

Trusts & Trustees' Tax Special Issue - Taxation of Offshore Trusts

The new regime for the enforcement of foreign taxes in the United Kingdom

By Robin Mathew QC¹

Introduction.

For centuries, the basic proposition was a trite legal truism and easily expressed. As Lord Mansfield said in *Holman v Johnson* (1775) 1 Cowp 341:

“... no country ever takes notice of the revenue laws of another”

That proposition, in recent years, has become much cut down and circumscribed in many common law jurisdictions and, in the United Kingdom, by statute consequent upon European Union legislation.²

Since 1st May 2008, Lord Mansfield's rule is simply no longer true with respect to many important foreign jurisdictions³. Subject to some formal qualification, H.M. Revenue & Customs (“HMRC”) must enforce any tax claim upon a valid request by the competent authority in that jurisdiction and, indeed, HMRC may similarly request enforcement of a United Kingdom tax claim in that jurisdiction.

This radical change has occurred almost without comment. It results from the introduction of The Recovery of Foreign Taxes Regulations 2007 (“the 2007 Regulations”) which were effective from 1st May 2008. These

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² See the Recovery of Duties and Taxes Etc. Due in Other Member States (Corresponding UK Claims, Procedure and Supplementary Regulations 2004 SI 2004 No 674 and subsequent amendment regulations –dealing with the enlargement of the EU- Si:s 2005 Nos 1479,1709 and SI 2007 No 3508 (together with section 134 and Schedule 39 to the Finance Act 2002) and Council Directive 76/308/EEC.

³ See footnote 12 below.

regulations are authorised by sections 173 to 176 of the Finance Act 2006 which recognised the Convention on Mutual Assistance on Tax Matters, some 18 years after it was agreed: (“the Convention”))⁴

The application of this legislation must be of particular concern to offshore trustees. For instance, if one of their number is resident in the United Kingdom, or a signatory jurisdiction, and trust assets, which may give rise to a tax liability, are situated there. Although the Convention gives no particular recognition to trusts or trustees, the taxes covered⁵ includes those which trustees may encounter – income tax, capital gains, net wealth and inheritance taxes.⁶

Shortly put, if a valid request⁷ is made to the Commissioners for HMRC by a competent foreign authority, of a signatory to the Convention, then (if they are prepared to entertain the claim⁸) they must enforce the claim for tax as if it were a claim for income tax under the United Kingdom’s domestic legislation.⁹ But the claim is only enforceable in the foreign state if it is enforceable in the applicant state and usually only if the foreign state has exhausted all appropriate measures in its own jurisdiction¹⁰. The power of HMRC to coerce information from domestic taxpayers has been extended to encompass and support the jurisdiction to provide information to signatories

⁴ The Recovery of Foreign Taxes Regulations 2007:S.I.2007 No.3507, setting out the domestic procedure to be employed, came into force on 3rd January 2008 to give effect to the Convention on Mutual Administrative Assistance in Tax Matters between the member states of the Council of Europe and the Organisation for Economic Co-operation and Development (the OECD) of 25th January 1988 was signed by the United Kingdom on 24th May 2007;ratified and duly deposited on 24th January 2008 and came into force, with respect to the United Kingdom, on 1st May 2008. The text of the convention may be found on the OECD website.

⁵ Article 2 of the Convention.

⁶ See Article 2 and Annex A *ibid*. Taxes covered by the Convention must be duly notified to the Secretary General of the OECD or the CoE. Customs Duties is the only substantial central government tax excluded. If notified, local taxes are included.

⁷ i.e. in the United Kingdom, in accordance with the 2007 regulations and the Convention.

⁸ See Article 19 entitled “Possibility of declining a request” –the requested state is not obliged to do so if the applicant state has not “...pursued all means available to it in its own territory...”

⁹ See regulation 3 of the 2007 Regulations, Article 11 of the Convention (“...as if they were its own tax claims..”) and generally, the Taxes Management Act 1970,as amended.

¹⁰ Article 19 *ibid* – see footnote 9 above

of the Convention and to enforce foreign taxes¹¹ Subject to a maximum of 15 years, the time limit for enforcement is that of the applicant state. The Convention, which is multilateral¹², does not have any express retrospective or retroactive effect. But an issue may arise as to the date on which a tax debt arose and whether it may be validly enforced under the Convention rules.

There is also provision in the Convention for automatic and spontaneous exchanges of information¹³ and for arrangements to preserve assets even though a tax claim, may not yet be enforceable¹⁴

The Convention introduces such a radical change that the approach of the Court, in the United Kingdom, will be much as influenced by the historical position as the reasons for its introduction. Some assistance, on the latter, may be gained from the lengthy Explanatory Notes and the Preamble to the Convention. But in order to put the Convention into its proper perspective, it is necessary to make a brief survey of the reasons why, from time immemorial, a Court in common law jurisdictions and elsewhere, would not entertain foreign tax claims.

The historical position.

In the United Kingdom, not only did the rule, mentioned by Lord Mansfield, prevent one sovereign state from suing, directly or indirectly, in the Court of another for taxes owed to it but it also prevented a judgment (obtained by action in the court of one state) directly or indirectly being

¹¹ Section 174 of the Finance Act 2006 and section 20 of the Taxes Management Act 1970, as amended.

¹² To date the countries where the Convention has entered into force are:

Belgium, Canada, Denmark, Finland, France, Iceland, Italy, Netherlands, Norway, Poland, Sweden, United Kingdom, United States. In addition it is in force in Azerbaijan and has been signed by the Ukraine. The latter two are not OECD member countries.

¹³ Articles 4 through to 7 inclusive.

¹⁴ Article 12 entitled "Measures of Conservancy".

enforced in the other.¹⁵ The basic rule, in modern authority, is set out in *Government of India v Taylor*¹⁶ (and *Re State of Norway's Application*¹⁷ as well as the Irish decision in *Peter Buchanan Ltd and MacHarg v McVey*.¹⁸) It is also cogently described Rule 3¹⁹ in *Dicey v. Morris*, the Conflict of Laws. The modern authority on the tax gathering defence begins with the Privy Council case of *Huntington v Attrill*²⁰ where penal sanctions, imposed by a foreign court, were not recognised or enforced by the domestic Court. The principle of non-enforcement has also in recent years been affirmed in two offshore jurisdictions: Guernsey in *Re Birbeck*²¹ and in Jersey in *Le Marquand v Chiltmead*²², and *In the matter of the T Settlement*.²³

The foundation for this policy is important. The basis of the rule is set out with clarity by the great United States judge, Learned Hand J, in *Moore v Mitchell* (1929) 30 F 2d 600. He said (30 F 2d 600 at 603)²⁴:

'While the origin of the exception in the case of penal liabilities does not appear in the books, a sound basis for it exists, in my judgment, which includes liabilities for taxes as well. Even in the case of ordinary municipal liabilities, a court will not recognize those arising in a foreign state, if they run counter to the "settled public policy" of its own. Thus a scrutiny of the liability is necessarily always in reserve, and the possibility that it will be found not to accord with the policy of the domestic state. This is not a troublesome or delicate inquiry when the question arises between private persons, but it takes on quite another face when it concerns the relations between the foreign state and its own citizens or even those who may be temporarily within its borders. To pass upon the provisions for the public

¹⁵ see Section 1(2)(b) of the Foreign Judgments (Reciprocal Enforcement) Act 1933; Article 1(1) of the Brussels Convention on Civil Jurisdiction and Enforcement of Foreign Judgments and *QRS Aps v Frandsen* (Court of Appeal: Simon Brown, Auld and Thorpe LJ) (1999) Simon's Tax Cases 616, which was an attempt at indirect enforcement and a case distinguished by Henderson J in the Grand Court of the Cayman Islands in *Wahr-Hansen v Compass Trust and others* (2007) ITEL 580. .

¹⁶ (1955) Appeal Cases 491

¹⁷ (1990) 1 Appeal Cases 723.

¹⁸ (1954) Irish Reports 89 noted in 1955 Appeal Cases 516

¹⁹ See Rule 3 in the 14th Edition.

²⁰ (1893) Appeal Cases 150 (see page 156).

²¹ 9th October 1980 Unreported (Court of Appeal)

²² (1987) Jersey Law Reports 86

²³ Royal Court of Jersey (6th February 2002 – unreported).

²⁴ Cited in *Wahr-Hansen* *ibid* at paragraph 40.

order of another state is, or at any rate should be, beyond the powers of a court; it involves the relations between the states themselves, with which courts are incompetent to deal, and which are entrusted to other authorities. It may commit the domestic state to a position which would seriously embarrass its neighbour. Revenue laws fall within the same reasoning; they affect a state in matters as vital to its existence as its criminal laws. No court ought to undertake an inquiry which it cannot prosecute without determining whether those laws are consonant with its own notions of what is proper.”²⁵

. The point thus is that, except by agreement, one sovereign jurisdiction may not exercise its powers in any form in the territory of another. It is thus strictly territorial. This rule is only eroded by international custom or treaty²⁶. Taxation exemplifies the power of the State and is unlike other debts²⁷.

The Convention.

Background

Given that historical perspective, the reasons given for the adoption of the Convention may be of interest, and possibly significant. The Preamble to the Convention recites one justification as follows:

“Considering that the development of international movement of persons, capital, goods and services-although beneficial in itself-has increased the possibilities of tax avoidance and evasion and therefore requires increasing co-operation among tax authorities”.

²⁵ The decision in *Commissioner of Taxes for the Federation of Rhodesia v McFarland* 1965 (1) SA 470 also contains a useful discussion of a different public policy foundation of the rule against tax gathering

²⁶ On the other hand, because the Court in the United Kingdom may have refused to enforce a foreign tax law or facilitate the collection of the tax debt, that does not mean that the Court will not recognise the fact of the indebtedness or the foreign tax law. Viscount Simonds in *Regazzoni v KC Sethia* said “*It does not follow from the fact that the Court will not enforce a revenue law at the suit of a foreign state that today it will enforce a contract which requires the doing of an act in a foreign country which violates the revenue laws of that country*” and see also the *State of Norway’ Application* per, Lord Goff ([1990] 1 AC 723 at page 809.

²⁷ See Prof. Edgar Allix says in the “*Receuil des Cours*” of the *Académie de Droit International*, (1937) 111 (61) at p. 559: also cited in the *Wahr-Hansen* case *ibid*.

This appears to emphasize, as such international treaties require, the necessity for purposive construction to the Convention's provisions. The difficulty for the judge is to find an express finding and an exact or true result from general words and weak grammar (inherent in multilateral, international agreements). Thus the need for an OECD press release to say that the Explanatory Notes issued, with the publication of the text of the Convention, were not an authoritative interpretation but "...may facilitate an understanding of the Convention".

On a political level, the decision to sign the Convention was announced by Gordon Brown as Chancellor of the Exchequer in the Pre-Budget Report of November 2005 and the matter was carried forward in Parliament by Dawn Primarolo, the Paymaster General. She said in the final session of the Standing Committee on the Finance Bill 2006 that the Convention was "open only" to members of the OECD and Council of Europe and both those organizations "have strict policies on human rights." Among those which have signed the Convention are Azerbaijan and Ukraine and they are not members of the OECD.

The Text

A summary commentary

Article 1 requires that parties to the Convention "*shall...provide administrative assistance to each other in tax matters...*" including the exchange of information; recovery of taxes and service of documents. These are the basic obligations refined in the remainder of the Convention. This is defined as "administrative assistance." The obligation is expressed in imperative terms as Article 1.3 emphasizes:

“A Party shall provide administrative assistance whether the person affected is a resident or national of a Party or of any other state”.

The Explanatory Notes say that Paragraph 3 “... makes it clear that administrative assistance between the Parties is not restricted by the residence or nationality of the taxpayer or of the other persons involved”. They go on to state that this paragraph prevents a taxpayer trying obstruct the operation of administrative assistance by saying that he has no necessary connection (residence or nationality) of one or other of the two states.

Article 2 has the rubric “Taxes Covered”. As noted earlier, modern central government’s principal taxes (income or profits, capital, and net wealth taxes) are primarily included with others of a different nature such as social security contributions. These are listed in Annex A of the Convention. The sole substantive express exception is customs duties. Excise, real estate and motor vehicle taxes are, with value added and sales taxes, expressly mentioned. Annex A also covers levies of political sub-divisions and local authorities. Generally, the OECD classifications system, for taxes, is used. It is up to a signatory party to notify those to which the Convention applies.²⁸ If a state does not have a tax in a particular category, it committed to providing administrative assistance to other signatories in respect of such taxes unless it makes a derogation.²⁹ By notification, a state may modify the Annex A list, after entry into force of the convention, by deleting or adding taxes.³⁰

In Article 3 (“Definitions”), “Tax” and “Tax Claim” cover all interest, penalties costs and surcharges in respect of tax. The word “Tax” not defined

²⁸ Article 2.2 of the Convention.

²⁹ Article 30.1.a *ibid.* this must be done by a declaration either at signature, ratification or at later date.

³⁰ Article 1.3 *ibid.* The modification takes effect on the first day on expiry of three months after notification.

except that it means “any tax or social security contribution”³¹ and covers all payments notified as tax in Annex A to the Convention, if the requested state is so requested

Article 4 provides generally for the exchange of information which is “foreseeably relevant” but a party can only use that information in criminal proceedings if prior permission is given by the transferor party. Articles 5,6,7,8,and 9 provide for exchanges of information on request; automatic exchange of information; spontaneous exchange; simultaneous tax examinations by signatories in their own territories and such examinations being undertaken by one party with the consent of the other in that other party’s territory. Article 10 requires any receipt of information by one party, which conflicts with that in its possession, to be notified to the other.

Article 11 (“Recovery of Tax Claims”) says that the requested state shall “...take the necessary steps to recover tax claims...as if they were its own tax claims”. But this can only be done if the tax claim is not contested or the appeal process is exhausted in the requesting state “...unless otherwise agreed between the parties...” The proviso is said by the Explanatory Notes to be there to deal with jurisdictions where taxpayers have extensive rights of appeal and the parties can agree that the tax be collected before these are concluded. It is to be hoped that HMRC will be slow to make such agreements (even though they are obliged to make reimbursement if the collection of tax proves to be wrong because the appeal is successful. By Paragraph 3, the amount claimed from a deceased is limited to the value of his estate or of the value of property acquired by a beneficiary.

Article 12 has the title: “Measures of conservancy.” This curious phrase (now found in other international treaties) introduces a requirement that the

³¹ In accordance with the usual rules governing the application of such international arrangements.

requested state will take steps to conserve or preserve by legal process “the amount of tax” even if the claim is contested.

By Article 13, the formal requirements for a request to recover tax are set out. The request must be accompanied by (a) a declaration that the relevant tax is covered by the Convention;(b) an official copy of the instrument permitting enforcement in the applicant state; and (c) “*any other document required for recovery or measures of conservancy*” The Explanatory Notes say that “The exact nature of the documents. referred to in ...(b) and (c) will have to be determined by the competent authorities.... If a tax claim has been contested ...(c) requires that a copy of the decision taken must be submitted with the request...” The applicant state must also indicate if the taxpayer has further remedies and if the lime limits for these remedies have elapsed. If a foreign instrument evidences a tax claim is not acceptable in the requested state then a domestic instrument in conformity, which is valid, must be made.

Article 14 is concerned with time limits for claims. These are governed by the law of the applicant state. If either state has rules which suspend the running of time against the claim then they must be tell each other. In any event, the requested state is not obliged to comply with a request for recovery “*...after a period of fifteen years from the date of the original instrument permitting enforcement*”³².

In Article 15, any priority for tax claims in the requested state does not apply to a Convention request. By Article 16, the requested state may permit deferral of payment of the tax if its laws permit that.

³² The period of 15 years is not mentioned in Regulation 12 of the 2007 Regulations which provides the rule on limitation for the purposes of those regulations.

The service of documents by Article 17 is according to the domestic rules of the requested state. But the documents so served need not be translated unless the requested state is satisfied that the taxpayer cannot understand the document. The Explanatory Notes say that this aspect is similar to that found in Article 7 of the European Convention on the Service Abroad of Documents.

Article 18 requires specific particulars to be provided with any request such as to whom it is addressed and the details of the information required or tax claim for recovery. The application state must also certify that the requirements of Article 19 have been met. Article 19 is in the following terms:

“The requested state shall not be obliged to accede to a request if the applicant state has not pursued all means available in its own territory, except where the recourse to such means would give rise to disproportionate difficulty”

The Explanatory Notes offer no practical or illuminating guidance on what constitutes “disproportionate” difficulty except to say that there should be little use of this Article where there are requests for information.

Articles 20 to 23 are mainly procedural or for the avoidance of doubt – a requested state need not offend its own rules or practice or public policy and its officers must observe secrecy and so on. In Article 26, it is provided that, unless otherwise agreed, the requested state had to bear the costs of effecting the request but not if they are “extraordinary costs”. Such costs are those incurred by the requested state by a use of a special procedure requested by the applicant state or the extra cost of using translators etc.

The remaining Articles deal with administrative issues - the commencement and termination provisions, territorial matters, and so on.

Enforcement of Convention “tax claims” in the United Kingdom

The 2007 Regulations.

These are concerned only with the procedural machinery of enforcing a tax claim as requested by an application state which is a signatory to the convention. As I have indicated above, such a claim is to be treated by HMRC as if it were a claim for income tax, which is to be enforced.³³ Such a request must be in writing and

“... shall be in such form and include such information and documentation as is agreed between the Commissioners... [of HMRC]..and the applicant authority for the purposes of effecting the recovery”³⁴

It is then provided that both parties will agree a minimum amount of tax which may be the subject matter of a request by a foreign authority.³⁵ HMRC are not obliged to collect an amount less than the minimum amount³⁶. There is no indication as to what amount that may be. It seems unlikely that HMRC will let that be known. The currency of the claim must be agreed and it is to be converted into sterling using a representative market rate³⁷. Provision is made for the parties to agree costs and the method and timing of the amount to be remitted to the foreign authority.³⁸

³³ Regulation 3 of the 2007 Regulations.

³⁴ Regulation 3 (1) (b) *ibid*.

³⁵ Regulation 3 (3) *ibid*

³⁶ Regulation 3 (4) *ibid*

³⁷ Regulation 3 (5), (6), (7) *ibid*.

³⁸ Regulation 3 (8), (9). *Ibid*.

Subject to some qualifications, a person may not contest liability if a request for enforcement has been made by a foreign authority unless her can prove that the request was not “duly made” in accordance with Convention arrangements³⁹. A certificate, by an HMRC officer, that the foreign tax is unpaid is sufficient evidence that that is so.⁴⁰ This is, of course, a procedural necessity if the Convention is to work. It also reflects the position in the United Kingdom, where an HMRC officer’s certificate is sufficient evidence of a tax debt for a Court, where enforcement proceedings take place after a tax liability has become final and conclusive⁴¹. The qualifications are (i) that the requesting authority certifies that the tax demand has been satisfied or the claim has been “cancelled”⁴²; (ii) the relevant person shows proceedings in relation to the claim are pending or about to be instituted about that claim in the foreign territory⁴³ and (iii) the person in question can show he has succeeded in defeating the claim in the foreign jurisdiction.⁴⁴

Regulation 12 provides that the law on limitation is that applicable in the requesting state and as Article 14.2 of the Convention provides, the effect of any interrupted or suspended period of limitation is found according to the rules of the requesting territory. But no mention is made in the 2007 Regulations of the overall 15 year time limit⁴⁵

If the parties agree then HMRC will charge interest on the tax claimed according to the rates charged by the applicant authority.⁴⁶

³⁹ Regulation 6 *ibid.*

⁴⁰ Regulation 14 *ibid.*

⁴¹ Section 70(1) of the Taxes Management Act 1970 as amended by section 139 and schedule 44 to the Finance Act 2008.

⁴² Regulation 9 *ibid.*

⁴³ Regulation 10 *ibid.*

⁴⁴ Regulation 11 *ibid.*

⁴⁵ Article 14.3 of the Convention.

⁴⁶ Regulation 132 *ibid.*

Concluding observations

The enforcement of foreign tax claims provides a difficult administrative task for HMRC. The task will be to gather in from or provide ~~to~~ to foreign tax authorities satisfactory documentary material, often in complex cases, Such foreign tax authorities, ~~who~~ may not be as efficient or well organised at HMRC.

One immediate issue may be whether the Convention is retrospective or retroactive in any degree. The issue may arise whether a pre-ratification tax claim, or even liability, can be subject to a Convention request. The basic rule is that such treaties are not to be read as either retrospective or retroactive. It would be unfair⁴⁷ to do so especially in light of the historic and radical change, for the private citizen, which the Convention introduces.⁴⁸ There is no language in the Convention which either expressly or impliedly encourages such a construction. However, if a tax liability, incurred before the Convention was ratified by a requesting state, matures into a tax claim, after its ratification, then a Court in the United Kingdom is likely to hold that it qualifies for enforcement as there is no retrospective element in terms of the Convention.⁴⁹

That said, how can a Convention claim be contested, in the United Kingdom?

If HMRC demonstrates that every procedural requirement has been met then proceedings must be brought to undermine the document certifying the tax claim. This can only be done by making an application⁵⁰ for Judicial

⁴⁷ See *L'Office Cherifien des Phosphates v Yamashita-Shinnihnon Streamship Co.* [1994] 1 Appeal Cases 486

⁴⁸ See the guidance on interpretation provided by Article 31 of the 1969 Vienna Convention on the Law of Treaties, 23rd May 1969, (1980) Cmnd 7964 and the observations of Mummery J in *Commissioners of Inland Revenue v Commerzbank AG* [1990] Simon's Tax Cases 285 at pages 297 -298 and approved in the Court of Appeal in *Memec plc v Commissioners of Inland Revenue* [1998] Simon's Tax Cases 754

⁴⁹ See, for instance, the approach of the Privy Council in *Income Tax Commissioner v Esperance Co Ltd* [1983] Simon's Tax Cases 789.

⁵⁰ See generally Civil Procedure Rules (2008) Pt.54.

Review⁵¹ of the HMRC decision to certify the tax as due. There is no other legal process available. The applicant, in such proceedings would have to show that the decision was as unfair or unreasonable as to amount to an abuse of process in the *Wednesbury*⁵² sense, which may entitle the Court to quash the decision, in question. It would be HMRC's administrative decision-taking and conduct which would be in issue and not directly that of the tax authority in the requesting state. Thus, if the paperwork was in order and HMRC has made all reasonable enquiries (to found its discretionary decisions such as whether to entertain the request), the Court will not go behind the certificate except in special circumstances. Thus even if the process of ascertaining liability, assessment and of appeal in the requesting state were flawed or even corrupt, the Court could only quash the certificate if the applicant shows, by cogent evidence, that the information upon which the certificate was based was clearly wrong (and HMRC had been misled). It is a formidable task and made even more difficult as the application for permission to bring Judicial Review proceedings must be made "promptly" and within three months of the relevant decision being made⁵³. In order to achieve permission from a High Court judge, the case must be persuasively shown by evidence produced on affidavit at that point.

Thus the Convention may introduce some very difficult cases to the Courts with jurisdiction in administrative matters in the United Kingdom.

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⁵¹ With the object of persuading the judge, in exercise of his judicial discretion, to quash the certificate or make a suitable declaration.

⁵² *Associated Provincial Picture Houses Limited v Wednesbury Corporation* [1948] 1 King's Bench 223 and the line of authority flowing from that decision. It has to be remembered that the threshold is a high one: see, for instance, the Court of Appeal in *Regina v North and East Devon Health Authority ex parte Coughlan* [2000] 2 Weekly Law Reports 622.

⁵³ See CPR (2008) Pt 54.5 and the Practice Statement thereto 54PD