Easter Term
[2020] UKSC 22
On appeal from: [2018] EWCA Civ 2544

JUDGMENT

Fowler (Respondent) *v* Commissioners for Her Majesty's Revenue and Customs (Appellant)

before

Lord Hodge, Deputy President
Lady Black
Lord Briggs
Lady Arden
Lord Hamblen

JUDGMENT GIVEN ON

20 May 2020

Heard on 24 March 2020

Appellant	*Respondent*
Akash Nawbatt QC Colm Kelly (Instructed by HMRC Solicitor's Office (Salford))	Jonathan Schwarz (Instructed by KPMG LLP (London))

LORD BRIGGS: (with whom Lord Hodge, Lady Black, Lady Arden and Lord Hamblen agree)

Introduction

1. Mr Martin Fowler is a qualified diver, resident in the Republic of South Africa. During the 2011/12 and 2012/13 tax years he undertook diving engagements in the waters of the UK Continental Shelf. Although his status has yet to be determined, the preliminary issue which is the subject of this appeal requires it to be assumed that he undertook those engagements as an employee, rather than as a self-employed contractor.

2. HMRC claim, but Mr Fowler denies, that the income which he earned from those diving engagements is subject to UK taxation. That depends on how the double taxation treaty between the UK and South Africa ("the Treaty") applies to a person in his position. In a nutshell, the Treaty provides for employment income to be taxed in the place where it is earned, in the present case in the UK, but for the earnings of self-employed persons to be taxed only where they are resident, in Mr Fowler's case in South Africa. Thus far the answer might appear to be simple. If (as is to be assumed) Mr Fowler was an employee, then he should be taxable only in the UK.

3. But the matter is complicated by two factors. The first is that employed divers doing the particular kind of diving work in UK waters which Mr Fowler did are, under UK tax law, to be treated as if they were self-employed for income tax purposes. The second is that terms used in the Treaty, if not defined in the Treaty itself, are to be given the meaning which they have in the tax law, or the general law, of the state seeking to recover tax, here the UK. Thus, if the effect of the UK tax law's requirement to treat Mr Fowler as if he was self-employed is to govern the meaning of relevant terms in the Treaty, the outcome might be that he was to be treated as self-employed under the Treaty, and therefore taxable, if at all, in South Africa.

4. This was the conclusion of the majority in the Court of Appeal, from which HMRC appeals to this court. In fact, such an outcome could mean that Mr Fowler was not taxable in either country, because the question whether he was taxable in South Africa would not be governed by the meaning of Treaty terms established by reference to UK tax law. He would probably be treated in South Africa as an employee. To the extent that domestic South African tax legislation did not tax the earnings of residents employed abroad he would not be taxable there or in the UK. There is no general provision in this Treaty, as there is in many others, to deal with

what is called "double non-taxation". But the question whether South Africa did tax the earnings of its residents employed abroad was not investigated in these proceedings so it would be inappropriate to place any weight on this consideration in construing the Treaty.

The Treaty

5. The Double Taxation Treaty between the UK and South Africa takes the form of a Convention (and is described in the Treaty as "the Convention") which came into force in the UK by means of the Double Taxation Relief (Taxes on Income) (South Africa) Order 2002 (SI 2002/3138), being annexed to the order in the form of a Schedule. Its preamble recites that it had been agreed for the purpose of promoting and strengthening the economic relations between the two countries, avoiding double taxation and preventing fiscal evasion. For present purposes the most relevant provisions are as set out below. Other provisions will be mentioned in due course.

6. Article 1 headed "Persons Covered" provides that:

> "This Convention shall apply to persons who are residents of one or both of the Contracting States."

Article 2 headed "Taxes Covered" provides in paragraph (1) that:

> "This Convention shall apply to taxes on income and on capital gains imposed on behalf of a Contracting State or of its political subdivisions, irrespective of the manner in which they are levied."

7. Article 3 is a definition provision. Paragraph (1) contains a number of specific definitions, some exclusive and some non-exclusive, and all under the preamble "unless the context otherwise requires". Only three need be quoted.

> "(d) the term 'business' includes the performance of professional services and of other activities of an independent character; …
>
> (g) the term 'enterprise' applies to the carrying on of any business; …

> (h) the terms 'enterprise of a Contracting State' and 'enterprise of the other Contracting State' mean respectively an enterprise carried on by a resident of a Contracting State and an enterprise carried on by a resident of the other Contracting State; …"

There is no definition of employment.

8. Article 3(2) is all-important:

> "As regards the application of the provisions of this Convention at any time by a Contracting State, any term not defined therein shall, unless the context otherwise requires, have the meaning that it has at that time under the law of that State for the purposes of the taxes to which this Convention applies, any meaning under the applicable tax laws of that State prevailing over a meaning given to the term under other laws of that State."

9. Looking at article 3 as a whole, the following points may be noted. First, paragraph (2) provides an "always speaking" means of ascertaining the meaning of terms in the Treaty which are undefined therein. It is always speaking because it requires meaning to be ascertained by reference to the national law of a Contracting State "at that time", that is at the time when the Treaty falls to be applied. Secondly, the "terms" of the Treaty which fall to be given meaning for the purposes of this appeal are "employment", "business" and "enterprise". "Employment" is not a defined term, so that article 3(2) applies to it with full force. But "enterprise" is defined, and "business" has a partial definition, in both cases in article 3(1).

10. Article 7 is concerned with business profits. Its relevant provisions are as follows:

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

> (6) Where profits include items of income or capital gains which are dealt with separately in other articles of this Convention, then the provisions of those articles shall not be affected by the provisions of this article."

11. Applying the definitions in article 3(1) quoted above, if Mr Fowler had been, within the meaning of the Treaty, carrying on an enterprise by his diving activities on the UK continental shelf, it would nonetheless have been an enterprise of South Africa and the profits taxable (if at all) there. This is because it is common ground that he had no permanent establishment in the UK.

12. Article 14 is about income from employment. It is only necessary to consider paragraph (1):

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

It is to be noted that article 14(1) does not prohibit the state in which an employee is resident from taxing him on his income earned abroad. It merely permits (but does not require) the state where he is working to tax him. In such a case article 21 then avoids double taxation, by requiring the state where the employee is resident to give credit for the tax paid in the state where he works. Nonetheless states may choose, in certain circumstances, not to tax resident employees on all or part of their foreign earnings.

13. Article 17 deals with pensions and annuities. Paragraph (1) provides that:

> "Subject to the provisions of paragraph (2) of article 18 of this Convention:
>
> (a) pensions and other similar remuneration paid in consideration of past employment, and
>
> (b) any annuity paid,

> to an individual who is a resident of a Contracting State shall be taxable only in that State."

14. Articles 7, 14 and 17 illustrate one of the main methods by which the Treaty seeks to avoid double taxation, namely by identifying specific categories of income (or profits) and providing for each to be taxable in one or other Contracting State. Thus employment income is taxed where it is earned, whereas business profits are (subject to the rules about permanent establishment) taxable where the relevant business enterprise is resident. By contrast with employment income, pensions are taxable where the employee is resident.

15. The other main method by which double taxation is avoided is by requiring credit to be given by one contracting state for tax charged or paid in the other. Article 21 headed "Elimination of Double Taxation" is the main provision to this effect. Article 24 headed "Mutual Agreement Procedure" enables a taxpayer to raise an objection to double taxation, leading to resolution by discussion between the competent tax authorities of both states. Finally, the recited objective of dealing with tax evasion is dealt with by provisions for exchange of information and mutual assistance in tax collection in articles 25 and 25A (as, respectively, substituted and inserted by the Schedule to the Double Taxation Relief and International Tax Enforcement (South Africa) Order 2011 (SI 2011/2441)).

16. Guidance as to how the Treaty is to be interpreted as a whole is to be found in the Vienna Convention on the Law of Treaties, concluded in May 1969, in OECD commentaries on the OECD Model Tax Convention ("the MTC"), on which the Treaty is based, and in some UK authorities. Beginning with the Vienna Convention, article 31 provides, so far as is relevant, that:

> "1. A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose. …
>
> 4. A special meaning shall be given to a term if it is established that the parties so intended."

17. Articles 7 and 14 of the Treaty have their origin in similar but differently numbered provisions in the MTC. The predecessors of articles 7 and 14 are articles 7 and 15 of the MTC. The OECD Commentary on article 15 notes, at para 8.1, that:

> "It may be difficult, in certain cases, to determine whether the services rendered in a State by an individual resident of another

> State, and provided to an enterprise of the first State (or that has a permanent establishment in that State), constitute employment services, to which article 15 applies, or services rendered by a separate enterprise, to which article 7 applies or, more generally, whether the exception applies."

The Commentary recognises that in different states, the national law may focus on either the form or on the substance of the relationship (paras 8.2 - 8.7). At para 8.7 it is acknowledged that the domestic law of the state applying the MTC is likely to prevail, but subject to two qualifications. The first is that the context may require otherwise (see again para 8.7). This qualification is of course expressly made in article 3(2) of the Treaty. The second qualification (expressed in para 8.11) is that:

> "The conclusion that, under domestic law, a formal contractual relationship should be disregarded must, however, be arrived at on the basis of objective criteria. For instance, a State could not argue that services are deemed, under its domestic law, to constitute employment services where, under the relevant facts and circumstances, it clearly appears that these services are rendered under a contract for the provision of services concluded between two separate enterprises. ... Conversely, where services rendered by an individual may properly be regarded by a State as rendered in an employment relationship rather than as under a contract for services concluded between two enterprises, that State should logically also consider that the individual is not carrying on the business of the enterprise that constitutes that individual's formal employer …"

18. The OECD Commentaries are updated from time to time, so that they may (and do in the present case) post-date a particular double taxation treaty. Nonetheless they are to be given such persuasive force as aids to interpretation as the cogency of their reasoning deserves: see *Revenue and Customs Comrs v Smallwood* (2010) 80 TC 536, para 26(5) per Patten LJ. Existing UK authority gives some relevant general guidance on the interpretation of double taxation treaties. In *Comrs for Her Majesty's Revenue and Customs v Anson* [2015] STC 1777 this court was considering the UK / USA Treaty. It was common ground that article 31 of the Vienna Convention applied. At paras 110-111, giving the leading judgment, Lord Reed said:

> "Article 31(1) of the Vienna Convention requires a treaty to be interpreted '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'. It is accordingly the ordinary

> (contextual) meaning which is relevant. As Robert Walker J observed at first instance in *Memec* [1996] STC 1336 at 1349, 71 TC 77 at 93, a treaty should be construed in a manner which is 'international, not exclusively English'.
>
> [111] That approach reflects the fact that a treaty is a text agreed upon by negotiation between the contracting governments. The terms of the 1975 Convention reflect the intentions of the US as much as those of the UK. They are intended to impose reciprocal obligations, as the background to the UK/US agreements from 1945 onwards makes clear."

19. In the *Smallwood* case the Court of Appeal was considering the UK / Mauritius double tax treaty. At paras 26-29 Patten LJ provided a useful summary of the correct approach to interpretation, largely based on dicta of Mummery J in *Inland Revenue Comrs v Commerzbank AG* [1990] STC 285. The whole passage repays reading, but para 29 is worth quoting in full:

> "As explained earlier, the provisions of the DTA [*the UK / Mauritius double tax treaty*] are given statutory effect in relation to the taxpayers concerned by section 788 TA 1988 [*the Income and Corporation Taxes Act 1988 ("ICTA")*] as a form of relief against what would otherwise be the relevant tax liability under UK law. But the DTA is not concerned to alter the basis of taxation adopted in each of the Contracting States as such or to dictate to each Contracting State how it should tax particular forms of receipts. Its purpose is to set out rules for resolving issues of double taxation which arise from the tax treatment adopted by each country's domestic legislation by reference to a series of tests agreed by the Contracting States under the DTA. The criteria adopted in these tests are not necessarily related to the test of liability under the relevant national laws and are certainly not intended to resolve these domestic issues."

Although this passage was about a different treaty implemented under earlier legislation, its description of what the DTA was and was not concerned with is equally applicable to the UK / South Africa Treaty.

The relevant UK tax legislation

20. Tax on the earnings of employees is regulated by the Income Tax (Earnings and Pensions) Act 2003 ("ITEPA"). Section 4 defines "employment", as follows:

> "'Employment' for the purposes of the employment income Parts -
>
> (1) In the employment income Parts 'employment' includes in particular -
>
> (a) any employment under a contract of service,
>
> (b) any employment under a contract of apprenticeship, and
>
> (c) any employment in the service of the Crown.
>
> (2) In those Parts 'employed', 'employee' and 'employer' have corresponding meanings."

21. Sections 6 and 7 of ITEPA deal with employment income (section 6(5) as amended by section 882(1) of, and paragraph 585 of Schedule 1 to, the Income Tax (Trading and Other Income) Act 2005 ("ITTOIA")). The relevant parts are as follows:

> "6. Nature of charge to tax on employment income
>
> (1) The charge to tax on employment income under this Part is a charge to tax on -
>
> (a) general earnings, and
>
> (b) specific employment income.

> The meaning of 'employment income', 'general earnings' and 'specific employment income' is given in section 7. …
>
> (5) Employment income is not charged to tax under this Part if it is within the charge to tax under Part 2 of ITTOIA 2005 (trading income) by virtue of section 15 of that Act (divers and diving supervisors).
>
> 7. Meaning of 'employment income', 'general earnings' and 'specific employment income'.
>
> (1) This section gives the meaning for the purposes of the Tax Acts of 'employment income', 'general earnings' and 'specific employment income'."

There follow detailed and precise definitions of each of those terms, the detail of which does not matter. The Tax Acts referred to in section 7(1) include ITEPA and ITTOIA.

22. Section 5 of ITTOIA contains the primary charging provision on trading profits, in the simplest possible terms:

> "5. Charge to tax on trade profits
>
> Income tax is charged on the profits of a trade, profession or vocation."

23. Section 15, dealing with the income of certain divers and diving supervisors is central to this appeal. It provides:

> "15 Divers and diving supervisors
>
> (1) This section applies if -
>
> (a) a person performs the duties of employment as a diver or diving supervisor in the United Kingdom or in any area designated by

> Order in Council under section 1(7) of the Continental Shelf Act 1964 (c 29),
>
> (b) the duties consist wholly or mainly of seabed diving activities, and
>
> (c) any employment income from the employment would otherwise be chargeable to tax under Part 2 of ITEPA 2003.
>
> (2) The performance of the duties of employment is instead treated for income tax purposes as the carrying on of a trade in the United Kingdom.
>
> (3) For the purposes of this section the following are seabed diving activities -
>
> (a) taking part as a diver in diving operations concerned with the exploration or exploitation of the seabed, its subsoil and their natural resources, and
>
> (b) acting as a diving supervisor in relation to any such diving operations."

24. Certain points about section 15 are plain, and common ground. First, it only applies to a particular class of employed divers, whose employment income would otherwise be taxable under ITEPA. Secondly, the types of divers covered are defined by reference to a particular kind of diving, and only if undertaken in UK or related waters. Thirdly, it may therefore apply only to part of the activities of divers under a particular contract of employment, since they might also be engaged to do other types of diving as well, or diving of the specified type in other waters.

25. The reason for this particular tax treatment of this class of divers was a matter of some debate in submissions before this court. But the FtT found that it was because, at least at the time of the enactment of the precursor to section 15, section 29 of the Finance Act 1978, this class of divers commonly incurred their own costs, and therefore deserved the more generous expenses regime afforded to the self-employed, by comparison with employees. The FtT relied on an opinion to that effect published by the Office of Tax Simplification in March 2011, in preference

to broader but less persuasive observations by the Financial Secretary to the Treasury in February 1978 when announcing the intention to introduce section 29: Hansard (HC Debates), 3 February 1978, written answers, col 359. There is no good reason to doubt that essentially factual finding by the FtT. It is clear that it was not a purpose of the deeming provision in section 15(2) to resolve some legal or factual uncertainty about whether such divers were genuinely employed or self-employed. On the contrary, section 15 applies only to employed divers.

26. ITTOIA contains two other deeming provisions similar to section 15(2), in section 9(1) relating to farming and market gardening and in section 12(2) relating to the profits of mines and quarries. But neither of these provisions, or their underlying purposes, shed useful light on the issues in this appeal.

Deeming provisions

27. There are useful but not conclusive dicta in reported authorities about the way in which, in general, statutory deeming provisions ought to be interpreted and applied. They are not conclusive because they may fairly be said to point in different directions, even if not actually contradictory. The relevant dicta are mainly collected in a summary by Lord Walker in *DCC Holdings (UK) Ltd v Revenue and Customs Comrs* [2011] 1 WLR 44, paras 37-39, collected from *Inland Revenue Comrs v Metrolands (Property Finance) Ltd* [1981] 1 WLR 637, *Marshall v Kerr* [1995] 1 AC 148; 67 TC 56 and *Jenks v Dickinson* [1997] STC 853. They include the following guidance, which has remained consistent over many years:

> (1) The extent of the fiction created by a deeming provision is primarily a matter of construction of the statute in which it appears.
>
> (2) For that purpose the court should ascertain, if it can, the purposes for which and the persons between whom the statutory fiction is to be resorted to, and then apply the deeming provision that far, but not where it would produce effects clearly outside those purposes.
>
> (3) But those purposes may be difficult to ascertain, and Parliament may not find it easy to prescribe with precision the intended limits of the artificial assumption which the deeming provision requires to be made.
>
> (4) A deeming provision should not be applied so far as to produce unjust, absurd or anomalous results, unless the court is compelled to do so by clear language.

(5) But the court should not shrink from applying the fiction created by the deeming provision to the consequences which would inevitably flow from the fiction being real. As Lord Asquith memorably put it in *East End Dwellings Co Ltd v Finsbury Borough Council* [1952] AC 109, at 133:

> "The statute says that you must imagine a certain state of affairs; it does not say that having done so, you must cause or permit your imagination to boggle when it comes to the inevitable corollaries of that state of affairs."

Analysis

28. Mr Jonathan Schwarz for Mr Fowler persuaded a majority of the Court of Appeal (Henderson and Baker LJJ), and has sought to persuade this court, that section 15 of ITTOIA compels us to treat a qualifying diver as carrying on a trade for all purposes under UK income tax law and therefore also under the Treaty as required by article 3(2), with the result that article 7 rather than article 14 applies to the taxation of his earnings. As Henderson LJ put it in the Court of Appeal at para 38:

> "What, then, is the state of affairs which section 15(2) requires us to imagine? In my judgment there can be no room for doubt about the answer to this question. It is that the relevant duties of Mr Fowler's actual employment are instead to be treated for income tax purposes as the carrying on of a trade in the UK. Accordingly, in the imaginary world which we have to enter, the actual earnings of Mr Fowler from his employment must instead be regarded as profits (or, more accurately, as receipts which form part of a computation of trading income) of the trade which he is now deemed to have carried on. It follows that this deemed trade is the only source, for income tax purposes, from which taxable income can arise to Mr Fowler in respect of his relevant activities."

29. Like Lewison LJ and Marcus Smith J in the Upper Tribunal I have, with respect, reached the opposite conclusion. My reasons follow. The starting point is that the question which of articles 7 and 14 of the Treaty applies to Mr Fowler's diving activities depends upon the true construction of those articles, in the context of the Treaty as a whole and its purposes, with the meaning of terms within those articles ascertained as required by article 3(2) by reference to UK income tax law. The relevant terms are, in article 7, "profits" and "enterprise of a contracting state"

and, in article 14, "salaries, wages and other similar remuneration" and "employment".

30. Nothing in the Treaty requires articles 7 and 14 to be applied to the fictional, deemed world which may be created by UK income tax legislation. Rather they are to be applied to the real world, unless the effect of article 3(2) is that a deeming provision alters the meaning which relevant terms of the Treaty would otherwise have. This much is confirmed by paragraph 8(11) of the OECD Commentary quoted above, and it would be contrary to the requirement to treat the Treaty as a bilateral international agreement to do otherwise, as required by the dicta in the *Anson* case. Were it not for section 15 of ITTOIA, there would be no doubt that article 14, not article 7, would apply to Mr Fowler's diving activities, at least on the necessary but as yet untested assumption that he really was an employee. The meaning of "employment" is laid down in section 4 of ITEPA, and his remuneration plainly constitutes employment income within sections 6 and 7. UK tax law would not regard him as making profits from a trade, or his business as being that of an establishment.

31. So the question is whether section 15 gives a different meaning to the relevant terms. That is not how a deeming provision works generally, nor does section 15(2) in particular. Section 15(1) uses "employment" and "employment income" in exactly the same way as is prescribed by sections 4, 6 and 7 of ITEPA, and the phrase "performance of the duties of employment" in section 15(2) again uses "employment" in the same way. Section 15 is about the taxation of income arising from the performance of those duties of employment but, introduced by the word "instead", provides that the income is to be taxed as if, contrary to the fact, it was profits of a trade.

32. Section 15 also uses "trade" in its conventional sense and does not therefore alter the meaning of "enterprise" in article 7, it being common ground that enterprise is descriptive of a business, and that business includes trade. In short, nothing in section 15 purports to alter the settled meaning of the relevant terms of the Treaty, viewed from the perspective of UK tax law. Rather it takes the usual meaning of those terms as its starting point, and erects a fiction which, applying those terms in their usual meaning, leads to a different way of recovering income tax from qualifying divers.

33. Furthermore section 15 creates this fiction not for the purpose of deciding whether qualifying employed divers are to be taxed in the UK upon their employment income, but for the purpose of adjusting how that income is to be taxed, specifically by allowing a more generous regime for the deduction of expenses. This appears clearly from the express language of section 6(5) of ITEPA, which recognises that the income being charged to tax under section 15 is indeed

employment income. If one asks, as is required, for what purposes and between whom is the fiction created, it is plainly not for the purpose of rendering a qualifying diver immune from tax in the UK, nor adjudicating between the UK and South Africa as the potential recipient of tax. It is for the purpose of adjusting the basis of a continuing UK income tax liability which arises from the receipt of employment income. Therefore to apply the deeming provision in section 15(2) so as to alter the meaning of terms in the Treaty with the result of rendering a qualifying diver immune from UK taxation would be contrary to its purpose. It would also produce an anomalous result.

34. Nor should article 3(2) of the Treaty be construed so as to bring a qualifying diver within article 7 rather than article 14. To do so would be contrary to the purposes of the Treaty. This is because, as is recognised by article 2(1), the Treaty is not concerned with the manner in which taxes falling within the scope of the Treaty are levied. Section 15, understood in the light of section 6(5) of ITEPA, charges income tax on the employment income of an employed diver, but in a particular manner which includes the fiction that the diver is carrying on a trade.

35. For those reasons I would allow this appeal.