CASE NOTES

Yates v GCA International Limited [1991] STC 157

The Facts

There was no dispute of fact either before the Special Commissioner or before the High Court. The taxpayer company ("GCA") was incorporated in the United Kingdom and at all material times was resident in the UK for tax purposes and carried on a trade as a petroleum and natural gas consultant. It had a single worldwide trade and its head office, from which the trade was conducted, was situated in the UK. At the relevant times GCA did not maintain a branch in Venezuela nor did it have a permanent representative there. On 9th May 1979, following the submission of a successful tender, GCA concluded a written contract in Caracas with the Venezuelan company, Maraven SA ("Maraven"). The contract required GCA to carry out a technical study with a view to the rehabilitation of three oilfields in Venezuela. The proper law of this contract was English law.

Under the terms of the contract, GCA was to receive a total of $209,300 (£97,345) as remuneration for its services. Certain of GCA's obligations were to be performed in the UK whereas others were to be performed in Venezuela. By Article 4 of the contract, GCA was to receive $161,000 as remuneration for its work and services provided in the UK and $48,300 for its work and services provided in Venezuela. It was agreed that this apportionment of the total consideration in the contract provided a reasonable allocation of the costs to GCA of the provision of the two elements of the contract.

Venezuelan tax was withheld by Maraven from payments made to GCA under the terms of the contract. Venezuelan tax was levied in accordance with the provisions of Article 54 of the Venezuelan tax code (Ley de Impuasto Sobre La Renta). Article 54 provides:

> *"The net profits of the taxpayers not resident or not domiciled in Venezuela, originating from non-commercial professional activities, will be constituted by ninety per cent (90%) of the amount of their gross receipts ..."*

Maraven therefore withheld a total of £22,253 from each payment and paid that sum to the Venezuelan fiscal authority.

The sum of £97,345 received by GCA for its services performed under the contract was included in its Schedule D Case I receipts for the accounting period ended 31st December 1979. GCA claimed unilateral double taxation relief from UK tax under TA 1970 s.498. The Revenue refused this relief.

The Issues

GCA claimed relief under TA 1970 s.498(1) which provided:

> *"To the extent appearing from the following provisions of this section, relief from income tax and corporation tax in respect of income shall be given in respect of tax payable under the law of any territory outside the United Kingdom by allowing the last-mentioned tax as a credit against income tax or corporation tax ..."*

The important proviso so far as GCA was concerned is contained in s.498(3):

> *"Credit for tax paid under the law of the territory outside the United Kingdom and computed by reference to income arising in that territory shall be allowed against any United Kingdom income tax or corporation tax computed by reference to that income (profits from, or remuneration for, personal or professional services performed in that territory being deemed for this purpose to be income arising in that territory) ..."*

Therefore, under sub-s(3) credit was allowed for foreign tax "computed by reference to income arising" in the foreign territory. GCA contended that the whole of the remuneration paid under the contract should be regarded as income arising in Venezuela. The Crown, on the other hand, argued that only the $48,300 attributed by the contract to the work to be performed in Venezuela should be so regarded. The Special Commissioner agreed with the Crown's contention.

Section 498(6) introduces a further proviso which was relevant to GCA's claim:

> *"... References to tax payable or paid under the law of a territory outside the United Kingdom include only references to taxes which are charged on income and correspond to income tax or corporation tax in the United Kingdom ..."*

The Crown, while accepting that the Venezuelan tax was "charged on income", contended that the tax did not "correspond to income tax or corporation tax in the United Kingdom". The Crown argued that a tax levied on 90% of gross receipts was not a tax on profits or gains but, truly viewed, a tax on turnover. Such a tax does not correspond to UK income tax or corporation tax. On this issue the Special Commissioner did not accept the Crown's argument, and held that the Venezuelan tax did, for the purposes of ss.(6), correspond to income tax or corporation tax. Unilateral relief under s.498 was therefore available to GCA.

The High Court Decision

In the High Court, GCA's first submission on s.498(3) was that the phrase "computed by reference to income arising in that territory" was a reference to the manner in which, under Venezuelan law, the computation takes place. Since, under Venezuelan law, the whole of the contractual remuneration was regarded as income arising in Venezuela, then, for the purposes of s.498(3), the whole of the UK tax was "computed by reference to income arising in" Venezuela. Scott J rejected this argument for two reasons. First, there was a reference to "income arising in" a particular country in TA 1970 s.516(1). The meaning of the phrase in the two sub-sections ought to be the same. Therefore, since there was no context in s.516(1) to permit a foreign law (such as Venezuelan) to be imported, it could not be imported into s.498(3). Secondly, the Venezuelan tax code did not impose tax on income on the ground that the income arose in Venezuela. There could be a charge on income arising outside Venezuela which was attributable to an act or event which occurred within Venezuela. As a result, since the Venezuelan tax code did not address the question, it was not appropriate to attempt to answer the question whether there had been income arising in Venezuela by applying that tax code.

GCA's second submission was that one must consider the approach of English law to a "mirror case". That is to say, a case like the GCA case but in which every UK and Venezuelan element was reversed. In such a case, it was argued, English law would treat the whole of the remuneration payable under the contract as taxable in the UK. However, Scott J decided that this was posing the wrong question. The correct question was what construction should be given to the expression "income arising in that territory" for the purposes of s.498(3). In attempting to find an answer to that question, Scott J found assistance in a dictum of Atkin LJ in *FL Smidth & Co v Greenwood (Inspector of Taxes)* [1921] 3 KB 583 at 593. The issue in that case was whether a foreign company had made profits from the exercise in the UK of a trade, profession or vocation. Atkin LJ said this:

> *"The contracts in this case are made abroad. But I am not prepared to hold that this test is decisive. I can imagine cases where the contract of re-sale is made abroad, and yet the manufacture of the goods, some negotiation of the terms, and complete execution of the contract takes place here under such circumstances that the trade was in truth exercised here. I think that the question is, where do the operations take place from which the profits and substance arise?"*

Scott J also drew assistance from a dictum of Lord Bridge in *Commissioners of Inland Revenue v Hang Seng Bank Limited* [1990] STC 733. This was a Privy Council case which concerned the question of whether certain profits made by the Hang Seng Bank were profits arising in Hong Kong. The relevant expression in the Hong Kong Tax Ordinance was "profits arising in or derived from Hong Kong". The Court of Appeal of Hong Kong held that, where profits derived from both Hong Kong

and from some outside source, it was not possible to apportion the profits as between a Hong Kong part, on the one hand, and an expatriate part, on the other hand. It was necessary to identify "a dominant factor or factors which put the profits on one side of the line or the other". Lord Bridge criticised this approach and said:

> *"... The question whether the gross profit resulting from a particular transaction arose in or derived from one place or another is always in the last analysis a question of fact depending on the nature of the transaction. It is impossible to lay down precise rules of law by which the answer to that question is to be determined. The broad guiding principle, attested by many authorities, is that one looks to see what the taxpayer has done to earn the profit in question. If he has rendered a service or engaged in an activity such as the manufacture of goods a profit will have arisen or derived from the place where the service was rendered or the profit making activity carried on. But if the profit was earned by the exploitation of property assets as by letting property, lending money or dealing in commodities or securities by buying and re-selling at a profit, the profit will have arisen in or derived from the place where the property was let, the money was lent or the contracts of purchase and sale were effected. There may, of course, be cases where the gross profits deriving from an individual transaction will have arisen in or derived from different places. Thus, for example, goods sold outside Hong Kong may have been subject to manufacturing and finishing processes which took place partly in Hong Kong and partly overseas. In such a case the absence of a specific provision for apportionment in the Ordinance would not obviate the necessity to apportion the gross profit on sale as having arisen partly in Hong Kong and partly outside Hong Kong."*

Scott J, while accepting that this passage was not strictly binding on him, found that it represented a commonsense approach to the meaning and correct application of ordinary words in the English language. There was no authority which precluded him from regarding apportionment as possible for s.498(3) purposes, and since commonsense seemed to require it, he held that there should be an apportionment under the Maraven contract. GCA accepted that the apportionment which the Special Commissioner had made was unassailable. Therefore, GCA's appeal was dismissed.

The Crown's other argument was that the tax under Article 54 of the Venezuelan Code constituted a tax on turnover which did not correspond to UK income tax or corporation tax. However, the Crown was not prepared to follow this argument to its logical conclusion. It took the view that where tax was charged, under other articles of the Venezuelan tax code, on a relatively low percentage of gross receipts, this was a tax which corresponded to UK income or corporation tax. This was because the percentage on which tax was charged represented a fair assessment, on a broad brush approach, of what the net income of the trade or business in question would be. In the case of Article 54, 10% of gross receipts could not possibly cover all the expenses on an oil consultancy business such as that which GCA carried on. However, Scott J could not accept that it was right, in order to decide whether the tax under a particular article of the Venezuelan tax code did or did not correspond to UK tax, to require evidence either from the Crown or from the taxpayer of some average level of business expenses that might be incurred by persons coming within the charge to tax. Article 54 sought to charge net profits to income tax, and it was therefore serving the same function as income tax and corporation tax serve in the United Kingdom in relation to the profits of a business carried on by an individual or by a company. Scott J therefore dismissed the Crown's appeal against the decision of the Special Commissioner on that point.

Comment

The taxpayer's two arguments in relation to "income arising in Venezuela", would appear to confuse two questions: where does income arise and where is that income taxed? It does, on the face of it, seem odd that unilateral relief is only available in relation to income arising in Venezuela when income which does not so arise can be the subject of tax in both that country and the UK. However, this is clearly the consequence of the restriction imposed by what is now TA 1988 s.790(4). The taxpayer's arguments showed up the unfairness of the rule; however, they did not go to addressing the true question of construction. When one does address the real issue, the conclusion to which Scott J came is the only possible answer. There might be scope for arguments in other cases as to the correct apportionment of payments under a global contract; however, the parties in the *GCA* case had carried out the exercise themselves.

The Crown's argument in relation to s.498(6) (now TA 1988 s.790(2) is interesting because it reveals a fundamental weakness in the Crown's presentation of the case before the Special Commissioner. The Crown's argument was that 10% of gross receipts was not any kind of attempt to quantify the expenses of an oil consultancy business such as that of GCA. However, as Scott J pointed out, there was no evidence before the Special Commissioner of the average level of business expenses of a person who might come within the charge under Article 54. The Crown was therefore forced to rely upon the much weaker argument that it was self-evident that 10% was a gross underestimate of those expenses. Without the necessary evidence, this argument was doomed to failure. One wonders whether the failure to adduce the

necessary evidence was due to the expense and difficulty in gathering the evidence, or lack of foresight by those preparing the case before the Special Commissioner. Since the majority of cases are won and lost at the Commissioner stage, it is unfortunate from the point of view of the body of taxpayers generally that the Revenue do not give more consideration to instructing experienced, independent advocates to represent them at that stage.

O'Leary v McKinlay [1991] STC 42

The Facts

David O'Leary ("the Taxpayer") is a well known footballer who has played for Arsenal and the Republic of Ireland. At all material times he was domiciled in Eire. Prior to August 1979 there were discussions between the Taxpayer and Arsenal Football Club Limited ("the Club") and their respective advisers as to the terms on which the Taxpayer would be employed for the future. The Taxpayer was anxious to ensure that he received an annual sum in addition to his agreed basic wage in such a way that it would not be liable to UK tax. The parties, therefore, entered into the following arrangements. On 1st August 1979, an Irish accountant settled a nominal sum of £10 upon trust to pay the income to the Taxpayer during his lifetime with remainder (subject to a discretionary power to pay capital to the Taxpayer) to the Catholic Church in Eire. Income arising to the trust was to be treated as accruing from day to day. The trustee was given express power to invest the trust fund in making a deposit on loan to an associated company, Hambros Bank (Jersey) Limited, without being liable to account for any profit thereby made. Subject to that, the trustee had a very wide power of investment which could not be exercised without the prior consent of the Taxpayer.

Also on 1st August 1979, the Taxpayer entered into an agreement with the Club under which he agreed to play for the Club for a period of two years unless his employment was previously determined or extended. The agreement was terminable (amongst other things) by mutual consent or if, before 31st July 1981, the Club demanded repayment of "the loan...made on 1st August 1979 by the Club" to the trustee. A copy of the settlement and of an undated letter from the Club to the trustee recording a loan of £266,000 free of interest and repayable on demand and an acknowledgement of receipt of the loan by the trustee were attached to the agreement. The sum of £266,000 was then placed on deposit by the trustee with the bank on a fixed account maturing on 30th July 1981 at interest payable half yearly at the rate of 11.5%. That came to £30,590 per annum, leaving after deduction of the trustee's fee £29,590.

The Issues

The Taxpayer's contention was that the income which he received was income arising from possessions out of the United Kingdom, not being income consisting of emoluments of any office or employment within Schedule D Case V and that accordingly (being domiciled in Eire) he was taxable only on the income remitted to the UK. None of the income had been so remitted. By contrast, the Crown claimed that the income was taxable as an emolument of the Taxpayer's employment with the Club under Schedule E Case I. The Special Commissioner accepted the Revenue's argument.

The High Court Decision

The Taxpayer submitted that a proper understanding of the structure of income tax compels the conclusion that (apart from the specific provisions of FA 1976 s.66) if an employer lends money to an employee the employee is taxable only if and to the

extent that a quantifiable benefit is conferred on him by the terms on which the loan is made. Any income which the taxpayer then derives from investing the money lent to him or for employing them in a trading adventure is taxable under the appropriate Schedule as income from the source from which it is directly derived; the income is not taxable under Schedule E as income from his employment. It therefore followed that the source of the income which accrued from the exploitation of the loan by the trustee was similarly the deposit with the bank and not the Taxpayer's contract of employment. Since that source was a deposit with a bank outside the UK, it was taxable only under Sch D Case V.

Vinelott J felt that there was an underlying fallacy in this submission. Where an employer lent money to an employee outright and the employee was therefore free to exploit the money in any manner he chose, his employment could not be said to have been the source of the income derived from that exploitation. However, if an employer were to lend money to a bank on terms that interest were paid to the employee until further orders, the interest paid to him while he remained an employee would almost inevitably be taxable as a emolument of his employment. This would also be the case if an employer were to lend money to an employee free of interest but on terms that the loan would be employed by placing it on deposit at an agreed bank and charged as security for repayment of the loan on demand. The benefit to the employee would then be the interest earned on deposit and nothing else. The Taxpayer's case was even weaker than that. He never had the free disposal of the £266,000. It was in fact very unlikely that the Club would have been willing to put a sum of that magnitude at his free disposal. The purpose and effect of the arrangement was to provide the Taxpayer with the income derived from the investment for so long as he continued to be employed by the Club; the £266,000 could not be otherwise invested without his consent and, if it had been, the income would equally have been an emolument from his employment. The Taxpayer's appeal, therefore, failed.

Comment

The issue in this case was simply whether the interest received on the loan provided to the trustees by his employer was an emolument from the Taxpayer's employment. If it was, then there was no doubt that the Schedule E charge took precedence over Schedule D Case V. The connection between the receipt of interest and the Taxpayer's employment was extremely close. The amount was designed to fulfil his desire to extra remuneration, and would almost certainly cease when his employment ceased. At any rate, the employer had the power to recover its loan at that time. This connection is so close (and seems *a fortiori* with *Brumby v Milner* (1976) 51 TC 583) that the irresistible conclusion is that the payments were emoluments.