical approach would be that the activities would be treated in the same way for both domestic law and the Treaty.

## Discussion

5 93. Deeming provisions are to be found in many Acts of Parliament. They are particularly common in the UK's tax code. Section 15 ITTOIA is one such deeming provision.

10 94. The exact purpose of the deeming provision contained in section 15 ITTOIA is difficult to discern from the *Hansard* extract quoted above. It is hard to see how dangers, vulnerability to long-term health hazards and shortness of working life, for example, are relevant to the question whether the individual should be taxed on an employment or a self-employed basis. The real purpose of section 15 ITTOIA, in my judgment, is to be found in the more relaxed rules (when compared with those for employment income) for deductibility of expenses<sup>1</sup> in the calculation of trading income (and, possibly, from the timing advantage conferred by the absence of  
15 PAYE).

20 95. The question that often arises in respect of deeming provisions is how far does the effect of the deemed treatment extend? Does it only extend to the immediate purpose addressed by the provision or does it go further? That, essentially, is the question in this case. Does section 15 ITTOIA simply have the effect that Mr Fowler must compute his income in accordance with the rules relating to trading income or does the treatment deemed by section 15 mean that his income falls within Article 7 rather than Article 14 of the Treaty?

96. The starting point for the interpretation of any international treaty is Article 31 of the Vienna Convention. This provides:

25 "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."

97. In my view, Article 31(1) contains one single, composite rule of interpretation rather than a series of alternatives.<sup>2</sup>

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<sup>1</sup> This was certainly the view of the Office of Tax Simplification in its "Review of tax reliefs" March 2011: "The regime [self-employed tax treatment for divers] was introduced in 1978 [FA1978 s. 29] to ensure fairness amongst divers of all nationality and employment status when engaged on the UK continental shelf. This is because at that time, the divers had to pay their costs themselves, and therefore being taxed as self-employed ensured they were able to obtain relief for these expenses. However since then, we understand that many employers have made agreements with the trade unions that they will cover these costs. It would therefore appear that there is no ongoing rationale for this regime to be retained."

<sup>2</sup> In a separate opinion in the *Land, Island and Maritime Frontier Dispute* case, ICJ Reports 1992 351 at [190] Judge Bernardez of the ICJ discussed Article 31(1) as follows:

"To determine objectively the intentions of the Parties as reflected in the Special Agreement, one must certainly start as provided for in the Vienna Convention, namely from the "ordinary meaning" of the terms used in the provision of the Special Agreement which is the subject of the interpretation, that is, paragraph 2 of Article 2 in the instant case. *But not in isolation*. For treaty interpretation rules there is no "ordinary meaning" in the absolute or in the abstract. That is why Article 31 of the Vienna Convention refers to "good faith" and to the ordinary meaning "to be given" to the terms of the treaty "in their context and in the light of its object and purpose". *It is, therefore, a fully qualified "ordinary meaning"*. In addition to the said "good faith", "context" and "object and purpose", account may be taken, together with the "context", of the other interpretative elements

98. Article 31(4), however, provides:

“4. A special meaning shall be given to a term if it is established that the parties so intended.”

99. Article 3(2) of the Treaty is a special rule of interpretation within Article 31(4) of the Vienna Convention, as opposed to the general rules of interpretation contained in Articles 31(1)–(3) of the Vienna Convention. Article 3(2) of the Treaty mandates that any term not defined in the Treaty “shall” have the meaning that it has under applicable the tax laws of the Contracting State applying the Treaty (i.e. the UK). The meaning shall be that for the purposes of the taxes to which the Treaty applies. It is fair to say that Article 3(2) has occasioned considerable debate amongst commentators.

100. As a special rule of interpretation Article 3(2) has priority over such general rules. That said, the meaning of the words used in Article 3(2) are themselves to be interpreted in accordance with the principles set out in Article 31 of the Vienna Convention. Thus, in applying the provisions of the Treaty as regards undefined terms, the right of a Contracting State to apply the ordinary meaning which the relevant term has under domestic law is subject to the general requirement of good faith and the need to have regard to the object and purpose of the Treaty.

101. Furthermore, in my view, the use of the word “shall” in Article 3(2) indicates a mandatory requirement to apply domestic law in the case of undefined terms, unless the context otherwise requires. Throughout the Treaty the words “shall” and “may” are used deliberately to indicate mandatory and permissive provisions. For example, in the definition of residents in Article 4(2) the word “shall” is used to indicate how the residents of an individual must be determined. In Article 10 (dividends) dividends paid by a company resident in a Contracting State to a shareholder resident in the other Contracting State “may” be taxed in that other Contracting State. Those dividends “may” also be taxed in the Contracting State of residence of the company but Article 10(2) states that the tax “so charged shall not exceed” certain percentages of the dividend. In Article 14 (income from employment), one of the relevant Articles in this appeal, provides that employment income derived by a resident of a Contracting State “shall” be taxed only in that Contracting State unless employment is exercised in the other Contracting State: in which case, the remuneration derived therefrom “may” be taxed in that other Contracting State. There are many other examples of the careful use of the mandatory word “shall” and the permissive word “may” that could be given. The essential point is that those drafting the Treaty (and the OECD Model Convention on which the Treaty is based) were careful to use the word “shall” when a mandatory provision was intended. For this reason, I reject Mr Nawbatt’s submission that the word “shall” in Article 3(2) may somehow have a directory rather than the mandatory meaning. The use of the word “shall” in Article

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mentioned in Article 31, including “subsequent practice” of the parties to the treaty and the “rules of international law” applicable between them. Furthermore, recourse to “supplementary means of interpretation” (preparatory work; circumstances of conclusion) is allowed for the purposes defined in Article 32. The elucidation of the “ordinary meaning” of terms used in the treaty to be interpreted requires, therefore, that due account be taken of those various interpretative principles and elements, and not only of words or expressions used in the interpreted provision taken in isolation. (Emphasis added)

3(2) indicates that recourse must be had to the relevant provisions of domestic tax law in priority to any other meaning, unless the context otherwise requires.

102. I should add, at this stage, that in my view, the Contracting State seeking to apply the Treaty is the UK for the purposes of Article 3(2) and it was not suggested otherwise in argument before me.<sup>3</sup>

103. With the above in mind, it is first necessary to ascertain the “terms” the meaning of which must be ascertained under domestic applicable tax law.

104. The two relevant Articles of the Treaty are Article 7 (business profits) and Article 14 (income from employment). It was common ground that the words “salaries, wages and other similar remuneration derived... in respect of an employment” in Article 14 were not defined in the Treaty.

105. As regards Article 7, the words “enterprise” and “business” are only partially defined in Article 3(1)(d) and (g). In this connection, it seems to me that the word “enterprise” is wide enough to encompass both the entity carrying on and the activity which can be described as a business. It is true that Article 3(1)(g) tells us the word “enterprise” applies to the carrying on of any business, but that does not, I think, take us very far. It focuses our attention on what is meant by the word “business”.

106. The word “business” is also only partially defined in Article 3(1)(d) as a concept which “includes the performance of professional services or other activities of an independent character.” In my view, this partial definition is intended to make it clear that income that would previously have fallen under the “Independent Personal Services” Article of the OECD Model Convention (since deleted) would now fall under the business profits article i.e. Article 7. An inclusive definition is not complete in that it simply identifies a specific meaning that is to be included in the more general meaning of the defined word or phrase. The general meaning must be given its ordinary meaning in accordance with domestic tax law as it applies to the income in question. In my view, therefore, an inclusive definition, save as regards the particular meaning identified, must be treated for the purposes of Article 3 (2) as leaving other meanings undefined.

107. I have concluded, therefore, that the words “enterprise” and “business” are not defined terms for the purposes of Article 3(2). It follows that the meaning of these terms, as well as the meaning of “salaries, wages and other similar remuneration derived... in respect of an employment”, must be determined in accordance with domestic UK tax law.

108. In ascertaining the meaning of these terms it is necessary not to seek words in domestic law which are identical to the terms used in the Treaty but to look for the

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<sup>3</sup> John F. Avery Jones et al., *The Interpretation of Tax Treaties with Particular Reference to Article 3(2) of the OECD Model—I* [1984] British Tax Review 14 at 50. There has been some debate amongst commentators on this point, see, for example, Klaus Vogel, *Double Tax Treaties and Their Interpretation*, 4 International Tax & Business Law. 1 (1986) at 71, but the view expressed above appears to be the majority view amongst commentators.

terms in domestic law which are synonymous.<sup>4</sup> That must be so because the tax code of each Contracting State will use slightly different language to express the same concepts. The terms that are at issue in this appeal, are, of course, derived from the OECD Model Convention. The OECD Model Convention is intended to apply in a standardised form to a very large number of different countries and tax codes. Its language is, therefore, in many cases conceptual rather than precise. The language of the Treaty must, for this reason, be interpreted as expressing concepts which broadly correspond to the detailed provisions of domestic tax codes.

109. As regards the UK tax provisions which correspond to “[t]he profits of an enterprise” within Article 7 (business profits), I have no doubt that these are intended to apply to the charge to income tax on the “profits of a trade, profession or vocation” within the meaning of section 5 ITTOIA 2005.<sup>5</sup> The question is whether they apply to the extended meaning of that phrase (at least as regards the word “trade”) contained in section 15 ITTOIA.

110. The UK tax provisions which correspond to “salaries, wages and other similar remuneration derived... in respect of an employment” are plainly those (so far as relevant to this appeal) to be found in sections 1, 4, 6, 7, 9 and 62 ITEPA 2003.<sup>6</sup> Section 1 charges to income tax “employment income”. Section 4 defines “employment” to include “any employment under a contract of service.” Section 6 explains that the charge to tax on employment income is a charge to tax on “general earnings” and “specific employment income”. Section 7 defines the three terms referred to in section 6. Section 9 makes it (at least tolerably) clear that what is chargeable is “earnings from an employment”. Finally, section 62 defines what is meant by “earnings”, viz “any salary, wages or fee”, gratuities and anything else that that “constitutes an emolument of the employment.” Taken together, these provisions, in my view, correspond to “salaries, wages and other similar remuneration derived... in respect of an employment” for the purposes of Article 14.

111. I have come to the conclusion that the phrase “[t]he profits of an enterprise” within Article 7 includes the charge to income tax on the “profits of a trade, profession or vocation” within the meaning of section 5 ITTOIA 2005 and that it also includes the profits arising from the deemed trade pursuant to section 15 ITTOIA.

112. Article 3(2) requires that the corresponding domestic tax law meaning be given to the particular income concerned: that is what is required by Article 3(2) in the

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<sup>4</sup> That was the view of the Special Commissioner (Dr John Avery Jones) in *Squirrel v Revenue and Customs* [2005] UKSPC SPC00493 in relation to Article 15 of the US/UK double tax treaty (1975):

"The first issue is whether article 15 applies to the termination payment on the basis that it is "salaries, wages and other similar remuneration ...in respect of an employment." These are undefined terms and accordingly article 3(2) refers one to their meaning under UK tax law (unless the context otherwise requires). Although the precise words "salaries, wages and other similar remuneration" are not used in UK tax law, according to the Shorter Oxford English Dictionary the meaning of the word "term" extends to "any word or group of words expressing a notion or conception, or denoting an object of thought; an expression (*for* something)." Remuneration in respect of an employment corresponds to income that was at the time taxed under Schedule E [the predecessor of ITEPA]."

<sup>5</sup> *Jowett (HMIT) v O'Neill & Brennan Construction Ltd* [1998] STC 482 per Park J at page 489b.

<sup>6</sup> The re-write of UK employment taxation in ITEPA 2003 has not, however, made all ways smooth. The concept that taxable remuneration must arise *from* a source (i.e. the employment) requires some effort to spell out from the re-written language, but the intention seems clear enough: see Michael Jones [2008] British Tax Review 99.

“application” of the Treaty by the UK. It is clear from the wording of section 15 ITTOIA that the income derived by Mr Fowler from his UK diving activities is to be treated as trading income. Section 15 treats Mr Fowler’s income as derived from the carrying on of a trade in the UK “for income tax purposes.” The result of the section 5 15 deemed trading treatment is that Mr Fowler’s income derived from his diving activities in the years in question constitutes profits within Article 7 of the Treaty.

113. I reject Mr Nawbatt’s submission that section 15 ITTOIA does not supply a “meaning” but only supplies a “treatment.” In applying Article 3(2) it is necessary to look at the meaning which domestic law gives to the particular item of income or 10 activity to which the Treaty is being applied. It is the clear purpose of section 15 ITTOIA to re-characterise what would otherwise be the exercise of employment duties as the carrying on of a trade. In so doing, in my view, section 15 ITTOIA has the meaning that the activities of an employed diver in the UK Continental Shelf constitute trading activities and that the income therefrom must be trading income 15 and, consequently, business profits within Article 7– the treatment is the meaning.

114. Moreover, section 6(5) ITEPA excludes income from the charge to income tax on employment income if the income falls within section 15 ITTOIA. This, therefore, has the meaning that, under the provisions of UK tax law which correspond to Article 14, Mr Fowler’s income is not employment income and cannot fall within Article 14.

20 115. Mr Nawbatt raised the objection that to allow a State to rely on a deemed domestic meaning would allow it unilaterally to change its law to expand its taxing rights under a Treaty. I do not agree. The fact that Article 3(2) refers to the domestic tax law meaning of undefined terms does not, in my view, permit a Contracting State to deprive a treaty article of its meaning or effect by unilaterally changing its domestic 25 law to deem income to fall within another category. If a Contracting State changes its domestic law *after* the conclusion of a double tax treaty in such a way as to reallocate income from one article to another – in other words, to change the effect of the distributive rules of a treaty with respect to the particular type of income – that could contravene the requirements of good faith imposed by Article 31(1) of the Vienna 30 Convention and by international law generally (“*pacta sunt servanda*”).<sup>7</sup> The amended meaning given by the subsequent change in domestic law would not be the “meaning” which could be applied under Article 3(2) when construed in accordance with Article 31(1) of the Vienna Convention.<sup>8</sup> In other words, a breach of the obligation of good faith can override the words “at any time” used in Article 3(2) 35 (which are generally taken to indicate that the domestic tax law meaning is an ambulatory rather than a static meaning). Alternatively, it may be said that in such a

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<sup>7</sup> See Article 26 of the Vienna Convention: “Every treaty in force is binding upon the parties to it and must be performed by them in good faith.” I express no view on what the position would be if the UK were to repeal section 15 ITTOIA.

<sup>8</sup> See also the decision of the Supreme Court of Canada in *The Queen v. Melford Developments Inc.* 82 DTC 6281 (SCC) where the Court held that a 1974 amendment to the Canadian tax code treating guarantee fees as “interest” did not apply for the purposes of the Canada/Germany double tax Treaty of 1956.

case, for the purposes of Article 3(2), the “context” of the treaty would require a meaning different from that supplied by domestic tax law.

116. The position is, however, different where the provision of domestic law which re-characterises the type of income is one which was already in existence at the date  
5 the relevant treaty was concluded. In that case, the requirements of good faith under Article 31 of the Vienna Convention would not prohibit Article 3(2) applying the re-characterised meaning for the purposes of interpreting undefined terms in in the Treaty nor does the context require a different meaning.

117. In the present case, the predecessor of section 15 ITTOIA was enacted in 1978,  
10 long before the Treaty was concluded in 2002. In my view, therefore, there is no reason to exclude the meaning given to Mr Fowler’s income by section 15 ITTOIA for the purposes of Article 3(2) of the Treaty.

118. Moreover, section 15 ITTOIA provides that the performance of the duties of Mr  
15 Fowler’s employment is to be treated “for income tax purposes” as the carrying on of a UK trade. The words “for income tax purposes” would include section 6 TIOPA which provides that “[d]ouble taxation arrangements have effect in *relation to income tax* ... so far as the arrangements provide....” I consider, therefore, that section 15 ITTOIA must have effect in relation to the Treaty.

119. I have also considered whether the words in Article 3(2) “unless the context  
20 otherwise requires” demands a different meaning from the domestic tax law meaning provided by section 15 ITTOIA. I accept that the word “requires” means that the “context” would have to present a strong case for a different meaning. I also consider that “context”, as used in Article 3(2) has a wider meaning than that used in Article 31  
25 of the Vienna Convention and permits internal and external contexts to be considered.<sup>9</sup> However, there is nothing in the context which, in my view, requires me to give a different meaning from that given by section 15 ITTOIA.

120. In reaching this conclusion, I have also considered the paragraphs relied on by  
Mr Nawbatt from the OECD Commentary, particularly paragraph 8.11 in relation to  
30 Article 15 of the OECD Model Convention. The relevant paragraphs of the OECD Commentary were, however, introduced in 2010, eight years after the Treaty was concluded in 2002. In my view, therefore, these passages can only have limited value in interpreting the Treaty.

121. For these reasons, I decide this preliminary point in favour of Mr Fowler. I  
35 conclude that, by virtue of section 15 ITTOIA when read with Article 3(2) of the Treaty, Mr Fowler’s income from diving activities in the UK or UK Continental Shelf for the years in question falls within Article 7 of the Treaty.

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<sup>9</sup> John F. Avery Jones et al., *The Interpretation of Tax Treaties with Particular Reference to Article 3(2) of the OECD Model—II* [1984] *British Tax Review* 90 *et seq* and Klaus Vogel *supra* note 3 at 74

122. In closing, I wish to express my thanks for the skilful and informative submissions of Mr Schwarz and Mr Nawbatt which I have found to be of considerable assistance.

### **Rights of Appeal**

5 123. This document contains full findings of fact and reasons for the decision. Any party dissatisfied with this decision has a right to apply for permission to appeal against it pursuant to Rule 39 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009. The application must be received by this Tribunal not later than 56 days after this decision is sent to that party. The parties are referred to 10 “Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)” which accompanies and forms part of this decision notice.

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**GUY BRANNAN  
TRIBUNAL JUDGE**

**RELEASE DATE: 12 April 2016**

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