COURT OF APPEAL'S QUALIFICATION OF THE TERRITORIALITY PRINCIPLE

Robert Grierson[1]

Introduction

Britannia still rules the waves, or, at least, the ways and means, for in the Schedule E severance payment case of *Nichols v Gibson (Inspector of Taxes)* (reported at first instance [1994] STC 1029), the Court of Appeal, in a judgment handed down on 14th June 1996, has stated that territoriality is not an absolute principle of United Kingdom taxing legislation, but merely a presumption which may be rebutted, not only by express words of United Kingdom taxing legislation, but also impliedly. This statement, which apparently runs counter to the evergreen House of Lords case of *Colquhoun v Brooks* (1889) 14 App Cas 493, may have far-reaching fiscal repercussions, not just for those who, like Mr Nichols, return to the United Kingdom in the year of assessment following the year of potential charge, but also for those who leave the United Kingdom for good thinking they have left the United Kingdom taxman behind forever.

The Facts of the Case

The taxpayer's employment at F W Woolworth Ltd was terminated after 33 years of service on 6th April 1984, whereupon he received a severance payment of £60,308. He had been given prior notice of the termination and had obtained employment in Jamaica which, with leave from Woolworths, he took up on 1st April 1984. The taxpayer remained in Jamaica until his return to the United Kingdom on 14th April 1985. In a letter dated 13th May 1988 the Inland Revenue

---

1 Robert Grierson, Barrister, MA (Cantab), LLM (Cantab), of 24 Old Buildings, Lincoln's Inn, London WC2A 3UJ.
Tel: (0171) 242 2744. Fax: (0171) 831 8095.

This article first appeared in the 8th August 1996 issue of *TAXATION* magazine.

Claims Branch ruled that the taxpayer was neither resident nor ordinarily resident in the United Kingdom between 2nd April 1984 and 13th April 1985, and the substance of this ruling was subsequently agreed as a fact by the Inland Revenue (see [1994] STC 1029 at 1030 *f* to *g* and 1031 *f* to *g*). The Inspector assessed the taxpayer to income tax under Schedule E on the ground that the severance payment was a payment on the termination of the taxpayer's employment within section 187 of the Income and Corporation Taxes Act 1970 (now section 148 of the Income and Corporation Taxes Act 1988). The taxpayer did not dispute that the severance payment fell within the terms of section 187 but he appealed against the assessment contending that the severance payment was not assessable to income tax under Schedule E on the grounds: (a) That section 187(4) treated payments falling within section 187(1) as emoluments of the employment; (b) That accordingly such payments had to fall within one of the Schedule E Cases of paragraph 1 of section 181(1) of the Income and Corporation Taxes Act 1970 (now section 19(1) of the Income and Corporation Taxes Act 1988) in order to be assessable; and (c) that the severance payment was not therefore assessable since none of the cases were applicable as the taxpayer had not been resident or ordinarily resident, nor had he performed any duties in the United Kingdom, in the year of assessment of deemed receipt (1984/85) under section 187(4). The General Commissioners dismissed the taxpayer's appeal on the ground that the charge to income tax under Schedule E in section 187 of the Income and Corporation Taxes Act 1970 was an independent charging provision which was not confined to the rules of the cases of Schedule E. Sir John Vinelott upheld that decision and the taxpayer appealed.

The Decision of the Court of Appeal

In a judgment delivered by Lord Justice Morritt, the Court of Appeal roundly endorsed the decision of Sir John Vinelott, holding, firstly, that the provision in paragraph 1 of section 181(1) that "tax shall not be chargeable in respect of emoluments of an office or employment under any other paragraph of this Schedule" did not exclude the possibility that other provisions of the Taxes Acts might charge to tax payments which did not exhibit all the features required to subject such payments to tax as such emoluments under that paragraph. The existence and independence of such provisions were expressly contemplated by paragraph 5 of section 181(1), and, indeed, sections 182(1) and 186(1) of the Income and Corporation Taxes Act 1970 were such provisions, to name but two.

Secondly, the Court of Appeal held that section 187(4) was wider than paragraph 1 of section 181(1), by requiring a payment, where appropriate, to be treated as emoluments of a past holder of an office or employment. In the court's view the inclusion of a past holder of an office or employment could not be read into paragraph 1 of section 181(1) by reference to *Williams (Inspector of Taxes) v*

Simmonds 55 TC 17, Chancery Division, and *Bray (Inspector of Taxes) v Best* 61 TC 705, House of Lords. For, in each of those cases, the question had been whether the payment in question was an emolument from the employment for a chargeable period so as to be chargeable under paragraph 1 of section 181(1) notwithstanding the cesser of the employment before the payment sought to be taxed. Neither of these cases decided that any payment made after the cesser of the employment by a former employer to a former employee was taxable under paragraph 1 of section 181(1). Accordingly, the inclusion of the words "or past holder" in section 187(1) gave to that sub-section an effect over and above that of paragraph 1 of section 181(1). Were that not the case, then section 187 would apparently be redundant, for all payments to which it applied would already be taxable under section 181.

Thirdly, the Court of Appeal held that section 187(1) was on its face independent of paragraph 1 of section 181(1), and that sub-section (1), not (4), of section 187 imposed the charge to tax under that section, and did so subject to the provisions of sections 187 and 188, not 181. The terms of a relief from the charge under section 187, namely the relief conferred by section 188(2)(a) of the Income and Corporation Taxes Act 1970, were identical to the terms of a relief under Cases I and II of Schedule E. Were the argument of the taxpayer correct, there would be no need for the relief under section 188(2)(a) in the case of a non-United Kingdom resident former employee; yet in the case of a United Kingdom resident former employee the relief apparently conferred by section 188(2)(a) would be denied by the liability imposed by Case III of paragraph 1 of section 181(1).

Extra-territoriality

It might have been expected that the Court of Appeal would adhere to the principle of territoriality in the present case by adding as a ground for their decision that the United Kingdom character of the taxpayer's former employer, Woolworths, and the United Kingdom *situs* of the duties performed by the taxpayer for Woolworths, were a sufficient territorial nexus for the independent charging provision of section 187 to apply; akin with the decision of the House of Lords in *Clark (Inspector of Taxes) v Oceanic Contractors Inc* [1983] AC 130.

Instead, the Court of Appeal held that "No issue of territoriality arises on the facts of the case", i.e., notwithstanding that the taxpayer was neither resident nor ordinarily resident in the United Kingdom in the relevant year of assessment. It would appear that by this statement the Court of Appeal forthrightly meant that section 187, being a charging provision separate and independent from section 181, should be given its fullest possible application, i.e., irrespective of concepts of territoriality. It does not appear that the Court of Appeal was *sub silentio* invoking

Clark v Oceanic Contractors by reference to the United Kingdom character of the taxpayer's former employer, Woolworths, and the United Kingdom *situs* of the duties performed by the taxpayer for Woolworths. Indeed, it should be stated that it was never found as a fact by the General Commissioners that Woolworths, and the duties performed by the taxpayer for Woolworths, had a United Kingdom *situs*, although this may be deduced with some confidence from the facts which were found.

Having stated that no issue of territoriality arose, Lord Justice Morritt continued, *ex facie obiter*:

> "But the principle of territoriality was relied on as support for the construction advanced on behalf of Mr Nichols. The principle was established in the well known case of *Colquhoun v Brooks* (1889) 14 App Cas 493 at 504 where Lord Herschell said
>
> > "The Income Tax Acts ... themselves impose a territorial limit; either that from which the taxable income is derived must be situate in the United Kingdom or the person whose income is to be taxed must be resident there."
>
> That passage was quoted with approval by Lord Hailsham of St Marylebone LC in *Westminster Bank PLC v National Bank of Greece* [1971] AC 945, 954. But it was not disputed that the principle is one of presumption and not absolute in that it is open to Parliament to legislate extra-territorially to greater or lesser extent if it sees fit to do so. Examples of such legislation drawn to our attention are to be found in ss.487(20) [*sic* (7)] and 488(13) of the Income and Corporation Taxes Act 1970. It is true that if the argument for Mr Nichols were otherwise acceptable then the importation of the conditions for taxability to be found in paragraph 1 of s.181(1) would include the territorial requirements contained in the three cases. But we see no necessity to accept that argument for that reason. Section 188(2)(a) and (b) contain provisions excluding liability in respect of foreign service as defined. We see no reason why Parliament should be presumed to have intended that further conditions as to extra-territoriality should be implied nor that the conditions to be implied are those contained in Cases I to III."

Thus, the Court of Appeal stated that section 187 of the Income and Corporation Taxes Act 1970 by necessary ***implication*** (from the relieving provisions of section 188(2)(a),(b)) excluded the principle of territoriality so squarely stated by the House of Lords in *Colquhoun v Brooks* and the *National Bank of Greece* case in 1889 and 1971. For, unlike the provisions cited by the Court of Appeal, namely sections 487(7) and 488(13) of the Income and Corporation Taxes Act 1970 (now sections 775(9) and 776(14) of the Income and Corporation Taxes Act 1988), which make (limited) extra-territorial provision, section 187 of the Income and Corporation Taxes Act 1970 makes no ***express*** extra-territorial provision.

No Appeal

The Court of Appeal rejected the taxpayer's application for leave to appeal to the House of Lords; and it would appear that in view of the automatic exemption under section 188(3) for £25,000 of the £60,308 payment involved in the case, the application for leave was not renewed before their Lordships' House.

Conclusion

It would seem that, in the realm of United Kingdom taxing legislation, the principle of the sovereignty of the Westminster Parliament will still be firmly adhered to, and will override the concept of territoriality (and perhaps also necessarily that of the comity of nations?), notwithstanding that in other areas the courts of the United Kingdom are now commonly content for the sovereignty of Parliament to cede to European Union legislation *via* the paradoxical (or entrenching) mechanism of sections 2 and 3 of the European Communities Act 1972.