TC02943

Appeal number: TC/2011/03655

INCOME TAX – UK-USA Double Tax Agreement SI 2002/2848 – whether pension income from the World Bank's retirement scheme was eligible for relief from UK income tax as income from a 'pension scheme established in' the USA for the purposes of the Agreement – articles 17(1)(b) and 3(1)(o) considered – held the scheme was not 'established in' the USA because it was not established under and in conformity with the USA's tax legislation relating to pension schemes

PROCEDURE – whether an assessment to recover tax repaid on the now-disputed basis that the income was eligible for relief under the Agreement was competent – section 29 TMA considered – held the assessment was competent as a discovery assessment and that the conditions in both s.29(4) and s.29(5) were satisfied – appeal dismissed

FIRST-TIER TRIBUNAL

TAX CHAMBER

MICHAEL MACKLIN **Appellant**

and

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

TRIBUNAL: JUDGE JOHN WALTERS QC

DEREK SPELLER FCA

Sitting in public at Bedford Square, London on 22, 23 and 24 January 2013

Jonathan Schwarz, Counsel, instructed by Thomas Westcott, Accountants, for the Appellant

David Yates, Counsel, instructed by the Solicitor for HM Revenue & Customs, for the Respondents

DECISION

Introductory

1. The appellant, Michael Macklin ("Mr Macklin"), appeals against the decisions of the Respondents ("HMRC") in relation to the income tax years 2003/04 to 2008/09 inclusive, incorporated in closure notices and a refusal of an error claim, that pension payments received by him from the retirement plan operated by his former employer, the International Bank for Reconstruction and Development ("IBRD" or "the World Bank"), did not qualify for any amount of exemption from UK tax under article 17(1)(b) of the UK-USA Convention for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital Gains, signed on 24 July 2001("the DTA") – see: SI 2002/2848. Mr Macklin also appeals against the consequential assessments made by HMRC. We refer to this issue in this Decision as "the DTA Issue".

2. In relation to the income tax year 2003/04 there is an additional issue, which becomes relevant only if our decision is that the pension payments received by Mr Macklin did not qualify for any exemption under article 17(1)(b) of the DTA. The additional issue is whether HMRC are entitled to make a discovery assessment under section 29 Taxes Management Act 1970 ("TMA") in respect of that year. We refer to this issue in this Decision as "the TMA Issue".

3. The parties provided to the Tribunal a Statement of Agreed Facts ("SAF"). The following introductory facts are taken from the SAF. Mr Macklin is (and was at all relevant times) an individual resident and ordinarily resident in the UK and domiciled within the UK – he is therefore a resident of the UK for the purposes of the DTA – see: article 4(1) thereof. He had been employed full time in the United States by the World Bank from July 1976 to March 1998, living there under a US G4 visa. He retired from the World Bank in March 1998 and at that time returned to the UK, and has lived here since then. He has never been a citizen of the United States. He participated in the World Bank's Staff Retirement Plan ("the SRP") and made contributions as required by the SRP throughout his employment with the World Bank. On his retirement, he became entitled to and received pension payments in accordance with the SRP. These pension payments were foreign pension payments for UK tax purposes. They qualified to be treated for UK tax purposes as income of an amount of only 90% of their actual amount pursuant to section 575 Income Tax (Earnings and Pensions) Act 2003 ("ITEPA").

4. Article 17(1) of the DTA is in the following terms:

> '(1) (a) Pensions and other similar remuneration beneficially owned by a resident of a Contracting State shall be taxable only in that State.
>
> (b) Notwithstanding sub-paragraph (a) of this paragraph, the amount of any such pension or remuneration paid from a pension scheme established in the other Contracting State

> that would be exempt from taxation in that other State if the beneficial owner were a resident thereof shall be exempt from taxation in the first-mentioned State'

5. The general rule under article 17(1) of the DTA can therefore be seen to be that pension income is taxable in the state of which the recipient is a resident (in this case, the UK), but that there is an exemption granted for certain pension income paid from a pension scheme established in the other state, which would be exempt from taxation in that other state if the recipient were a resident of that other state.

6. It is argued on behalf of Mr Macklin that the SRP is 'a pension scheme established in [the USA]' for the purposes of article 17(1)(b) of the DTA and that he would be exempt from taxation in respect of some of (but not all) the pension in the USA if he were a resident of the USA.

7. The term 'pension scheme' is defined for relevant purposes by article 3(1)(o) of the DTA, as follows:

> '(o) the term 'pension scheme' means any plan, scheme, fund, trust or other arrangement established in a Contracting State which is-
>
> (i) generally exempt from income taxation in that State; and
>
> (ii) operated principally to administer or provide pension or retirement benefits or to earn income for the benefit of one or more such arrangements.'

8. The requirement that the SRP should be 'a pension scheme established in [the USA]' therefore is both a requirement of article 17(1)(b), under which Mr Macklin claims a tax exemption, and also article 3(1)(o), which contains the relevant definition of 'pension scheme'.

9. Whether or not the SRP is 'established in [the USA]' is the core of the DTA Issue. It is asserted on behalf of Mr Macklin, and accepted by HMRC, that the SRP is generally exempt from income taxation in the USA and is operated so as to fulfil the condition in article 3(1)(o)(ii) of the DTA.

10. Furthermore there is no dispute between the parties, which we are asked to determine, as to the extent of the exemption to which Mr Macklin would be entitled pursuant to article 17(1)(b) if the SRP is determined to be or to have been 'established in [the USA]' for the purposes of article 3(1)(o) and article 17(1)(b) of the DTA.

The evidence

11. Besides a documents bundle in four parts, we received a witness statement from Mr Stephen Eccles of an address in Virginia, USA, introduced on behalf of Mr Macklin, and on which Mr Yates, for HMRC, did not require to cross-examine. We also received two expert reports containing expert evidence on US law, one from Mr Marco Blanco, a New York attorney, who was instructed on behalf of Mr Macklin, and one from Ms Marla J. Aspinwall, a California attorney, who was instructed on behalf of HMRC. Both experts gave oral evidence, Mr Blanco in person, and Ms Aspinwall by video link.

The facts

12. In addition to the facts already stated, we found the following relevant facts included in the SAF.

The foreign pension payments

13. The foreign pension payments from the SRP, received by Mr Macklin, were as follows:

Income Tax Year	Amount
2003/04	£37,540.55
2004/05	£35,872.20
2005/06	£38,666.00
2006/07	£38,826.00
2007/08	£39,195.46
2008/09	£43,476.63

14. Mr Macklin included the above pension payments relative to the years 2003/04 to 2006/07 inclusive in his self-assessment tax returns (subject to the 10% abatement under section 575 ITEPA referred to above) and subsequently claimed repayment of tax for those years on the basis of exemption under article 17(1)(b) of the DTA.

The correspondence in which claims for exemption were made

15. On 21 July 2008 Messrs Thomas Westcott ("TW"), who had recently been appointed to act for Mr Macklin, wrote to a named individual (Mr K J Fitzgerald) at HMRC in Cardiff informing them that Mr Macklin had included his pension payments (subject to the section 575 ITEPA abatement) in his self-assessment tax returns and making the point that the exemption under article 17(1)(b) of the DTA applied to the pension payments. TW informed HMRC in that letter that they would be completing 'the next tax return' for Mr Macklin on the basis that 'the agreed excluded amount' was not taxable in the UK. TW's letter stated that a letter dated 27 May 2008 from the World Bank was enclosed, which showed that, with effect from 16 March 1998 (the date of Mr Macklin's retirement from the World Bank), $2,136.21 out of the monthly pension payment made was not taxable (in the USA). TW argued in their letter that by virtue of the DTA that amount was not taxable in the UK. TW asked that their letter should be accepted as an error or mistake claim 'in respect of past years'.

16. A substantive response to TW's letter of 21 July 2008 was sent by Mr Fitzgerald of HMRC Customer Operations PAYE and Self Assessment in Cardiff. It is dated 10 December 2008. Mr Fitzgerald had consulted internally within HMRC and stated that the correct position was that the pension payments, subject only to the 10% abatement under section 575 ITEPA, were taxable in the UK. He stated that the obstacle to Mr Macklin's claim under article 17(1)(b) of the DTA was that the SRP was not established in the USA. He acknowledged that the US tax authorities were, by concession, treating beneficiaries of the SRP as if it were a USA scheme but stated that 'that does not change the pension scheme into one established in the [USA]'. He refused the error or mistake claim made in TW's letter dated 21 July 2008.

17. TW replied to that letter by a letter addressed to Mr Fitzgerald, dated 14 January 2009. They stated that they maintained the error or mistake claim and continued to make the case that Mr Macklin was entitled to exemption under article 17(1)(b) of the DTA. This was not on the basis that the SRP was established in the USA – it was expressly accepted that the SRP was not, as a matter of fact, established in the USA – but it was on the basis that UK exemption under the DTA followed from the fact that the US tax authorities had agreed, for the purposes of assessing retired employees of the World Bank who are resident in the USA, that the SRP is to be treated as resident or established in the USA. TW maintained that the true or actual location of the establishment of the SRP was irrelevant, as was the (accepted) fact that it was not established in the USA. The important, and determinative, fact was that the US tax authorities treated the SRP as established in the USA for the purposes of granting exemption to US-resident retired employees of the World Bank.

18. TW also stated that Mr Macklin's tax returns for 2009 and subsequent years would be filed on the basis that he was entitled to exemption under article 17(1)(b) of the DTA and that a note explaining the basis on which that entitlement would be claimed would be included in his returns. Such a note was included in Mr Macklin's tax return for 2009 (in respect of the year to 5 April 2008), and the note also referred to the claim made 'in respect of all past years where the excludable amounts have already been taxed'.

19. On 21 April 2009, TW sent a letter to 'South Wales Area' at HMRC's address in Cardiff citing Mr Macklin's name and HMRC's tax reference for him (UTR), in which they made another error or mistake claim under section 33 TMA. The claim was made on the basis of entitlement to 'reduced assessibility in line with the treatment afforded to US citizens'. The claim covered the years 2003/04 to 2006/07 inclusive (years included in the claim made on 21 July 2008 and refused by Mr Fitzgerald's letter dated 10 December 2008) and showed the reduction in taxable foreign pension claimed in each year and the consequential tax reduction claimed. TW's letter made no reference to the earlier claim made and refused and Mr Schwarz at the hearing accepted that it would have been best practice to refer to the earlier claim (which he argued was not a claim within section 42 TMA, but an 'assertion of entitlement').

20. The claim made in TW's letter dated 21 April 2009 was accepted by HMRC and a tax repayment was made by means of a credit added to Mr Macklin's self assessment statement of account.

21. By a letter dated 18 January 2010, C M Barr, an Inspector of Taxes at HMRC Local Compliance, Individuals & Public Bodies, in Salford, informed TW that it had come to his attention that a claim similar to that made on 21 April 2009, and allowed, had been refused, with reasons given for HMRC's refusal. Mr Barr informed TW that he intended to raise assessments under section 29 TMA for the tax years 2003/04 to 2006/07 inclusive to recover the tax. Those assessments were raised on 3 March 2010.

22. TW responded to Mr Barr's letter of 18 January 2010 in a letter dated 23 February 2010 stating that the original claim was not similar to the later one and that TW believed that both claims were valid and that they intended to appeal against the assessments once they were made. TW also made the point that they knew that other UK resident World Bank pensioners in receipt of 'identical pensions' from the World bank had been given the relief claimed. Appeals against the assessments raised on 3 March 2010 were forwarded by TW to HMRC on 15 March 2010.

23. HMRC raised assessments in respect of the tax years 2007/08 and 2008/09 on 20 January 2011, which were also appealed against by Mr Macklin.

The World Bank

24. The World Bank is established by Articles of Agreement ("the Articles"), which were drawn up at the United Nations Monetary and Financial Conference at Bretton Woods, New Hampshire, USA between 1 and 22 July 1944. The Articles became effective on 27 December 1945 and were amended in 1965 and 1989 respectively. The Articles as amended effective February 16, 1989 were with our papers.

25. Article V of the Articles, which deals with Organization and Management, includes in Section 9, under the heading 'Location of Offices', the following language:

> '(a) The principal office of the Bank shall be located in the territory of the member holding the greatest number of shares.
>
> (b) The Bank may establish agencies or branch offices in the territories of any member of the Bank.'

26. The member of the World Bank holding the greatest number of shares is, and always has been, the USA.

27. Article VII of the Articles deals with the status, immunities and privileges of the World Bank.

28. By-Laws ("the By-Laws) of the World Bank have been adopted under the authority of the Articles and are intended to be complementary to the Articles. The By-Laws as amended through September 26, 1980 were with our papers.

29. By section 1 (Places of Business) of the By-Laws, it is laid down that the principal office of the Bank shall be located within the metropolitan area of Washington DC, USA. The principal office and headquarters of the World Bank is, and always has been, located in Washington DC, USA.

30. Two-thirds of the World Bank's staff of over 9,000 employees (who come from over 160 countries) are based in Washington DC, USA. The remaining members of the World Bank's staff work in more than 100 offices in the developing world.

31. The shareholders of the World Bank are represented by a Board of Governors. The governors are ministers in the governments of the member countries. They meet

annually. These meetings are traditionally held in Washington DC, USA, in two years out of three and in a different member country every third year.

32. Pursuant to the By-Laws, Executive Directors are authorised by the Board of Governors to exercise all the powers of the World Bank, except those reserved to the Board of Governors by the Articles. Executive Directors may not take any action pursuant to powers delegated by the Board of Governors which is inconsistent with any action taken by the Board of Governors.

33. Pursuant to the By-Laws, the Executive Directors are authorized by the Board of Governors to adopt such rules and regulations, including financial regulations, as may be necessary or appropriate to conduct the business of the World Bank. Any rules and regulations so adopted, and any amendments thereof, are subject to review by the Board of Governors at their next annual meeting.

34. The Board of Governors delegates specific duties to 25 Executive Directors, who work on-site at the World Bank. The five largest shareholders, France, Germany, Japan, the UK and the USA, each appoints an Executive Director and the remaining member countries are represented by 20 Executive Directors.

35. The Executive Directors make up the Board of Directors of the World Bank. The President of the World Bank chairs meetings of the Board of Directors and is responsible for the overall management of the World Bank. The President is selected by the Board of Directors for a 5-year renewable term. The Board of Directors, which is based in Washington DC, USA, normally meet at least twice a week to oversee the business of the World Bank.

The SRP

36. The SRP is a funded contributory pension plan, established by the World Bank to provide retirement benefits for employees of the World Bank and related institutions.

37. The SRP became effective on 31 May 1948 pursuant to a resolution of the Executive Directors of the World Bank on 5 May 1948, which was made in Washington DC, USA.

38. The governing document of the SRP is called 'Staff Retirement Plan and Trust of the International Bank for Reconstruction and Development' ("the Trust Deed"). A copy of the Trust Deed as amended and restated effective January 1, 2008 was with our papers.

39. Subject to limitations, the World Bank may amend the Trust Deed or terminate it. All amendments to the Trust Deed in relation to which minutes have been located show that the meetings at which the amendments were made took place in Washington DC, USA. Mr Eccles's unchallenged evidence (which we accept) is that all meetings at which the Trust Deed has been amended have taken place in Washington DC, USA and that there is no management or administration of the SRP other than at the World Bank's principal office in Washington DC, USA.

40. The World Bank is the trustee of the SRP and holds the funds of the SRP in trust for the purposes of the SRP and its assets for the exclusive benefit of participants, retired employees and beneficiaries. No governing law is specified in the Trust Deed. The privileges and immunities accorded to the World Bank (see: Article VII of the Articles) are expressed in the Trust Deed (see: Article 14.2 thereof) as applying to the trust assets and activities.

41. Pursuant to the Trust Deed, the SRP is administered by a Pension Benefits Administration Committee, a Pension Finance Committee, a Pension Benefits Administrator and a Pension Finance Administrator. The Pension Finance Committee is responsible for the oversight of investment and actuarial activities of the SRP, including the World Bank's contributions to the SRP. The Pension Benefits Administration Committee is responsible for administering the SRP's benefits.

42. Members of these committees include Executive Directors of the World Bank, other World Bank staff, and a retired employee of the World Bank (and alternate). The Pension Finance Committee is chaired by the World Bank Group Chief Financial Officer and the Pension Benefits Administration Committee is chaired by the World Bank's Vice-President of Human Resources. All meetings of the committees of the SRP are held in Washington DC, USA.

43. The World Bank appoints a Finance Administrator of the SRP pursuant to the Trust Deed. The Finance Administrator is the secretary of the Pension Finance Committee. The Finance Administrator is the Director of the Pension and Endowments Department ("the PEN") of the World Bank. He is responsible for the financial management of the SRP. The PEN is responsible for all investment-related functions of the SRP. Most SRP assets are in the custody of the Bank of New York Mellon. An in-house actuary within the PEN is responsible for overseeing the annual valuation of the SRP's liabilities and the determination of the annual contributions recommendations of the external actuarial consultants (a New York firm).

44. The Quantitative Strategies, Risk and Analytics Department of the World Bank is responsible for defining the SRP's asset class benchmarks, measuring and monitoring the SRP's risks and developing risk management tools.

45. The Treasury Operations Department of the World Bank, through the Pensions Operation Division, is responsible for accounting, asset valuation, performance measurement, management reporting, cash management and certain other functions, for the SRP.

46. The Pension Administration Division, a division of the PEN, manages the administration of SRP plan benefits.

47. The Legal Vice Presidency of the World Bank supports pension investment management of the SRP in relation to legal issues.

Further facts

48. From the evidence, we find the following further facts.

49. A G4 visa is a type of visa available for employees of certain designated international organizations. As a holder of a G4 visa, Mr Macklin was treated for US income tax purposes, as a non-resident alien.

50. The World Bank is an international organization which enjoys privileges and immunities in both the USA (under the International Organizations Immunities Act of 1945) and the UK (under the International Organisations Act 1968, which superseded the International Organisations (Immunities and Privileges) Act 1950).

51. The SRP is an arrangement which is 'operated principally to administer or provide pension or retirement benefits' for the purposes of article 3(1)(o)(ii) of the DTA (definition of 'pension scheme').

52. TW, on behalf of Mr Macklin, endeavoured to invoke the mutual agreement procedure, provided for by article 26 of the DTA, with a view to the resolution of the of the issues under the DTA giving rise to this appeal. There was an exchange of correspondence between HMRC and the IRS, which we were shown. However, we were informed that no such resolution had been achieved.

The expert evidence

53. The experts in the law of the USA (Mr Blanco and Ms Aspinwall) gave evidence as to the law of the USA in relation to several issues, of which the following are relevant to the issues we have to determine:

1 Whether the SRP is 'established in' the USA for the purposes of articles 3(1)(o) and 17(1)(b) of the DTA;

2 Whether the SRP is 'generally exempt from income taxation in' the USA for the purposes of article 3(1)(o)(i) of the DTA; and

3 Whether pensions or similar remuneration paid from the SRP would be exempt from taxation in the USA if the beneficial owner thereof were a resident of the USA.

54. As indicated above, the first of these issues represents the core of the DTA Issue, and there was a difference of opinion between the experts. Before referring in detail to their evidence on this issue, we deal with their evidence on the second and third issues, which were less controversial and on which there was a measure of agreement between them.

55. As to the second issue, both experts agree that it is likely that under US law the SRP is generally exempt from income taxation in the USA (US federal income tax) by reason of Article VII of the Articles (dealing with the immunities of the World Bank), which, as stated above, are expressed in the Trust Deed as applying to the trust assets and activities (of the SRP). We were told that for the purposes of this appeal HMRC accept that the SRP is generally exempt as a matter of law from income tax in the USA and we so find.

56. However, apart from its immunity, the SRP would generally be subject to US federal income tax on its income and capital gains because it is not an exempt trust under IRC § 501(a). This also is agreed by both experts, and we so find.

57. As to the third issue, both experts agree that benefits paid by the SRP to pensioners and other beneficiaries who are resident aliens of the USA are exempt from US federal income tax to the extent of contributions made by the World Bank as employer and by the employee. They also agree that if, at the time he received pension benefits, Mr Macklin had been a US resident, pension benefits received from the SRP would have been exempt from US federal income tax to the extent of contributions made by him and the Bank while he was an employee. We find facts accordingly.

58. Turning now to the first, and core, issue, we record that the Internal Revenue Service of the USA ("IRS") issued a 'favorable determination letter' dated 13 September 2002 to the World Bank in relation to the SRP. By the favorable determination letter, the IRS determined that that SRP is a plan which meets the requirements of IRC § 401(a) in all respects except that it was not 'created or organized in the United States', and that it would have qualified for exemption under IRC § 501(a) 'except for the fact that it was created or organized outside the United States'. Both experts agreed that the favourable determination was not concessionary.

59. In consequence of the IRS's determination, beneficiaries of the SRP are taxed in the USA as if the pensions received from the SRP qualified for exemption from US federal income tax under IRC § 501(a) – that is, beneficiaries of the SRP do not suffer the adverse tax consequences which would otherwise flow from a determination of the IRS that the SRP was not 'created or organized in the United States' and for that reason does not itself qualify for exemption under IRC § 501(a). In addition to this measure of exemption from US federal income tax for beneficiaries of the SRP, the SRP itself is generally exempt from US federal income tax by reason of the immunities contained in Article VII of the Articles (see: above).

60. The significance of the fact that the SRP was not 'created or organized in the United States' is that it prevents the SRP from being a 'qualified trust' under IRC § 401(a), which in turn has the consequence that the SRP does not qualify for exemption from taxation on this basis under IRC § 501(a). Further, on the same point, Federal Regulation § 1.401-1(a)(3)(i) makes it clear that in order for a trust forming part of a pension plan to constitute a 'qualified trust' under IRC § 401(a), it must be created or organized in the USA, and it must be maintained at all times as a 'domestic trust' in the United States.

61. The term 'domestic trust' means a trust that is a 'United States person', and any trust other than a 'domestic trust' is a 'foreign trust' (Federal Regulation § 301.7701-7(a)(2)). A trust is a 'United States person' if two tests, the 'Court' test and the 'Control' test, are satisfied – that is, if a court within the USA is able to exercise primary supervision over the administration of the trust, and one or more United States persons (i.e. citizens or residents of the USA or 'domestic partnerships' or

'domestic corporations' or estates other than 'foreign estates') have the authority to control all substantial decisions of the trust (IRC § 7701(a)(30)(E)).

62. The experts agree that the SRP is not a 'domestic trust' or a 'United States person' for US tax purposes and we so find. Both experts agreed that the 'Control' test is not satisfied in relation to the SRP – that is, that the World Bank has authority (as trustee of the SRP) to control all substantial decisions of the SRP and the World Bank is not a 'United States person'. We so find. Mr Blanco's view is that the 'Court' test is satisfied in relation to the SRP, but Ms Aspinwall disagrees. Mr Blanco considers that the 'safe harbor' provisions of Treasury Regulation § 301.7701-7(c) apply – *viz*: that the Trust Deed does not direct that the SRP be administered outside of the USA, that the SRP is in fact administered in the USA and that the SRP is not subject to an automatic migration provision – so that the 'Court' test is satisfied. Ms Aspinwall disagrees, on the basis that the 'safe harbor' provisions are inapplicable in the current context and to apply them would be inconsistent with the statute giving effect to the immunities of the World Bank and with the purpose of the 'safe harbor' provisions themselves. We prefer Ms Aspinwall's opinion to that of Mr Blanco. We consider that the 'safe harbor' provisions would not apply, because such application – and the satisfaction of the 'Court' test – would be held to be inconsistent with the immunities of the World Bank.

63. The experts also agree that, following *Mendaro v The World Bank* 717 F.2d 610 (D.C. Cir. 1983) and *Chiriboga v International Bank for Reconstruction and Development* 616 F. Supp. 963 (D.D.C. 1985), it is reasonable to conclude that employees and other beneficiaries of the SRP would not be entitled to bring claims in the courts of the USA in respect of benefits provided under the SRP. That is, the courts of the USA would not have jurisdiction in such matters. This is because the US courts have concluded that under Article VII of the Articles (immunities of the World Bank) such immunities are only waived in relation to actions relating to external commercial activities and contracts, and not the World Bank's employment relationships. However, both experts also agreed that the US courts would have jurisdiction to determine its jurisdiction in such a matter. We find facts accordingly.

64. The experts also agree that the term 'established' is widely used in US legal enactments and has no uniform or technical meaning. There is no relevant definition of the word. Its meaning must be determined by reference to the context in which it is used. It has, however, the connotations, derived from dictionary definitions, of 'setting up' or 'bringing about'. We so find.

65. In Mr Blanco's opinion, the term 'established' is used for US tax purposes to address issues other than the connecting factors for the taxing jurisdiction in relation to trusts. Those connecting factors are addressed by the technical term 'created or organized' in the relevant jurisdiction. He considers that we should regard the test of 'establishment' in the USA as suggesting different linking factors to the test of 'created or organized' in the USA. For the reasons advanced for his opinion that the 'Court' test is satisfied in relation to the SRP, because the 'safe harbor' provisions apply, his view is that a court within the USA is able to exercise primary supervision over the administration of the SRP. He accepts that there is no proper or governing

law indicated in the Trust Deed, but his opinion is that this is neutral in relation to the question of jurisdiction to exercise primary supervision over the administration of the SRP. He cited Rev. Rul. 70-242, 1970-1 C.B. 89, an IRS ruling that an employees' trust created in Canada that operated exclusively in the USA for the benefit of US employees of a Canadian organization doing business in the USA was a 'domestic trust'. The reasoning given in that ruling was that the trust was a US resident trust and was subject to the continuous jurisdiction of the USA.

66. When asked in cross-examination whether he accepted that under US law a court lacking subject matter jurisdiction cannot render a valid and enforceable judgment or order, he responded that the World Bank's immunity could be waived and the case of *Novak v World Bank et al.* 7-3 F.2d 1305, 277 U.S.App.D.C. 83 demonstrated that it was a matter for the US court to determine its jurisdiction in such cases. He recognised that the decision in *Mendaro* showed that the parties to a case cannot grant the court a competence which it does not have and that whereas the Articles (of the World Bank) waive the World Bank's immunity from actions arising out of the World Bank's external relations with its debtors and creditors, a waiver of immunity to suits arising out of the World Bank's internal operations, such as its relationship with its own employees, would contravene the express language of Article VII, section 1 of the Articles. He accepted that, in *Mendaro*, the court had distinguished between the World Bank's external relations and its internal relations, and had held that it had subject matter jurisdiction over the World Bank's external relations, with its debtors and creditors.

67. Ms Aspinwall's opinion was that in determining whether the SRP was established in the USA, a US court would look to evidence of the intent of the agreement between the treaty partners, that is, the partners to the DTA, as well as a number of other factors, including whether US law governs the SRP, whether the SRP is subject to the jurisdiction of a US court, and whether the SRP has been 'created or organized' in the USA for US income tax purposes. She made reference to the Exchange of Notes regarding the DTA which provided a list of US pension schemes which the parties intended should be covered by the DTA. Her view was that the Notes served as good evidence of the DTA's meaning, and the language employed indicated that the schemes envisaged would be 'established pursuant to legislation' which, she considered, must mean US legislation.

68. Ms Aspinwall made reference in her evidence to the report prepared by the Joint Committee on Taxation, a joint congressional committee established under the Internal Revenue Code (IRC § 8001), for the US Senate Foreign Relations Committee in 2003. The report concerned the DTA which had been signed (on 24 July 2001) but not at that stage ratified. The report, when dealing with article 18 headed 'Pension schemes', the language of which also refers to a 'pension scheme established in a Contracting State', contained the following observation:

> 'Under the proposed treaty, if an individual who is a member of a pension plan established and recognised under the law of one country performs personal services in the other country, contributions made by the individual to the plan during the period he or she performs such personal services are deductible in computing his or her taxable income in the other country

> within the limits that would apply if the contributions were made to a pension plan established and recognized under the laws of the other country.

69. Other relevant factors, in Ms Aspinwall's opinion, were that the SRP is not governed by US law, and indeed the Trust Deed contains no governing law provision, and is not subject to the jurisdiction of a US court with respect to matters relating to its obligations to its participants (*Mendaro*). The World Bank, as trustee of the SRP, is an international organization whose assets are generally immune from the supervision of the US courts and this general immunity is extended to the SRP, so that the SRP would not, in her view, be subject to the jurisdiction of any US court, state or federal, in the event that an employee or former employee were to be in dispute with the World Bank with respect to any of its terms. The Trust Deed (at section 10.2(f)) makes it clear in her view that the exclusive avenue of appeal in such a case would be to the World Bank Administrative Tribunal.

70. Ms Aspinwall's opinion was that the fact that many of the administrative activities of the SRP are conducted from and through the World Bank's offices in Washington DC and New York was not sufficient to establish it in a jurisdiction under US law. She cited a passage from the judgment in *Compagnie Financière de Suez et de l'Union Parisienne v United States* 492 F.2d 798, 808 (Ct. Cl. 1974) as follows:

> '[h]aving one's corporate administrative office in a given place is very different from being created or organized in that place. The latter involves the sovereign's scrutiny and eventual approval of the rules by which the corporation will function.'

71. Ms Aspinwall's evidence included her conclusions as to the likely interpretation which a US court would put on the phrase 'established in' the USA in the relevant contexts in the DTA. Mr Schwarz submitted that opinion evidence on how a US court would likely construe the phrase 'established in a contracting state' in the DTA is inadmissible, relying on HH Judge Pelling QC's judgment in *Commissioners for HM Revenue and Customs and another v Ben Nevis (Holdings) Limited and others* in the Chancery Division ([2012] EWHC 1807 (Ch)). What Judge Pelling said (*ibid.* at [41] was as follows:

> '… Even in relation to documents that are to be construed in accordance with laws other that the laws of England and Wales, expert evidence is admissible only for the limited purpose of identifying the relevant principles of construction, not for the purpose of expressing an opinion as to true construction applying those principles – see the authorities summarised by Waller LJ at paragraphs 66-68 of his judgment in *King v Brandywine Reinsurance Company (UK) Limited* [2005] EWCA Civ 235.'

72. This passage immediately before the passage quoted, which referred to the inadmissibility of evidence relating to the questions of construction to be decided by the court, received approval in the Court of Appeal – see: the judgment of Lloyd Jones LJ at [2013] STC 1579 at [34]. Lloyd Jones LJ did not refer to Judge Pelling's decision on the inadmissibility of expert opinion as to the true construction of a document to be construed in accordance with a foreign law, but we agree that it is likely that he did agree with Judge Pelling, otherwise he would have indicated that he did not.

73. However, we are not engaged in the task of arriving at the true construction of any document in accordance with US law. The expert evidence is before us in order to assist us in reaching a view (a finding of fact) on the meaning, as a matter of US law, of the expression 'established in' with reference to a Contracting State, where it appears in the DTA.

74. Further, whatever the position as to the inadmissibility of evidence in High Court proceedings may be, the procedural rules applicable in this Tribunal are looser. The position was summarised by Arnold J in the Upper Tribunal in *Megantic Services Ltd v HM Revenue & Customs* [2011] STC 1000 (at [80]) as follows:

> "... r 15(2)(a) of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009, SI 2009/273, allows the tribunal to admit evidence whether or not the evidence would be admissible in a court trial. It follows that the tribunal is entitled to admit evidence which would not be admissible in a court and give it such weight, if any, as the tribunal considers that it is worth. What weight should be given to the evidence is a matter for the tribunal to decide in the light of all the evidence at the hearing."

75. We accept that we must consider the expert evidence having regard to the overriding objective to deal with cases fairly and justly. If there is no unfairness or injustice in the admission of opinion evidence as to the conclusion on a point of foreign law by an expert in that law, then we consider that it may be admitted. We have concluded that since Ms Aspinwall was presented for cross-examination and was cross-examined at the hearing of the appeal by Mr Schwarz, there is no unfairness or injustice in admitting her opinion evidence as to her conclusions, which were as follows.

76. In order for a pension scheme to be considered, as a matter of US law, to be 'established in' the USA, for the purposes of the DTA, Ms Aspinwall's opinion was that the scheme must be 'established pursuant to [US] legislation' and be 'created or organized' in the USA and that neither of these conditions was satisfied by the SRP.

77. Ms Aspinwall's opinion was that the phrase 'established in a Contracting State' in the DTA with respect to a pension scheme required, as a matter of US law, that the scheme be both established and recognized under the law of the country concerned and that that conclusion was supported by the report of the Joint Committee on Taxation.

78. Ms Aspinwall's opinion was also that the SRP is a foreign trust for US income tax purposes, not created or organized under or governed by US law, and its administration is generally not subject to the jurisdiction of any US court and that for those reasons it would not be considered, as a matter of US law, to be 'established in' the USA for the purposes of the DTA.

79. We prefer Ms Aspinwall's evidence to that of Mr Blanco and, for the reasons she gives, find that, so far as US law is concerned, a US court would conclude that the SRP is not established in the USA for the purposes of the DTA. We do not accept that a US court would be able to exercise primary supervision over the administration of

the SRP by virtue of the 'safe harbor' provisions. We consider that the Trust Deed and the immunities of the World Bank, which are extended to the SRP make it sufficiently clear that no US court has jurisdiction to exercise primary supervision over the administration of the SRP. The IRS ruling relative to an employees' trust created in Canada, which Mr Blanco cited, did not concern an international organization, such as the World Bank or the SRP, and therefore was, we consider, of very limited relevance. No doubt a US court would have jurisdiction to consider whether it had jurisdiction to decide an issue raised by the SRP's internal relations with employees or pensioners of the World Bank, but we find that such a court would decide it had no such jurisdiction, following *Mendaro* and *Chiriboga*.

The DTA Issue – the parties' submissions

80. Both Mr Schwarz and Mr Yates submitted that we should follow the approach to the interpretation of tax treaties contained in the judgment of Mummery J in *IRC v Commerzbank* [1990] STC 285 at 297-298, endorsed by the Court of Appeal in *Revenue and Customs Commissioners v Smallwood & Anor* [2010] EWCA Civ 778 at [26] and *Bayfine UK v HM Revenue and Customs* [2011] EWCA Civ 304.

81. In *Commerzbank*, Mummery J said that the House of Lords in the earlier case of *Fothergill v Monarch Airlines* [1981] AC 251 had indicated the proper approach to be adopted by the court to the interpretation of provisions in a double taxation convention. He made the following points. First, one looks for the clear meaning of the words used in context, adopting a purposive approach. Secondly, the language of an international convention should be interpreted, not as an English statute, but 'unconstrained by technical rules of English law, or by English legal precedent, [and] on broad principles of general acceptation'. Thirdly, one of the applicable principles of interpretation is 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', the 'essential quest in the application of treaties' being 'the search for the real intention of the contracting parties in using the language employed by them'. (Mummery J made reference in this connection to article 31(1) of the Vienna Convention on the Law of Treaties, and the point was made in argument by Mr Yates that the USA had not ratified the Vienna Convention. This point is however immaterial having regard to the comment of Lloyd Jones LJ in *Ben Nevis (Holdings) Ltd* (*ibid.* at [17]) that the rules of interpretation set out at articles 31 and 32 of the Vienna Convention are rules of customary international law and therefore binding on all states regardless of whether or not they are parties to the Convention.) Fourthly, in cases of ambiguity or manifest absurdity, recourse may be had to 'supplementary means of interpretation' including *travaux préparatoires*. Fifthly, subsequent commentaries or decisions of foreign courts may have persuasive value. Sixthly, such aids to the interpretation of a treaty are not a substitute for study of the terms of the convention.

82. Mr Yates placed importance on the Exchange of Notes of 24 July 2001 (the same date as the signature of the DTA). He submitted that it is mandatory for the Tribunal to have regard to the Exchange of Notes in the interpretation of the DTA because they represent an agreement between the contracting parties (the UK and the USA) coming into force at the same time as the DTA and obviously relevant to 'the search for the

real intention of the contracting parties in using the language employed by them'. They were not in the same category as *travaux préparatoires.*

83. The passage in the Exchange of Notes on which Mr Yates relied is as follows:

> '*With reference to sub-paragraph (o) of paragraph 1 of Article 3 (General Definitions)*: it is understood that pension schemes shall include the following and any identical or substantially similar schemes which are established pursuant to legislation introduced after the date of signature of the Convention:
>
> (a) under the law of the United Kingdom, employment-related arrangements (other than a social security scheme) approved as retirement benefit schemes for the purposes of Chapter I of Part XIV of the Income and Corporation Taxes Act 1988, and personal pension schemes approved under Chapter IV of Part XIV of that Act; and
>
> (b) under the law of the United States, qualified plans under section 401(a) of the Internal Revenue Code, individual retirement plans (including individual retirement plans that are part of a simplified employee pension plan that satisfies section 408(k), individual retirement accounts, individual retirement annuities, section 408(p) accounts, and Roth IRAs under section 408(A), section 403(a) qualified annuity plans, and section 403(b) plans.'

84. Mr Schwarz points out that the above list is not exclusive or exhaustive and that the Notes do not clarify the meaning of the term "established".

85. Mr Schwarz submits that the terms 'established in a contracting state' in its clear and ordinary meaning encompasses both being 'set up' (i.e. 'established') by reference to a particular legal system and being 'set up' physically in or at a particular place, and that there is nothing in the DTA or in the purposes for which it was concluded, nor in the context in which the phrase is used, that requires only one of these meanings to apply. He contends that both a scheme set up by reference to US law and a scheme set up physically in the USA qualify as schemes 'established in' the USA for the purposes of the DTA.

86. He relies on the factual evidence (and facts as found by us above) to make good his case that the SRP is an arrangement set up physically in the USA, and, for that reason 'established in' the USA for the purposes of the DTA. Thus, for example, the World Bank's Executive Directors meet and make their decisions at the World Bank's headquarters in Washington DC, USA and did so in relation to the setting up of the SRP in 1948 and all amendments to it. Thus, for example, all management and administration of the SRP is undertaken at the World Bank's headquarters in Washington DC, USA by US-based employees or agents. Thus, for example, the IRS has issued a favourable determination letter confirming the SRP's status and the treatment of the SRP and payments made by it as an exempt trust. Thus, for example, the main custodian of the assets of the SRP is in the USA.

87. Mr Schwarz submits that the SRP has a legal nexus with the USA which supports the case that it is established in the USA. The treaty constituting the World Bank has been made part of US law. He submits that the evidence is that the SRP is within the jurisdiction of the US courts subject to the limitations imposed by the Articles (of the World Bank) and article 14.2 of the Trust Deed (of the SRP) and that the immunities of the SRP (and the World Bank) are limited, leaving areas in which they are subject to the jurisdiction of the US courts.

88. Mr Schwarz invites us to compare the DTA with the Canada-UK double taxation convention which does not contain any equivalent to article 17(1)(b) of the DTA but states (in article 25(2)) that '[t]his Convention shall not apply to International Organizations, to organs or officials thereof'. He argues that this specific exclusion in the Canada-UK convention confirms that there was no intention to exclude International Organizations or their employees from the application of the DTA, particularly as several such Organizations are based in the USA.

89. He submits that the purpose of article 17(1)(b) of the DTA is to provide equal treatment for pensioners resident in one contracting state (here, the UK) with pensioners resident in the other contracting state (here, the USA) in receipt of certain pension income. He contends that article 17(1)(b) is akin to article 25 (Non-Discrimination) rather than those provisions of the DTA that allocate taxing rights between the contracting states. Article 17(1)(b), he submits, specifically contemplates double non-taxation, because exemption in one contracting state is a requirement for exemption in the other.

90. Mr Yates drew to our attention article 3(2) of the DTA, which sets out the general rules on interpreting terms in the DTA. Article 3(2) is as follows:

> '2. As regards the application of this Convention at any time by a Contracting State, any term not defined therein shall, unless the context otherwise requires, or the competent authorities agree on a common meaning pursuant to the provisions of Article 26 (Mutual Agreement Procedure) of this Convention, have the meaning which 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 the other laws of that State.'

91. He reminded us that there was no common meaning of the phrase 'established in a Contracting State' as it appears in article 17(1)(b) and 3(o) which had been agreed between the competent authorities under the Mutual Agreement Procedure. The meaning to be given to the phrase might be the meaning which it has under the law of the UK, since the DTA is sought to be applied by the UK in relation to Mr Macklin's UK tax liability. Alternatively, it might be the meaning which it has under US law, since the question posed is whether the SRP is 'established in' the USA.

92. He referred us to dicta of Arden LJ in *UBS AG v HMRC* [2007] STC 588 at [64]-[65] and submitted that article 3(2) of the DTA required the Tribunal to ascertain whether there is a meaning of 'established' under UK tax law. We ought, in his submission, to take account of the meaning of 'established' in US law, as we have found it to be, because 'the factual situation (which includes foreign law) has to be examined in order to apply the English law' (per Lord Pearce in *Rae v Lazard* [1963] 1 WLR 555).

93. Mr Yates contended that there were no meanings of 'established' in either UK law or US law which have been found to apply specifically to the place where a pension scheme could be said to the 'established' and so the task facing the Tribunal was to resolve what the autonomous meaning of the term is under the DTA.

94. He referred us to section 150(7) Finance Act 2004 (post-dating the DTA) which defines an 'overseas pension scheme' as one 'established in a country or territory outside the United Kingdom', and to regulation 2 of the Pension Schemes (Categories of Country and Requirements for Overseas Pension Schemes and Recognised Overseas Pension Schemes) Regulations 2006 (SI 2006/206) made under that section. He submitted that the format of regulation 2, with its separate provision for overseas pension schemes established (outside the United Kingdom) by an international organisation, indicated an awareness that such schemes might not be established in any country and might not, or would not, be required to be subject to regulation by any national pension regulator.

95. Mr Yates submitted that the closest UK case law appears to come to defining the meaning of the word 'established' is in *Camille and Henry Dreyfus Foundation Inc v IRC* [1954] 1 Ch 672, [1956] AC 39. He relied on the decision of the Court of Appeal in *Dreyfus* that the expression 'any body of persons or trust established for charitable purposes only' in the section 37(1)(b) of the Income Tax Act 1918 meant any body of persons or trust established in the United Kingdom for charitable purposes. Evershed MR placed emphasis in his decision on the need for a charity to be subject to the jurisdiction of particular courts (those of the United Kingdom) so that its purposes can be defined or regulated.

96. Mr Yates, however, recognised that *Dreyfus* was concerned with a charity rather than a pension scheme and that the category of arrangement contemplated by article 3(1)(o) of the DTA to constitute a pension scheme is different to the category of 'any body of persons or trust' considered in *Dreyfus*.

97. He submitted that while the meaning of 'established' discerned in *Dreyfus* (that is, established under the laws of the relevant State and subject to supervision by its courts) might seem a simple and attractive meaning to attribute to the term in the context of article 3(1)(o) and article 17(1)(b) of the DTA, a difficulty with that approach would be that it would exclude various registered schemes which qualify under the UK legislation identified in the Exchange of Notes. For example, it has never been a requirement under section 590 of the Income and Corporation Taxes Act 1988 (occupational schemes) that the relevant trust must be governed by the law of England and Wales or the law of Scotland or the law of Northern Ireland. Equally, for personal pension schemes, EU companies and EEA firms are eligible to establish registered schemes.

98. Mr Yates's submission, on behalf of HMRC, was that interpretations of 'established in' a State for the purposes of the relevant provisions of the DTA which require identification of the governing law of the pension scheme, the residence of the scheme operator or where the scheme is administered from are all inherently inadequate and potentially exclude some of the pension schemes which the UK and the USA agreed, in the Exchange of Notes, would fall within the definition in article 3(1)(o) of the DTA.

99. His positive case was that the only sensible interpretation of 'established in' a State for relevant purposes was 'established under and in conformity with the relevant

Contracting State's *tax legislation relating to pension schemes*'. He submitted that this might stipulate a requirement that a scheme was governed by the State's general law or controlled by its courts. He prayed in aid for support for this interpretation the language in the Exchange of Notes which referred to schemes established pursuant to the tax legislation of the UK and of the USA.

100. He further prayed in aid for support for this interpretation the conditions in article 3(1)(o) of the DTA requiring that a 'pension scheme' within the definition must be generally exempt from income taxation in the State in which it is established and must be operated principally to administer or provide pensions etc. He submitted that these conditions pointed to a meaning of 'established in' which was aligned to the respective States' tax legislation relating to pension schemes – in that a scheme which was recognised under a Contracting State's tax legislation, but did not enjoy exemption from taxation as such, would be excluded from qualification as a 'pension scheme' within the definition.

101. Mr Yates submitted that while HMRC accepted that the SRP is generally exempt from income taxation in the USA, it is not so exempt by reason of its being recognised as entitled to exemption pursuant to the US tax legislation relating to pension schemes. The SRP's exemption from income taxation in the USA has nothing to do with its being a pension scheme, but arises from the privileges and immunities of the World Bank which it enjoys. Therefore, HMRC submits that the SRP does not fall within the requirement of general exemption from income taxation in the USA for the purposes of article 3(1)(o)(i) on any sensible reading of the article. Mr Yates reminded us of Ms Aspinwall's evidence that the SRP does not fall within the scope of any of the schemes identified by the USA in the Exchange of Notes.

102. In summary, Mr Yates's submission was that the SRP is not governed by any US tax legislation relating to pension schemes and further is not, for relevant purposes, generally exempt from income taxation in the USA and that it follows that it must fall outside the definition of 'pension scheme' in article 3(1)(o) of the DTA and so Mr Macklin is not entitled to rely on article 17(1)(b) of the DTA in relation to pension income derived by him from the SRP.

The DTA Issue – Discussion and Decision

103. As the 'essential quest in the application of treaties' is 'the search for the real intention of the contracting parties in using the language employed by them' (*Commerzbank supra*), it would, we consider, be strange if we were to conclude that the SRP, which we have found as a fact would not be considered, as a matter of US law, to be 'established in' the USA for the purposes of the DTA, was, as a matter of English or UK law, 'established in' the USA for those purposes.

104. We accept that our finding of fact as to the position in US law is not determinative of (although it is relevant to) the matter before us and that, pursuant to article 3(2) of the DTA we must attribute to the phrase 'established in' a State the meaning which it has (or had at the relevant time(s)) under UK law for the purposes of income tax or, failing such a meaning, the meaning which it has (or had) under general English or UK law.

105. Applying the *Commerzbank* principles of interpretation, we agree with Mr Yates that we must take account of the Exchange of Notes of 24 July 2001 as the best evidence of the real intention of the contracting parties in using the language employed in the definition inn article 3(1)(o) of the DTA. We accept that the list of schemes intended to be included in the definition, as set out in the Exchange of Notes is not exclusive or exhaustive, but we agree with Mr Yates that the language and structure of the Exchange of Notes is very persuasive in support of his main proposition, that the contracting parties meant by the phrase 'established in' a Contracting State the concept of being established under and in conformity with the relevant Contracting State's tax legislation relating to pension schemes.

106. This provides a sensible and workable definition in accordance with what we discern as the purpose of the provision, which is to recognise the special categories of pension scheme to which the Contracting States have chosen to give exemption from income taxation under their respective domestic laws because they are schemes operated principally to administer or provide pension or retirement benefits, etc. The exemption from income taxation in the USA which the SRP enjoys does not, we are satisfied, arise from its status as a pension scheme, but from the relevantly unconnected privileges and indemnities enjoyed by the World Bank.

107. We entirely accept Mr Schwarz's point that the SRP is an arrangement set up physically in the USA. Although it would not be a misuse of ordinary language to describe it as 'established in' the USA, that is not the meaning which we have concluded should be attributed to the phrase 'established in' a Contracting State for the purposes of articles 3(1)(o) and 17(1)(b) of the DTA as a matter of UK law.

108. We do not accept that the SRP has a sufficient legal nexus with the USA to support the case that it is 'established in' the USA for relevant purposes. This conclusion follows from our finding above that a US court would not have jurisdiction to exercise primary supervision over the administration of the SRP by virtue of the 'safe harbor' provisions or otherwise.

109. Comparison of the language of the DTA which we are called upon to construe with the language of another double taxation convention (that between Canada and the UK) would be a very unsure basis to reach a conclusion contrary to the one we have reached by reference to directly related materials (particularly the Exchange of Notes) and we reject it.

110. We do not accept that the purpose of the exemption under article 17(1)(b) of the DTA is to provide equal treatment for pensioners resident in either Contracting State with regard to the taxation of pension income. It is, as we discern it, to give exemption in both Contracting States to pension income which the parties to the DTA have chosen to exempt from income taxation under their respective domestic laws because they are schemes operated principally to administer or provide pension or retirement benefits, etc.

111. We accept Mr Yates's submissions on the DTA Issue for the reasons he advanced and decide in consequence that the SRP falls outside the definition of

'pension scheme' in article 3(1)(o) of the DTA, and that Mr Macklin is not entitled to rely on article 17(1)(b) of the DTA in relation to pension income derived by him from the SRP. We dismiss his appeal on this basis accordingly.

The TMA Issue

112. It is therefore necessary for us to decide whether HMRC are entitled to make a discovery assessment on Mr Macklin under section 29 TMA in respect of the year 2003/04.

113. The relevant facts are included in our findings above.

114. To recapitulate, the assessment in respect of the year 2003/04 was raised on 3 March 2010, to reverse the effect of the repayment of tax made by HMRC to Mr Macklin in response to the claim in that regard made in TW's letter dated 21 April 2009. HMRC accept that the assessment was made outside the ordinary time limit provided by section 34 TMA and that the condition for the application of the extended time limit under section 36(1) TMA (6 years from the end of the year of assessment concerned) must be satisfied. That condition is that the loss of income tax sought to be cured by the assessment must have been brought about carelessly.

115. Mr Yates submits that the assessment was not in any event a discovery assessment and so it is unnecessary for HMRC to prove that a discovery has been made within section 29(1) TMA or that the condition in section 29(5) TMA was satisfied. That condition is as follows:

> '… at the time when an officer of the Board-
>
> > (a) ceased to be entitled to give notice of his intention to enquire into the taxpayer's return under section 8 or 8A [TMA] in respect of the relevant year of assessment; or
> >
> > (b) informed the taxpayer that he had completed his enquiries into that return,
>
> the officer could not have been reasonably expected, on the basis of the information made available to him before that time, to be aware of [the loss of tax sought to be assessed].'

116. Mr Yates submits that section 788(7) ICTA provided power to make the assessment – within the time limits provided by sections 34 and 36 TMA. Section 788(7) ICTA is relevantly in the following terms:

> '(7) Where-
>
> > (a) under any [double taxation convention] relief may be given, either in the United Kingdom or in the territory in relation to which the arrangements are made, in respect of any income … and
> >
> > (b) it appears that the assessment to income tax … made in respect of the income … is not made in respect of the full amount thereof, or is incorrect having regard to the credit, if any, which falls to be given under the arrangements,
>
> any such assessments may be made as are necessary to ensure that the total amount of the income … is assessed, and the proper credit, if any, is given in respect thereof …'

117. Mr Yates accepts that the assessment made for the year 2003/04 identifies itself as having been made under section 29 TMA but submits that this is not determinative and, in any event, it is open to HMRC to rely on section 114 TMA, which is relevantly in the following terms:

> '(1) An assessment … which purports to be made in pursuance of any provision of the Taxes Acts shall not be quashed, or deemed to be void or voidable, for want of form, or be affected by reason of a mistake, defect or omission therein, if the same is in substance and effect in conformity with or according to the intent and meaning of the Taxes Acts, and if the person or property charged or intended to be charged or affected thereby is designated therein according to common intent and understanding.
>
> (2) An assessment … shall not be impeached or affected-
>
> (a) by reason of a mistake therein as to-
>
> (i) the name or surname of a person liable, or
>
> (ii) the description of any profits or property, or
>
> (iii) the amount of the tax charged, or
>
> (b) by reason of any variance between the notice and the assessment …'

118. But in any event, Mr Yates seeks to meet the case that the requirements of section 29 TMA as to there having been a discovery and the conditions of section 29(5) being satisfied, as follows.

119. He submits that what is required is the discovery of an insufficiency of tax, although not necessarily its precise extent (*Langham v Veltema* [2004] STC 544 at [11]).

120. He also submits that a discovery can occur despite there being no new facts or a changed view of the law. A new inspector simply taking a different view from his predecessor is sufficient (*Cenlon Finance Co Ltd v Ellwood* [1962] AC 783 at 794).

121. He submits that 'discover(s)' in the context of section 29 TMA means 'comes to the conclusion', 'has reason to believe' or 'finds' or 'satisfies himself' (*R v Kensington Income Tax Commissioners ex p Aramayo* (1913) 6 TC 279) and that similar challenges to 'discover' have failed recently in the cases of *Charlton v HMRC* [2011] SFTD 1160 and *Sanderson v HMRC* [2012] SFTD 1033.

122. As to the condition in section 29(5) TMA, Mr Yates submits that since the claims made on behalf of Mr Macklin were made on 21 July 2008 (and reiterated on 14 January 2009) and 21 April 2009 respectively, they were clearly made after the time when HMRC were entitled to enquire into the 2003/04 year of assessment, and so, plainly, the officer could not have been reasonably expected, on the basis of the information made available to him before that time, to be aware of the loss of tax sought to be assessed. Thus the condition in section 29(5) TMA was satisfied.

123. Mr Yates also submits that the alternative condition (in section 29(4) TMA) was satisfied, namely, that the loss of tax sought to be assessed 'was brought about carelessly … by the taxpayer or a person acting on his behalf'. Specifically, he submits that there was negligent conduct on the part of Mr Macklin or TW. The assessment concerned the claim made on 21 April 2009, which covered the same matters as the claim made on 21 July 2008, which had been rejected by HMRC (in Mr Fitzgerald's letter dated 10 December 2008) and not appealed. The second claim (made on 21 April 2009) failed to mention that the first claim had been rejected and not appealed, and was not addressed to the officer who had dealt with the first claim (Mr Fitzgerald).

124. He adds that, following the approach of Laws LJ in *John Wilkins (Motor Engineers) Ltd v HMRC* [2010] STC 2148 (at [74]), the second claim could be characterised as abusive. Mr Macklin's proper course was to apply for permission to appeal out of time against the rejection of the first claim.

125. He submitted that when a taxpayer is dealing with HMRC minimum standards of behaviour must be observed and this imposed on Mr Macklin and TW an obligation to mention the unppealed rejection of the first claim when the second claim was made.

126. Mr Schwarz submitted that there was no discovery within section 29(1) TMA and therefore HMRC had no power to raise a discovery assessment. HMRC were put fully on notice of Mr Macklin's claim in the correspondence dating from 2008. He submitted that the condition in section 29(5) TMA was not fulfilled.

127. He also submitted that the burden of proving fraud or neglect (or careless or deliberate action) was on HMRC and 'the facts are insufficient to discharge that burden'. Accordingly neither the condition in section 29(4) TMA nor the condition in section 36(1) TMA was satisfied.

128. He submitted that HMRC's case on negligent or careless conduct was flawed because there were not in fact two error or mistake claims made under section 33 TMA. This is because the so-called first claim (i.e. that made on 21 July 2008, although TW asked in the body of their letter that it should be accepted as an error or mistake claim) in fact did not meet the requirements laid down by section 42 TMA (Procedure for making claim etc.). In particular, section 42(1A) TMA requires such a claim to be 'for an amount which is quantified at the time when the claim is made', and TW's letter dated 21 July 2008 did not quantify the relief claimed – unlike TW's letter dated 21 April 2009, which Mr Schwarz submitted constituted a claim in proper form. Mr Schwarz submitted in his Skeleton Argument that HMRC had recognised this in their letter of 21 June 2010, but this is incorrect – that letter made the point that following the refusal of the first claim which had not been appealed, the second claim 'was simply not a valid error or mistake claim'.

129. Mr Schwarz submitted that the fact that the first claim was not expressly drawn to HMRC's attention at the time when the second claim was made did not prove negligent or careless conduct on the part of Mr Macklin or TW. First, TW's letter

dated 14 January 2009 had made it clear that Mr Macklin and TW disagreed with HMRC's rejection of the first claim and would persist in claiming the benefit of the DTA. Mr Schwarz reminded us that the second claim (on 21 April 2009) went to the same Cardiff address as the earlier correspondence and Mr Macklin's name and tax reference number had been included on all correspondence. He submitted that it was reasonable to assume that by the time the second claim was made, the earlier correspondence would have found its way to HMRC's file on Mr Macklin.

The TMA Issue – Discussion and Decision

130. On the view we have taken (in agreement with Mr Yates's submissions) on the DTA Issue, no relief may be given under the DTA. It follows that the conditions precedent for making an assessment under section 788(7) ICTA are not satisfied.

131. Therefore it seems to us that HMRC must show that the conditions in section 29 TMA have been satisfied in relation to the assessment made for the year 2003/04 and that that assessment is indeed a discovery assessment, as Mr Barr indicated to TW in his letter dated 18 January 2010 (and repeated in his letter dated 3 April 2010 covering the notices of the assessments made on that date).

132. Mr Yates's submission that the nature of the assessment (i.e. that it is other than a discovery assessment) can be determined by reference to section 114 TMA falls away following our decision that an assessment under section 788(7) ICTA was not competent. In any event we regard the submission as unattractive. If an assessment is purportedly made pursuant to section 29 TMA, we would expect HMRC to be obliged to show that the conditions in that section were satisfied with regard to it.

133. As to those conditions, we consider it is plain that HMRC have made a 'discovery' within section 29(1) TMA. It newly appeared to Mr Barr, following the repayment made in response to the claim made in TW's letter dated 21 April 2009 that a similar claim had been made earlier (on 21 July 2008) and refused (on 10 December 2008). There obviously was inconsistency within HMRC in dealing with the matter between 2008 and 2010 but, on the authority of *Cenlon Finance*, this does not negate the fact that the first precondition to the application of section 29 TMA – that there should be a discovery – was satisfied. A change of mind within HMRC is enough to constitute a discovery. Mr Schwarz's point that HMRC had no power to make a discovery assessment because they had been put fully on notice of Mr Macklin's claim in the correspondence dating from 2008 must be rejected.

134. Section 29(3) TMA provides that nevertheless a discovery assessment cannot be made unless either the condition in section 29(4) or the condition in section 29(5) is satisfied.

135. The condition in section 29(4) refers to the loss of tax being brought about by the fraud or neglect, or deliberate or careless conduct, of the taxpayer or a person acting on his behalf.

136. The condition in section 29(5) refers to a situation where the loss of tax is not brought about by deliberate or careless conduct, but where at the latest time when an

officer of HMRC could take action to enquire into a return he could not have been reasonably expected on the basis of the information by then made available to him to be aware of the loss of tax.

137. Dealing first with the condition in section 29(5), the latest time when an officer of HMRC could take action to enquire into Mr Macklin's return for the year of assessment 2003/04 predated the provision of any information to HMRC in relation to Mr Macklin's claim under the DTA – which was first intimated in TW's letter dated 21 July 2008. We can therefore see no basis on which to conclude that the condition in section 29(5) TMA was not satisfied.

138. Dealing next with the condition in section 29(4), we consider whether or not the loss of income tax sought to be cured by the assessment in relation to the year 2003/04 made on 3 March 2010 was brought about by carelessness on the part of Mr Macklin or TW.

139. We consider that it was carelessness on the part of TW not to mention in their letter dated 21 April 2009 that the claim made on that date had in effect been made and refused in the correspondence in 2008. That was, at the very least, information relevant to the later claim which should have been given to HMRC when the later claim was made. Indeed it appears to us that HMRC are correct in their submission that the later claim was abusive, and the proper course, if Mr Macklin had decided that he wished to pursue the matter in the face of HMRC's refusal of 10 December 2008, was to seek to bring an appeal out of time against that refusal.

140. The facts prayed in aid by Mr Schwarz, that TW in their letter dated 14 January 2009 had made it clear that the claim would be persisted in, and that the second claim was sent to the same address as the first claim, and that Mr Macklin's name and tax reference number had been included on all the correspondence does not, in our judgment, cure the carelessness of sending in a second claim – not for the attention of Mr Fitzgerald, the officer who had refused the first claim – without reference to the refusal of the first claim.

141. We cannot accept that any technical aspect of the first claim which meant that it was not a claim made in accordance with the procedure provided for by section 42 TMA affects the matter. We are satisfied that the circumstances in which the second claim was made – without reference to the refusal of the first claim – brought about the loss of tax in respect of which the assessment was made on 3 March 2010. Therefore we conclude that the condition in section 29(4) TMA was satisfied in relation to the assessment, as well as the condition in section 29(5).

142. We therefore decide the TMA Issue in favour of HMRC and dismiss the appeal.

Costs

143. Mr Schwarz applied to us to consider making an order in respect of costs against HMRC on the basis that they had acted unreasonably in defending or conducting the proceedings (rule 10(1)(b), Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009 ("the Rules"). It is to be noted that this appeal was

allocated as a Complex case under rule 23 of the Rules and Mr Macklin had made a timeous written request to the Tribunal that the proceedings be excluded from potential liability for costs under rule 10(1)(c).

144. The basis on which Mr Schwarz's application was made was that HMRC had acted unreasonably in requiring extensive expert evidence of US law to be adduced in the appeal. Mr Schwarz submitted that this had been a disproportionate approach, having regard to the relatively modest amounts of tax at issue.

145. We dismiss the application. We have regard to the overriding objective of the Rules, which require us to deal with cases fairly and justly and, in particular, to deal with cases in ways which are proportionate to the importance of the case, the complexity of the issues, the anticipated costs, and the resources of the parties (rule 2(1) and (2)(a)).

146. Although relatively modest amounts of tax are at issue in this appeal, we were informed that there were other cases where the same or similar issues were raised. Apart from this, the interpretation of the expression 'established in' a Contracting State for the purposes of the DTA seems to us to be a point of general importance for HMRC, which they may reasonably require to litigate with the advantage of full expert evidence on US law. We have seen no reason to conclude that HMRC have acted unreasonably in defending or conducting these proceedings.

Applications for permission to appeal this Decision

147. 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 "Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)" which accompanies and forms part of this decision notice.

JOHN WALTERS QC
TRIBUNAL JUDGE

RELEASE DATE: 10 October 2013