TC03360

Appeal number: TC/2011/09374

INCOME TAX – Employment Income –appeal against HMRC's refusal to issue NT (nil-tax) PAYE code - pilot resident in UK working for Hong Kong airline and subject to tax in Hong Kong – whether application of UK / Hong Kong Double Taxation Agreement had effect that only Hong Kong had taxing rights over appellant's remuneration– no - whether remuneration not subject to PAYE regime because of territorial limitations – no- appeal dismissed in principle

FIRST-TIER TRIBUNAL
TAX CHAMBER

RUSSELL FRYETT **Appellant**

- and -

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

TRIBUNAL: JUDGE SWAMI RAGHAVAN
MR WILLIAM HAARER

Sitting in public at Exeter Magistrates Court on 12 September 2013

Stephen Mills, tax adviser of Havant Tax Ltd for the Appellant

Jonathan Davey, counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

Introduction

1. The appellant is an airline pilot who is resident in the UK and who flies on international routes for a Hong Kong airline, Cathay Pacific and is subject to Hong Kong tax on his employment remuneration. The appellant applied to HMRC for a NT (nil-tax) PAYE code on the basis that under the special provisions within the double taxation treaty between Hong Kong and the UK ("the DTA") which cover pilots of aircraft operating in international traffic the UK has no taxing rights over the remuneration. This is the case, the appellant argues, even though the appellant is UK resident for tax purposes. His employment is based in Hong Kong and his duties are performed almost entirely outside the UK. Further, while Cathay Pacific have operations in the UK, the appellant has nothing do with these and deals directly with the Hong Kong base in relation to all matters relating to his duties and HR. He is not employed by an entity in the UK.

2. HMRC disagree. Because the appellant is UK resident for tax purposes he is taxed on his worldwide income. It is irrelevant where his duties are performed and whether his employer is UK or Hong Kong based. The provisions of the DTA do not preclude the UK from having taxing rights on that employment income and there are provisions in the DTA which envisage that the same income may be taxed by both Hong Kong and the UK but then provide for relief against double taxation through allowing the foreign tax to be credited against the other country's tax. The conditions set out in the legislation for HMRC to determine the appellant has an NT PAYE code are not satisfied. The appellant's remuneration is chargeable to UK tax.

3. The decision in this appeal relates to Mr Fryett's PAYE code for the tax year 2011/12. While we understand from the appellant that there are a number of pilots working for the same airline for whom the outcome of this appeal will be of interest (on the basis their circumstances are materially similar to Mr Fryett's) we were not made aware that any appeals from such pilots had been notified to the Tribunal. In the absence of other cases or proceedings having been started by the other pilots before the Tribunal, the issue of whether a direction on a lead case arrangement should be directed (whether under Rule 5 or Rule 18 of the Tribunal's Rules) did not arise.

Evidence

4. We heard oral evidence from the appellant, Mr Fryett, which was cross-examined by HMRC. Mr Fryett also answered the Tribunal's questions. We found Mr Fryett to be a credible witness. While a witness statement had been filed by Mr Fryett in advance of the hearing this was made up mainly of matters which amounted to legal arguments. We have therefore considered those as part of our consideration of the appellant's arguments. The appellant had originally sought to include evidence from another pilot as to that pilot's circumstances. We indicated that given Mr Fryett was giving evidence; it seemed to us that he would be better placed to give evidence

relevant to his circumstances. (Relying on the other pilot's evidence would entail having to ask the Tribunal to infer that the evidence of the other pilot as to his circumstances would tell us relevant matters about Mr Fryett's circumstances.) The appellant did not bring forward the evidence from the other pilot. The appellant also sought to put in evidence from Elaine Wood, a tax consultant. This was described as expert evidence but contained matters of legal opinion (it considered evidence and facts put to her and gave her views on how those should be interpreted under the law). We refused to allow this in as evidence. To the extent the statement contained within it matters of legal argument we considered these as part of the appellant's case.

5. We also had before us various files of documents which included correspondence between the parties, and a completed HMRC P46(Expat) form. In the course of the hearing the appellant also put forward a document which sought to set out excerpts and commentary on double taxation agreements between various other countries.

Facts

6. The appellant is a pilot with the Hong Kong based international airline, Cathy Pacific Airways. The airline has various corporate entities and operations which in Hong Kong include Cathay Pacific Airways Limited, a Hong Kong limited company with a registered office in Hong Kong.

7. It was not in dispute that the appellant was UK resident for tax purposes in the period relevant to this appeal. Since January 2011 he has lived in Devon, in a property outside Exeter, which he has owned since 1999. He is married and lives with his wife there.

8. From 1 January 2011 the appellant started working on the London Heathrow to Hong Kong route. Prior to that date he was rostered from Amsterdam.

9. The appellant's typical work day (following the change in working arrangements on 1 January 2011) was as follows. After getting up he packs his uniform, drives to London Heathrow. He uses the staff car park at Terminal 3. He goes through security as foreign air crew using his Hong Kong air card. He goes through to the aircraft and his duties begin there. There is 1 hour of preparation, the aircraft is fuelled and loaded with cargo. The flight departs over the Baltic, Russia, China and then on to Hong Kong. Once in Hong Kong he has training duties or flights to other destinations in Asia. He estimates his time in UK airspace is 5% of his flying duties and that approximately 90% of his flying time is outside of the EU. He rarely travels as a passenger (around 2-3 times a year). The appellant told us he needs to know about airline conventions relating to criminal law and hijacking as he is the arbiter of law onboard. On board the law of the state of the registration is adhered to. Once he steps on board the aircraft he regards himself as being on Hong Kong territory. He does not regard himself as having any duties in the UK, only days off there.

Employment terms / salary

10. The appellant received a new contract upon no longer being rostered from Amsterdam. We did not have the contract before us. The appellant told us his contract was the same as the one he had before but with minor changes to ensure minimum compliance with UK law, maternity leave, health and safety etc.

11. The appellant deals with the Hong Kong office on every issue to do with his duties, including, rostering, training, and use of flight simulators. His immediate superior, the director of flight operations sits on a board of directors in Hong Kong.

12. The appellant is paid in sterling into a bank account in the UK. The payroll provider is Morepay. The pay calculation is done by Cathay's Hong Kong Finance Department – this is a basic salary plus variable of 10% depending on how many hours have been flown. If he goes over 86 hours then there is excess pay. The Hong Kong office also prepares the tax disclosure to the Hong Kong Inland Revenue Department ("HKIRD"). Hong Kong has a simple self assessment system with currency conversion rates table. He declares his salary in Hong Kong dollars and HKIRD determine the tax. He then pays this by cheque.

13. The appellant described the payslip he received as looking like a UK payslip with a tax code on it.

Cathy Pacific's UK operations

14. Cathay Pacific have operations in the UK including an office in Hammersmith, London. The operation has a call centre for ticketing and booking UK flights. It has its own accounting and HR department. Mr Fryett described it as a big operation with over 100 people in the office. The cabin crew also have an office at Heathrow, which handles their administrative processes (roster and pay). There was no evidence before us to suggest any of these operations took the form of a corporate entity. While for part of the period relevant to this appeal there was in existence an entity called Cathay Pacific Airways (London) Limited with a registered office at 8 Salisbury Square, London EC4Y 8BB the last accounts filed at Companies House were for the period ending 31 December 2009. These accounts did not show any turnover or wages or salaries payments. A liquidator was appointed on 9 August 2011 and the company was dissolved on 20 July 2012.

HMRC P46 (Expat) Form

15. On 7 January 2011 the appellant completed HMRC P46 (Expat) form headed "Employee seconded to work in the UK".

16. The form contained the following instructions:

> For the purposes of this form only, *a seconded employee* includes:
>
> –individuals working wholly or partly in the UK for a UK resident employer on assignment whilst remaining employed by an overseas employer

> – individuals assigned to work wholly or party in the UK at a recognised branch of their overseas employer's business
>
> – all individuals included by an employer within a dedicated expatriate scheme
>
> – all individuals included by an employer within an expatriate modified PAYE scheme

17. Mr Fryett completed Section one "to be completed by employee" with his name, national insurance details and his UK address. Under the heading of "your present circumstances" Mr Fryett ticked the statement in Box A "I intend to live in the UK for more than six months".

18. Section two was headed "to be completed by the employer". This was completed as follows. The date employment started was 01/01/2011. Job title "pilot". The employer's PAYE reference number was given, and under the UK employer name and address the following appeared:

> "Cathay Pacific Airways Ltd, 3 Shortlands, Hammersmith, London, WE 8AQ."

19. Under the section "Tax code used" the entry was "NT".

20. Although Mr Fryett signed section 1 he told us he did not want to sign it but was told by his employer he had to. He regarded himself as having been put under "economic duress" to sign it and wrote and told the employer this.

Hong Kong Inland Revenue ("HKIRD") letter

21. In a letter from HKIRD addressed to the flight operations department at "Cathay City" in Hong Kong dated 6 September 2011 HKIRD stated the following:

> "Location of employment
>
> Having regard to all the relevant factors in your case, the Revenue considers that you have all along held an employment with Cathay Pacific Airways Limited ["CPAL"]. The location of your employment with CPAL since CPAL is an airline registered and based in Hong Kong, and having their principal place of business in Hong Kong. In the circumstances, your income from the employment with CPAL should be wholly assessable to Salaries Tax under section 8(1) of the Inland Revenue Ordinance…"

Law

22. While this case raises issues as to the interpretation of a particular provision of the UK/Hong Kong DTA, the context in which this issue arises is an appeal against HMRC's determination of the appellant's PAYE code.

23. The determination of PAYE codes and the provisions relating to objections and appeals are set out in the Income Tax (PAYE) Regulations 2003 (the "PAYE regulations").

24. Under Regulation 7 of the PAYE Regulations "code" includes "special codes" which amongst other special codes includes under Regulation 7(3)(c) "the nil tax code, which requires no deductions of tax".

25. Regulation 13 requires HMRC to determine the code for use by an employer in respect of an employee for a tax year.

26. Regulation 15(3) sets out the circumstances in which HMRC may determine the code as follows:

> "15—
>
> …
>
> (3) The Inland Revenue may determine that the code for use by an employer in respect of an employee for a tax year is the nil tax code, if—
>
> (a) the employee's PAYE income will be taken into account as taxable income other than PAYE income in any assessment,
>
> (b) the Inland Revenue are not satisfied that the employee's income will be chargeable, or
>
> (c) the Inland Revenue have reason to believe that the employee will be entitled to a deduction under Chapter 6 of Part 5 of ITEPA (deductions from seafarers' earnings) in respect of the employee's PAYE income or so much of it as remains after any deductions under sections 188 to 195 of the Finance Act 2004 (members' contributions).
>
> (4) References in this regulation to an employee's relevant payments, PAYE income and income are references to the payments or income in respect of which the employee's code is being determined for the purposes of the employment in question."

27. An employee who objects to the determination of the code has a right of appeal. This is set out at Regulation 18 of the PAYE Regulations.

> "18—
>
> (1) An employee who objects to the determination of a code must state the grounds of objection.
>
> (2) On receiving the notice of objection the Inland Revenue may amend the determination of the code by agreement with the employee.
>
> (3) If the Inland Revenue and employee do not reach agreement, the employee may appeal … against the determination of the code by giving notice to the Inland Revenue.

(4) On an appeal that is notified to the tribunal, the tribunal must determine the code in accordance with these Regulations."

28. In this matter HMRC determined that the code was not a nil tax code. The appellant appeals against that determination. If the appellant's appeal is successful the code will be determined as nil tax. If HMRC are successful, the parties will seek to agree the code, and if agreement cannot be reached the code will be determined by the Tribunal. The Tribunal could only determine a nil tax code in accordance with Regulation 15(3)(b) of the PAYE Regulations if it is not satisfied that the income will be chargeable to tax.

29. The UK's provisions on taxation of remuneration are set out in the Income Tax (Earnings and Pensions) Act 2003 ("ITEPA"). The relevant provisions are as follows:

"62 Earnings

(1) This section explains what is meant by "earnings" in the employment income Parts.

(2) In those Parts "earnings", in relation to an employment, means

(a) any salary, wages or fee,

…

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".

(2) "Employment income" means—

(a) earnings within Chapter 1 of Part 3,

…

(3) "General earnings" means—

(a) earnings within Chapter 1 of Part 3, or

(b) any amount treated as earnings (see subsection (5)) [not relevant],

excluding in each case any exempt income.

…

10 Meaning of "taxable earnings" and "taxable specific income"

(1) This section explains what is meant by "taxable earnings" and "taxable specific income" in the employment income Parts.

(2) "Taxable earnings" from an employment in a tax year are to be determined in accordance with [Chapters 4 and 5 of this Part—

…

15 Earnings for year when employee UK resident

(1) This section applies to general earnings for a tax year in which the employee is UK resident.

(2) The full amount of any general earnings within subsection (1) which are received in a tax year is an amount of "taxable earnings" from the employment in that year.

(3) Subsection (2) applies whether or not the employment is held when the earnings are received."

30. Part 11 of ITEPA deals with PAYE. The relevant provisions provide as follows:

"682 Scope of this Part

(1) This Part provides for the assessment, collection and recovery of income tax in respect of PAYE income and includes provision in respect of the deduction of certain other amounts from, and the repayment of certain other amounts with, PAYE income.

(2) The provisions of this Part are contained in—

this Chapter (which gives the meaning of "PAYE income"),

Chapter 2 (PAYE: general),

Chapter 3 (PAYE: special types of payer or payee),

Chapter 4 (PAYE: special types of income),

Chapter 5 (PAYE settlement agreements), and

Chapter 6 (miscellaneous and supplemental).

(3) Provision for PAYE regulations is made by Chapters 2 to 6.

683 PAYE income

(1) For the purposes of this Act and any other enactment (whenever passed) "PAYE income" for a tax year consists of—

(a) any PAYE employment income for the year,

…

(2) "PAYE employment income" for a tax year means income which consists of—

(a) any taxable earnings from an employment in the year (determined in accordance with section 10(2)), and

…

684 PAYE Regulations

(1) The Commissioners must make regulations ("PAYE regulations") with respect to the assessment, charge, collection and recovery of income tax in respect of all PAYE income.

…

689 Employee of non-UK employer

(1) This section applies if—

(a) an employee during any period works for a person ("the relevant person") who is not the employer of the employee,

(b) any payment of, or on account of, PAYE income of the employee in respect of that period is made by a person who is the employer or an intermediary of the employer or of the relevant person,

(c) PAYE regulations do not apply to the person making the payment or, if that person makes the payment as an intermediary of the employer or of the relevant person, the employer, and

(d) income tax and any relevant debts are not deducted, or not accounted for, in accordance with the regulations by the person making the payment or, if that person makes the payment as an intermediary of the employer or of the relevant person, the employer.

(1A) Subject to subsection (4), subsection (1)(b) does not apply in relation to a payment so far as the sum paid is employment income under Chapter 2 of Part 7A.

(2) The relevant person is to be treated, for the purposes of PAYE regulations, as making a payment of PAYE income of the employee of an amount equal to the amount given by subsection (3).

(3) The amount referred to is—

(a) if the amount of the payment actually made is an amount to which the recipient is entitled after deduction of income tax and any relevant debts due under the PAYE regulations, the aggregate of the amount of the payment and the amount of any income tax and any relevant debts deductible due, and

(b) in any other case, the amount of the payment.

(4) If, by virtue of any of sections 687A and 693 to 700, an employer would be treated for the purposes of PAYE regulations (if they applied to the employer) as making a payment of any amount to an employee, this section has effect as if—

(a) the employer were also to be treated for the purposes of this section as making an actual payment of that amount, and

(b) paragraph (a) of subsection (3) were omitted.

(5) For the purposes of this section a payment of, or on account of, PAYE income of an employee is made by an intermediary of the employer or of the relevant person if it is made—

(a) by a person acting on behalf of the employer or the relevant person and at the expense of the employer or the relevant person or a person connected with the employer or the relevant person, or

(b) by trustees holding property for any persons who include or class of persons which includes the employee.

(6) In this section and sections 690 and 691 "work", in relation to an employee, means the performance of any duties of the employment of the employee and any reference to the employee's working is to be read accordingly."

31. The appellant argues his PAYE code should be "NT" (nil tax) on the basis that under the DTA concluded between Hong Kong and the UK, the UK does not have taxing rights over his remuneration.

32. The DTA is an agreement between two governments; the Government of the United Kingdom and the Government of the Hong Kong Special Administrative Region of the People's Republic of China.

33. Under s2 of the Taxation (International and other provisions) Act 2010 ("TIOPA"), where Orders in Council are made specifying the arrangements and declaring certain matters, the double taxation arrangements take effect in accordance with the provisions of the Act.

34. The Order in Council which enables the DTA to have effect is the Double Taxation Relief and International Tax Enforcement (Hong Kong) Order 2010 ("the Order"). The DTA appears as a Schedule to that Order.

35. The explanatory note to the Order states:

> "The Arrangements aim to eliminate the double taxation of income or gains in one country and paid to residents of the other country. This is done by allocating the taxing rights that each country has under its domestic law over the same income and gains, and/or by providing relief from double taxation. There are also specific measures which combat discriminatory tax treatment and provide for assistance in international tax enforcement."

36. Article 2 of the Order provides:

> **"2 Double taxation and international tax enforcement arrangements to have effect**
>
> It is declared that—
>
> (a) the arrangements specified in the Agreement set out in Part 1 of the Schedule to this Order and the Protocol set out in Part 2 of that Schedule have been made with the Government of the Hong Kong Special Administrative Region of the People's Republic of China;
>
> (b) the arrangements have been made with a view to affording relief from double taxation in relation to income tax, corporation tax, capital gains tax and taxes of a similar character imposed by the laws of the Hong Kong Special Administrative Region and for the purposes of assisting international tax enforcement; and
>
> (c) it is expedient that those arrangements should have effect."

37. Although the parties' arguments centre on Article 14 it is necessary to set out some of the other articles to put Article 14 in context. Where relevant the DTA as it appears in the Schedule to the Order provides as follows:

"**Article 1**

Persons Covered

This Agreement shall apply to persons who are residents of one or both of the Contracting Parties.

…

Article 3

General Definitions

…

(h) the term "international traffic" means any transport by a ship or aircraft operated by an enterprise of a Contracting Party except when the ship or aircraft is operated solely between places in the other Contracting Party;

…

Article 2

Taxes Covered

(1) This Agreement shall apply to taxes on income imposed on behalf of a Contracting Party or of its political subdivisions or local authorities, irrespective of the manner in which they are levied.

(2) There shall be regarded as taxes on income all taxes imposed on total income, or on elements of income, including taxes on gains from the alienation of movable or immovable property and taxes on capital appreciation.

(3) The existing taxes to which this Agreement shall apply are:

(a) in the case of the Hong Kong Special Administrative Region:

(i) profits tax;

(ii) salaries tax; and

(iii) property tax;

whether or not charged under personal assessment;

(b) in the case of the United Kingdom:

(i) the income tax;

(ii) the corporation tax; and

(iii) the capital gains tax.

…

Article 4

Resident

(1) For the purposes of this Agreement, the term "resident of a Contracting Party" means:

(a) in the case of the Hong Kong Special Administrative Region:

(i) any individual who ordinarily resides in the Hong Kong Special Administrative Region;

(ii) any individual who stays in the Hong Kong Special Administrative Region for more than 180 days during a year of assessment or for more than 300 days in two consecutive years of assessment one of which is the relevant year of assessment;

(iii) a company incorporated in the Hong Kong Special Administrative Region or, if incorporated outside the Hong Kong Special Administrative Region, being centrally managed and controlled in the Hong Kong Special Administrative Region;

(iv) any other person constituted under the laws of the Hong Kong Special Administrative Region or, if constituted outside the Hong Kong Special Administrative Region, being centrally managed and controlled in the Hong Kong Special Administrative Region;

(b) in the case of the United Kingdom, any person who, under the laws of the United Kingdom, is liable to tax therein by reason of his domicile, residence, place of management, place of incorporation or any other criterion of a similar nature. This term, however, does not include any person who is liable to tax in the United Kingdom in respect only of income from sources in the United Kingdom;

…

Article 14

Income from Employment

(1) Subject to the provisions of Articles 15, 17 and 18, salaries, wages and other similar remuneration derived by a resident of a Contracting Party in respect of an employment shall be taxable only in that Party unless the employment is exercised in the other Contracting Party. If the employment is so exercised, such remuneration as is derived therefrom may be taxed in that other Party.

(2) Notwithstanding the provisions of paragraph 1, remuneration derived by a resident of a Contracting Party in respect of an employment exercised in the other Contracting Party shall be taxable only in the first-mentioned Party if:

(a) the recipient is present in the other Party for a period or periods not exceeding in the aggregate 183 days in any twelve-month period commencing or ending in the taxable period concerned, and

(b) the remuneration is paid by, or on behalf of, an employer who is not a resident of the other Party, and

(c) the remuneration is not borne by a permanent establishment which the employer has in the other Party, and

(d) the remuneration is taxable in the first-mentioned Party according to the laws in force in that Party.

(3) Notwithstanding the preceding provisions of this Article, remuneration derived in respect of an employment exercised aboard a

> ship or aircraft operated in international traffic by an enterprise of a Contracting Party may be taxed in that Party."

Parties' submissions

38. These are discussed in more detail in our consideration of the issues in the discussion section below. In essence the appellant argues Article 14(3) of the DTA make special provision for remuneration derived from employment exercised aboard an aircraft operated in international traffic, and allocates taxing rights over the remuneration exclusively to the state of the enterprise operating the aircraft (Hong Kong). The UK is precluded from having taxing rights and there is no basis under the other paragraphs of Article 14 for the UK to have taxing rights.

39. It does not matter that the appellant is UK resident. He does not perform duties in the UK, and his employer is in Hong Kong. He has nothing to do with Cathay's UK operation and should not be subject to PAYE.

40. HMRC say the essential issue is whether Regulation 15(3)(b) of the PAYE regulations applies. HMRC could not be satisfied that the remuneration was not chargeable to tax. Because the appellant is UK resident he is chargeable to tax on his worldwide income. Article 14 of the DTA does not change that position as in the DTA a distinction is made between situations where only one state is allocated taxing rights and where both are allocated taxing rights and any double taxation is resolved through relief or a credit. Article 14(3) enables Hong Kong to tax the remuneration but it does not prevent the UK from also taxing that income.

Discussion

41. The context in which the issue of interpretation of the DTA arises is an objection by the appellant to his PAYE code and in particular HMRC's refusal to issue an NT (nil-tax) code. The basis upon which HMRC may issue such a code is set out in Regulation 15 of the PAYE Regulations. As HMRC identify, the particular focus of that Regulation is Regulation 15(3)(b) (HMRC not satisfied that employee's income will be chargeable).

42. Regulation 15(3)(a) (income taken into account as taxable income other than PAYE income) is not in point as it is not part of appellant's case that the appellant's income is something other than "PAYE income". PAYE income has a specific defined meaning which for present purposes is capable of corresponding to the remuneration of the appellant from his job as a pilot. Regulation 15(3)(c) deals with deductions for seafarers and is not in point.

43. The appellant's primary argument rests on the remuneration not being chargeable to UK tax because under the DTA Hong Kong has the exclusive right to tax that income. The UK cannot tax it too. We deal with that issue first which involves interpreting the provisions of the DTA.

44. In the event the conclusion is that the UK *may* tax the income as well as Hong Kong we must then consider whether the UK legislation *does* tax the income. We

consider here what difference, if any, it makes whether and to what extent the appellant's duties are performed outside the UK, and the relevance or otherwise of whether the appellant's employer is the Hong Kong entity or is an entity in the UK.

Interpretation of the DTA

45. Both parties agree that it is paragraph 3 of Article 14 whose interpretation is at the heart of this appeal.

46. The issue of interpretation is whether when the article states that "remuneration…may be taxed [in the contracting state whose enterprise operates the aircraft]" this precludes the other contracting state from taxing the remuneration. This means, the appellant argues that the UK cannot tax the remuneration. The appellant also gets to the same position by an argument that paragraph 3 of Article 14 is to be viewed as a special rule, a free standing provision, which deals with remuneration in respect of employment exercised on board aircraft in international traffic. The provision does not state anywhere that the other contracting party may also have taxing rights over the remuneration. It follows from this that although paragraph 1 of Article 14 gives taxing rights to the state where the employee is resident this does not apply to the special case of remuneration from employment exercised on board aircraft in international traffic. The reference in paragraph 3 to "notwithstanding the previous provisions of this Article" means that paragraphs 1 and 2 are to be disregarded. There is therefore no provision which gives the UK, as the state where the employee is resident taxing rights over that income.

47. HMRC highlight the difference between the drafting in paragraph 3 and that in paragraph 1 of Article 14. In respect of remuneration derived by a resident of a contracting party paragraph 1 provides it "shall" (as opposed to "may") be taxed only in that party.

48. We begin by observing that HMRC's interpretation is consistent with the ordinary meaning of "shall…be taxable only in…" and "may be taxed in…". In other words "shall…be taxable only in…" means the subject matter cannot also be taxable in another state whereas "may be taxed in…" leaves open the possibility that another state may also tax the subject matter.

49. The appellant refers however to a number of other articles in support of its view that the distinction HMRC draw is not correct and that the "may be taxed in" formulation means the same as the "shall only be taxed" formulation. He argues the DTA is vague and ambiguous and refers to various other articles in the DTA in support of his argument that only Hong Kong has taxing rights over his remuneration.

Relevance of other articles in DTA

50. Article 8 of the DTA states that trading income from operating ships or aircraft in international traffic shall be taxable only in the "operating state" which the appellant says is Hong Kong. The appellant says this result should also apply to the appellant's earnings since he is flying Hong Kong owned, and Hong Kong operated

aircraft for his Hong Kong employer. The appellant argues that for the most part the DTA's articles state that the residence of the employer/ enterprise is the main factor to consider.

51. Article 8 states:

> "Profits of an enterprise of a Contracting Party from the operation of ships or aircraft in international traffic shall be taxable only in that Party."

52. The appellant refers to Article 13 under which gains derived from ships or aircraft in international traffic shall be taxable only in the "operating country". Article 13(3) states:

> "Gains derived by an enterprise of a Contracting Party from the alienation of ships or aircraft operated in international traffic or movable property pertaining to the operation of such ships or aircraft shall be taxable only in that Party."

53. The appellant also refers to Article 17 which under which Hong Kong source pensions shall be liable to Hong Kong tax only. The appellant is employed by a Hong Kong employer – only Hong Kong tax should be levied on the same earnings that would be used to fund Hong Kong pension schemes.

54. Article 17 provides:

> "Pensions and other similar remuneration (including a lump sum payment) arising in a Contracting Party and paid to a resident of the other Contracting Party in consideration of past employment or self-employment and social security pensions shall be taxable only in the first-mentioned Party."

55. We have considered the above articles. However in our view we cannot approach the DTA in the generalised terms the appellant suggests. The DTA lays down a specific allocation of taxing rights for specific subject matter. The treatment set out for specific income or gains applies to what it is stated to apply to. The allocation of taxing rights for a particular type of income cannot be read across to another type of income.

56. We cannot extrapolate from the requirement that profits from, and gains derived from aircraft operating in international traffic are to be taxed only in the state of enterprise, this means that where different language is used in the DTA in relation to remuneration, the remuneration is only taxable in the state of enterprise too. If anything, the fact the contracting parties have not stated the taxing rights are only for the state of enterprise in relation to remuneration highlights that a different effect was intended as those words could easily have been used for paragraph 3 of Article 14 if it was the intention to confer sole taxing rights on the state of enterprise. Similarly in relation to Article 17 we cannot extrapolate from the fact sole rights are given in relation to pension remuneration this means that other remuneration (which under Article 14) has its own particular treatment should be treated similarly and ignore that different wording has been used in Article 14.

57. HMRC's interpretation means that there are some provisions which allocate sole taxing rights to one state but there are others where both states may have taxing rights. That is entirely consistent with the presence of Article 21 which sets out the methods for elimination of double taxation and which envisages that subject to certain provisions a credit for the Hong Kong tax will be allowed against UK tax. (In passing we also note it is consistent with explanatory note to the Order (at [35]) in so far as the note refers to allocating the taxing rights each country has "and/or" by providing relief from double taxation i.e. it is not assumed that allocation of taxing rights and double taxation relief are mutually exclusive ways of furthering the aim of eliminating double taxation.)

58. If the appellant's interpretation were correct and the instances where the agreement referred to income that "may be" taxed by one state were to be interpreted as meaning the income was only to be taxed in that state it is not apparent when a situation of the same income being taxed by both states under the agreement would arise. There would be no apparent need for the prevention of double taxation provisions in Article 21 to apply, as they do on their face, to the employment income of individuals. (The question of double taxation arising through a person being resident in both states for the purposes of the agreement is not within the contemplation of the agreement, given that the "tie breaker" provisions in paragraph 2 of Article 4 mean that for the purpose of the agreement there will in relation to individuals always be only one state in which the individual is resident.)

59. The appellant essentially depicts paragraph 3 of Article 14 as a free standing provision. It does not mention residence anywhere, and it is the state of enterprise which is determinative. The reference to "notwithstanding the preceding provisions" means the preceding provisions are to be ignored.

60. We disagree. The terms "Notwithstanding the preceding provisions" indicate that paragraph 3 is a provision which overrides the provisions which would otherwise apply. It does not necessarily mean the preceding provisions are set aside in their entirety.

61. The terms "Notwithstanding the preceding provisions" serve a purpose because as explained below the elements of paragraph 1 and 2 which allocate sole taxing rights to the state of residence (UK) need to be overridden in order for the state of the enterprise operating the aircraft (Hong Kong) to be given taxing rights.

62. The appellant argues that the term "notwithstanding" means paragraph 1 and paragraph 2 may be "set aside". That is correct insofar as there is a conflict between paragraph 3 and the other provisions. But the conflict is between paragraph 3 saying Hong Kong may tax, and paragraphs 1 and 2 which contain elements which envisage that only the UK may tax.

63. Is it possible to read the reference to "notwithstanding" as also overriding the provisions where taxing rights are available to both the UK and Hong Kong with the effect that taxing rights are only available in Hong Kong as the appellant suggests? We would say no. The language used to express sole taxing rights is very clear. It says

"taxable only" in both paragraphs 1 and 2 in contrast to "may be" taxed. As explained above this is a distinction as a matter of ordinary language, and a distinction which is consistent with the existence of the provisions to eliminate double taxation in Article 21. It is in our view a distinction which must be reflected in the interpretation of the DTA.

64. To the extent paragraphs 1 and 2 envisage that both Hong Kong and UK may tax, there is no conflict with paragraph 3 saying Hong Kong may tax. The reference to "Notwithstanding" does not override the ability of the UK to tax.

65. It is possible to interpret Article 14 so that the term "notwithstanding" in paragraph 3 has some purpose, but also in such a way that meaning is given to the distinction drawn between situations where exclusive taxing rights are allocated, and situations where it is left open for both states to tax the subject matter. We prefer this interpretation (HMRC's) over the appellant's one because although the appellant's interpretation gives a purpose to the term "notwithstanding" it does so in a way which fails to respect the distinction drawn in the drafting between "shall only be taxed" and "may be taxed".

66. We therefore see Article 14 operating as follows (taking the example where the UK is the state of the employee's residence and Hong Kong the state of the enterprise operating the aircraft.) The situations where only the UK may tax arise under paragraph 1 arise where the employee is resident in the UK and the employment is not exercised in Hong Kong. Remuneration derived from employment exercised on board a ship or aircraft operating in international traffic (defined in Article 3) would not necessarily be remuneration in respect of an employment which was exercised in Hong Kong. If it were not for the provisions of paragraph 3 the remuneration which was derived from employment exercised outside of Hong Kong would be taxed solely in the UK. But because of paragraph 3, Hong Kong as the state of enterprise may tax the remuneration.

67. The second part of paragraph 1 (the words following "unless…") provide an exception to the rule set out in the first part where the employment is exercised in Hong Kong. The exception enables both the UK and Hong Kong to have taxing rights when the employment is exercised in Hong Kong. Paragraph 2 provides an "exception to the exception". Taxing rights revert to the UK solely where the conditions of paragraph 2a), b) and c) are fulfilled. So, where for instance, the employee was not present in Hong Kong for sufficient time, the UK would have sole taxing rights over the remuneration. Again paragraph 3 has a role in saying that despite paragraph 2 saying the UK has sole taxing rights Hong Kong may also have rights as the state of the enterprise which operates the aircraft.

68. The appellant highlights the fact that nowhere in paragraph 3 does it say that the UK may also tax the income as the state where the employee is resident.

69. However, the DTA does not say the contracting state where the employee is resident may also tax the remuneration because that proposition is already set out at paragraph 1. It does not need to be restated because as discussed above the

proposition that Hong Kong "may tax" certain income is not inconsistent with the UK also being able to tax that income. If that was what was intended we would expect to see the formulation "shall only be taxable in…" or something similar being used in relation to the remuneration covered by paragraph 3.

70. Once taxing rights are given, we would expect to see clear words to say they are taken away and given to only one state. This is how paragraph 1 and 2 work, giving rights to one state, creating an exception so that both may tax, and then an exception to that exception throwing taxing rights back to only one state if certain conditions are met. Further, it is clear the DTA cannot just be about one state or the other having taxing rights otherwise there would be no need for the provisions giving relief from double taxation.

71. A variant of the appellant's argument is that the formulation "may be taxed" leaves it open to the state in which the employee is resident to tax the remuneration income but only if the other state has not taxed it. In other words the reference to "may be taxed" is to be read as saying either one country or the other may tax but not both. However, this interpretation requires words to be read into the agreement which simply are not there. Further, the point again arises that the fact that there are provisions to eliminate double taxation suggests that "may" is not to be read in this way.

72. It is to be noted (as discussed below) that even where the agreement states the income "shall be taxable only" in one state the agreement does not set out an obligation to impose tax, so where it is stated that certain income is "taxable" it is clear that the state is able to tax the income but does not have to. While it would be open to the UK not to tax the income if it had been taxed by Hong Kong, under the agreement the UK is able to tax the income even if it is taxed by Hong Kong.

73. It follows that we are not persuaded from looking at the terms of the DTA itself that the interpretations the appellant argues for are correct. The appellant has raised a number of other matters relating to materials outside of the agreement itself which it argues are relevant to interpreting the DTA which we now deal with.

Relevance of commentary to OECD model convention

74. The OECD produces a model draft convention with an accompanying explanatory memorandum. The appellant referred to an extract from HMRC's International Manual INTM152070 which in turn refers to the statement of Vinelott J in *Sun Life Assurance Co of Canada v Pearson* (59 TC 310) that the OECD commentary "can and indeed must be referred to as a guide to the interpretation of the agreement". (That extract from *Sun Life Assurance* was actually made "in the light of the House of Lords decision in *Fothergill v Monarch Airlines Ltd.* [1981] AC 251). HMRC accept that the wording in the model convention is materially the same but say that recourse to the commentary is only relevant where there is ambiguity, and there is no ambiguity in the interpretation of Article 14. Irrespective of whether it is correct that ambiguity is required before recourse can be made to the commentary, for the reasons below we do not think the commentary assists the appellant.

75. Article 15 in the model convention deals with income from employment and corresponds in very similar terms to Article 14 of the UK/ Hong Kong DTA. The commentary which the appellant referred us to deals with the situation where under the law of the contracting state tax is levied on remuneration received by non-resident members of the crew in respect of employment aboard ships only if the ship has the nationality of such a state.

> "… states having that taxation principle in their domestic laws may agree bilaterally to confer the right to tax remuneration in respect of employment aboard ships on the State of the nationality of the ship".

76. The actual text of Article 15 of the model convention does not allocate taxing rights by reference to the nationality of the vessel. The above commentary deals with a situation where it is open to the contracting parties to insert a provision by reference to ship nationality if they wish. Article 15 of the model convention allocates taxing rights to the state in which the place of effective management of the enterprise is situated.

77. The main body of the commentary on Article 15 refers to allocation of taxing rights on this basis following the rule in relation to income from shipping, air transport etc. (Article 8 in the model convention). It also points out that in respect of income from air transport, the reasons why states may want to confer the right to tax on the state of the enterprise operating the aircraft would be also valid in respect of remuneration of the crew. (The commentary on Article 8 observes the state of the place where the effective management of the enterprise is situated does not necessarily correspond to the state of residence of the enterprise). The commentary on Article 15 indicates that contracting states are left free to agree on a provision which gives the right to allocate tax rights over Article 15 remuneration to the state of enterprise. This option (of giving taxing rights to the state of enterprise) is the one which most closely reflects the wording of the UK/Hong Kong DTA.

78. We note that none of the commentary on Article 15(3) of the model convention, whether this allocates taxing rights to the state by reference to the place of effective management, the state of the nationality of the vessel, or the state of the enterprise is inconsistent with the other state having taxing rights. While the reference to conferring "the right to tax" uses the singular this is not significant in our view given the wider context of the explanation. It does not suggest to us that there is only one right to tax available to allocate.

79. The commentary on the OECD model convention article which corresponds to Article 14 does not suggest to us that the state other than the state of the enterprise operating the aircraft, in this case the UK, is precluded from having taxing rights.

Relevance of Double Taxation Agreements with other countries

80. The appellant has referred to other DTAs where taxing rights are given only to the state where the enterprise is based. He refers to DTAs between Hong Kong, and Ireland, the Netherlands, Austria, Portugal, New Zealand, France and Spain where a pilot pays tax in Hong Kong and does not pay tax where he is resident. He argues that

if taxing rights are intended to be given to the state of residence then this is specifically provided for and that this has not been done in the UK/Hong Kong DTA.

81. Double taxation agreements are bilateral agreements that must be construed according to their particular terms. They are the product of negotiations between the governments of the two particular contracting states. We approach with caution any suggestion that because one country has worded its DTA with another country in a particular way, the absence of wording or different wording can throw interpretative light on how a DTA negotiated between different countries should be interpreted. This is the case even if the DTA has one party in common. On this basis any insight that may be gained from looking at the UK's other DTAs, or at Hong Kong's other DTAs is immaterial to the matter before us.

82. We note that some of the DTAs the appellant referred us to include DTAs where the DTA makes a point of referring to only the state of enterprise having taxing rights. This only serves to illustrate the point that different DTAs take different approaches. The commonality is that a specific provision is made in relation to remuneration for employment exercised on board aircraft operated in international traffic. Some DTAs on their face allocate taxing rights to the enterprise's state of residence. Some say it is the state of the employee's residence. Some say it is the enterprise's state of residence but only if tax is charged there. Ultimately, the comparisons do not assist and we have to return to the specific provisions in the UK/Hong Kong DTA.

83. The appellant further argues that in relation to other countries where the DTA with Hong Kong uses the same formulation as the UK / Hong Kong DTA one e.g. the Belgium / Hong Kong DTA, the country of residence does not exercise taxing rights.

84. We did not receive evidence which would enable us to make a finding on what the Belgian practice was but even if we were to assume that the Belgian practice is not to tax this is in our view entirely consistent with DTAs allowing states to tax the specified subject matter rather than requiring them to tax it. The state of residence would be allowed to, but not required to, tax the remuneration. It would be open to them to either not tax the remuneration at all, or to tax it only if it were not taxed in the other state (there being no obligation on the state of enterprise to tax the remuneration).

Relevance of statements in HMRC's manual

85. The appellant also referred us to a number of extracts from HMRC manuals which it is argued support his position.

86. While statements in HMRC's manuals may disclose HMRC's view of the law they are not determinative of what the law is. It is our view in any case that none of the extracts the appellant referred us to assist the appellant in explaining why an NT code should be determined in respect of his circumstances.

87. In relation to PAYE81720:

> "Workers on supply ships or aircraft
>
> Employees working on supply ships or aircraft involved in oil or gas exploration are usually treated as performing their duties in the country of residence of the operator. Taxation requirements are normally those of the home country of the operator, not the place or places where duties are actually performed."

88. The appellant acknowledges this applies to workers in the offshore oil and gas industries but argues that is consistent with the way the DTA at 14(3) is applied internationally. The excerpt states that such employees are usually treated as performing their duties in the country of residence of the operator. It is not clear how this assists the appellant. We have before us a specific treatment in the DTA and UK legislation to apply. The fact that HMRC apply a certain treatment to workers in other circumstances (supply ships or aircraft involved in oil or gas exploration) does not effect the interpretation of the particular legislation that applies to this appeal.

89. In relation to PAYE11010 it provides:

> "Coding: codes: how they are used and calculated: cases where you should use code NT…
>
> Double Taxation Agreements
>
> Visiting teachers, foreign language assistants, students and others exempt under a double taxation agreement. The Double Taxation (DT) Manual explains these cases..."

90. This reflects the fact it is possible for the effect of a DTA to mean that a person is not chargeable to tax. Whether the person is chargeable will depend on the particular DTA and, if the UK has been allocated taxing rights, whether the UK has availed itself of that right through its domestic legislation. It does not follow that because there is a DTA between Hong Kong and the UK that an NT code should be issued to the appellant.

91. The appellant also refers to the following:

> "INTM153050 - Description of double taxation agreements: Residence
>
> This Article deals with the question of residence. A person is a resident of a country if they are is liable to tax therein by reason of their domicile, residence, place of management or other criterion of a similar nature. It does not include any person who is liable to tax in one country only on income from that country or on capital situated therein."

92. This is making the point that a person will not be treated as resident because they have received income from a country upon which they are liable to tax in that country. There is no suggestion that the appellant is UK resident for reasons not connected to domicile, residence or criterion of a similar nature so it is not clear how this passage assists the appellant.

Significance of Hong Kong Inland Revenue ruling

93. The appellant refers to Hong Kong Inland Revenue's determination in its letter of 6 September 2011 (set out at [21]) in support of his argument that he has a Hong Kong employment.

94. This assumes that the question of whether the appellant has a Hong Kong employer is relevant to whether he is chargeable to UK tax. However that issue as explained below at [102] is not relevant.

95. The letter from the Hong Kong Inland Revenue Department (HKIRD) expresses the view of the Hong Kong tax authority. It is not clear to us that the copy before us relates to Mr Fryett, but even if we were to assume that it did, or that it related to a pilot whose circumstances were the same, the view of HKIRD could not be determinative of the facts or the legal position for the purposes of this appeal (in the same way that HMRC's view of the facts and legal position would not be determinative).

96. In any case whether Hong Kong is able to tax the remuneration is not in issue. The issue is whether the UK is prevented from having taxing rights over the remuneration and there is nothing in the HKIRD letter which assists the appellant one way or the other on that point.

Conclusion on interpretation of DTA

97. The UK is not prevented under Article 14 of the DTA from having taxing rights over remuneration derived in respect of any employment exercised on board an aircraft operating in international traffic.

98. Article 14(1) envisages that a contracting party has taxing rights over remuneration derived by someone who is a resident of the contracting party. The term "resident of a contracting party" is set out in Article 4 which in the case of the UK means a person who "under the laws of the United Kingdom is liable to tax therein by reason of his domicile, residence…". It is not in dispute that the appellant is UK resident for tax purposes. He is accordingly a person who is liable to tax by reason of his residence under the laws of the UK for the purposes of Article 4 of the DTA. Under Article 14(1) the UK is *able* to tax his remuneration.

99. As set out below the next issue to consider is whether the UK *does* tax the remuneration. The appellant argues that it is relevant to consider whether the appellant's duties are performed in the UK or the extent to which the duties are performed there to determine whether the remuneration is chargeable to tax in the UK.

ITEPA taxes worldwide income / relevance of extent to which duties performed outside the UK

100. HMRC say that when it comes to someone who is UK resident for tax purposes, it does not matter where their duties are performed.

101. To the extent the appellant has Hong Kong duties and works on a Hong Kong registered aircraft, this does not affect the conclusion that under ITEPA the appellant, as a UK resident, is chargeable on his UK and worldwide income.

102. We agree with HMRC. The provisions of ITEPA clearly distinguish between employees who are UK resident and those who are not UK resident. Chapter 4 of ITEPA covers UK resident employees. Under s15 ITEPA which is the charging provision for UK residents, the taxable earnings are the UK resident's "general earnings". This provision is not affected by where the employment duties are performed. There is no territorial limitation on what constitutes "general earnings". A UK resident earning income from performing employment duties is accordingly taxed on those earnings. It also does not matter whether the earnings are from an employment with a UK employer or with a Hong Kong employer. Either way they are "general earnings" of the UK resident employee.

103. Chapter 5 deals with taxable earnings for non-UK resident employees. As set out in s20(1)(a) and (b) the chapter sets out what are taxable earnings from an employment in a tax year in which the employee is one to whom the remittance basis applies or to employees who are non-UK resident. That chapter does refer to whether duties are performed in the UK or outside the UK (ss38-41 ITEPA).

104. The appellant refers to s40 ITEPA which is a specific provision in Chapter 5 which deals with the performance of duties on board vessel or aircraft in relation to the place where duties of employment are performed. It refers in particular to:

"…duties which a person resident in the United Kingdom performs on a vessel or aircraft…".

The appellant argues that where the employment is "based" is relevant even for UK resident pilots.

105. This provision does not indicate that the place where the appellant performs his duties is relevant to the circumstances of the appellant. The rules on the place where duties are performed are as stated in s40(2) "for the purposes of this Chapter" which refers to Chapter 5. That Chapter as set out in s20 deals with earnings from an employment in which the employee is non-UK resident. This does not apply to the appellant who it was agreed is UK resident.

106. In order to make sense of the reference in s40 to a person resident in the UK it has to be appreciated that Chapter 5 also applies to earnings from an employment where the remittance basis applies to the employee (s809B, s809D or s809E of the Income Tax Act 2007 each of which would only be satisfied, amongst other matters if the employee is not domiciled in the UK). It has not been argued, and there is any case no indication on the evidence that the appellant is an employee to whom the remittance basis applies. Section 40 in Chapter 5 of ITEPA is not relevant to the appellant. Chapter 4 of ITEPA which deals with taxable earnings from an employment where the employee is UK resident however is relevant. This does not contain any provisions which require the place at which the duties are performed to be ascertained.

107. In this case it is accepted that the appellant is UK resident for tax purposes. Accordingly the place where Mr Fryett performs his duties is not relevant for UK tax purposes because he is UK resident and he is not an employee to whom the remittance basis applies. In terms of the DTA, the question of where the employment is *exercised* may be relevant to the question of whether Hong Kong may also have taxing rights even though the appellant is not resident there depending on which provision Hong Kong sought to rely on for its taxing rights. But the issue of whether Hong Kong is able to tax the employment income and on what basis is not a matter for this Tribunal. The issue for us is whether it is correct that as the appellant argues the UK does not have taxing rights over the income. As explained above our conclusion is that the UK does have taxing rights over the appellant's income and therefore is able to tax that income.

108. The appellant's point that DTAs overrule domestic law does not arise because the DTA as construed above does not preclude the UK from exercising taxing rights over the remuneration. We note in any case that the DTA takes effect through UK law. The conflict if it arose would be between two provisions of UK law.

109. The point does not arise, but if it was the case that under the DTA sole taxing rights were to be accorded to Hong Kong, the issue of the effect of the provisions in TIOPA 2009 which set out what it means for the DTA to "have effect…despite anything in any enactment" and in accordance with s6(2) TIOPA which provides for the arrangements to have effect "in relation to income tax…so far as the arrangements provide" for various specified matters would need to be addressed.

110. In the appellant's reply, the appellant's representative Mr Mills raised an argument that the way HMRC had applied Article 14(3) was discriminatory. He gave the example of an Easyjet pilot based in Copenhagen who he said would only pay UK tax and not Danish tax. We are unclear as to the basis on which it is suggested the application of Article 14(3) is discriminatory. We do not consider the point further in view of the late stage in the proceedings at which it was raised. To the extent any point was being raised in relation to discrimination, this argument was first raised in the appellant's closing reply at the hearing. It was not raised, in the grounds of appeal, or the appellant's correspondence or written arguments which we were referred to. There was no reason why if such a point was to be made it could not have been made earlier and properly articulated with any relevant legal authorities in order that the Tribunal would have the benefit of both parties' submissions and the relevant law before it.

Relevance of 1944 Chicago Convention on International Civil Aviation

111. The appellant argues the aircraft he flies are insured and registered in Hong Kong and that under the 1944 Chicago Convention of International Civil Aviation ("the Chicago Convention") they are thus deemed to have Hong Kong nationality. He refers to Article 17 of the Chicago Convention which deals with "Nationality of aircraft" and states that "Aircraft have the nationality of the State in which they are registered". To the extent this forms the basis of the appellant's point that he performs duties outside the UK the relevance of this is discussed at [100] to [107].

112. The application of the Chicago Convention cannot mean that Hong Kong had taxation rights as the state of the nationality of the aircraft. As pointed out in the commentary to the Model Convention (discussed above at [75]) it would have been open for a nationality of aircraft rule to be stipulated in the UK/Hong Kong DTA but this option was not taken.

113. Whether or not the aircraft the appellant flies have Hong Kong nationality under the Chicago Convention is irrelevant to the issue of whether under paragraph 3 of Article 14 the UK is deprived of taxing rights. (The paragraph in any case refers to the state of the enterprise which operates the aircraft.)

114. Even if it were to be assumed that the appellant's duties were to be treated as carried out in Hong Kong, and that the basis upon which Hong Kong founded its taxing rights was the proviso to paragraph 1 of Article 14 (the words following "unless…") this would not mean the UK's taxing rights were removed. Under 14(1) the remuneration "may be taxed" in the other state if the employment is exercised there. It is not stated that the remuneration shall only be taxed there.

115. The appellant argues it is necessary to establish whether the appellant had a Hong Kong employer or a UK employer.

116. We agree with HMRC that this issue is irrelevant to the question of whether the appellant was chargeable to tax under ITEPA.

117. As explained above at [102], the appellant, as a UK resident, is chargeable to tax on his worldwide earnings. Whether his employer is a Hong Kong employer or UK employer the earnings from his employment are chargeable to UK tax.

UK National Insurance Contributions ("NIC")

118. The appellant argues that he is exempt from UK NIC and /or other social security payments in the EU because he flies non EU registered aircraft. Since no UK NIC is due and only Hong Kong social security is payable then only Hong Kong salaries tax should be due on the same income.

119. This appeal concerns whether it is correct that no UK tax is chargeable on the appellant's remuneration. The appellant's position in relation to NIC and social security will depend on the particular NICs and social security legislation. NIC liabilities and tax liabilities arise under different legislation. While there are numerous situations where the NICs treatment and the tax treatment reflect each other (because that is the effect of what the respective NICs and tax provisions provide for) it does not follow, if it is the case that the appellant is exempt from NIC, that this means he is not liable to tax.

Territorial limits of PAYE – no "tax presence" in the UK?

120. In his statement of case the appellant argues that just because he is a UK resident, if he has an overseas employer and minimal UK duties then the UK branch

should not be obliged to operate UK PAYE on the full amount of salary. The appellant argues that the case of *Clark (HMIT) v Oceanic* [1983] 2 AC 130 [1983] STC 35 established that it does not necessarily follow that an overseas employer is obliged to operate PAYE and that some territorial limitation has to be imposed on the scope of the PAYE system.

121. HMRC say that the question of whether PAYE is operated is between HMRC and the employer and the employer is not party to these proceedings. The fact is that PAYE *is* operated on the remuneration. It follows from *Clark (HMIT) v Oceanic* that even if the employer is non-UK, if it has a tax and trading presence in the UK then PAYE nevertheless has to be operated. HMRC say s689 ITEPA is a statutory expression of this basic point and that is the other route to the conclusion that PAYE is to be operated on the remuneration.

122. We go back to the point that the context of this appeal is the appellant's objection to a PAYE code, and that the Tribunal's jurisdiction on appeal is to determine the PAYE code. The argument the appellant raises is at odds with this jurisdiction which assumes that the PAYE provisions are applicable, that the issue is the PAYE code to be determined and that there is someone who will implement the PAYE code determined. In that sense the issue the appellant raises is a preliminary issue which goes to our jurisdiction because if there is no-one who is liable to operate PAYE then there is no need and no point in determining a PAYE code whether that is an "NT" code or any other code.

123. For this reason, although HMRC say the issue of whether PAYE is operable is not relevant as there is no-one from the employer in these proceedings contesting liability to PAYE, we think we do need to consider the appellant's argument that the PAYE liability is subject to territorial limitations. This issue was considered in the House of Lords case of *Clark (HMIT) v Oceanic*.

Clark (HMIT) v Oceanic Contractors [1983] 2 AC 130 [1983] STC 35

124. The facts concerned an employer that was not a UK company and not resident in the UK. Its activities included installing platforms and laying pipelines in the UK sector of the North Sea. Those activities were controlled from Antwerp in Belgium. There was no dispute as to whether the pay of its 400 workers in its North Sea operations was chargeable to income tax. The issue was whether the employer was under an obligation to operate PAYE under s204 of the Income Taxes Act 1970. (Section 204 provided a deduction requirement subject to regulations.)

125. The Inland Revenue submitted that in all the circumstances the employer had a sufficient "tax presence" in the UK to justify the imposition of the s204 liability.

126. The appeal was allowed by 3:2. Lord Scarman and Lord Wilberforce who allowed the appeal both gave judgments. Lord Roskill agreed with both (although he did not consider the Inland Revenue's alternative argument that territorial limitations were governed by the charge to tax and that the PAYE obligation was not subject to

any further territorial limitations). Lord Edmund-Davies and Lord Lowry gave dissenting judgments.

127. Lord Scarman explained the territorial limitations to PAYE by reference to "tax presence" as follows:

> "Schedule E contains the territorial limitations upon the charge to tax. The only question is to determine in what circumstances the tax may be collected by PAYE. This question can be answered by invoking an old principle, even though to-day it has a new name. The "tax presence" for which the Crown contends signifies no more and no less than that the foreigner in question, i.e. the employer who makes the payment on account of wages or salary, has by coming into this country made himself subject to United Kingdom jurisdiction: or, as Cotton L.J. in *ex parte Blain*, supra 1, put it, he has for the time being brought himself within the allegiance of the legislating power.
>
> My Lords, it has been repeatedly, and correctly, asserted in argument that this appeal is not concerned with the charge to tax. Indeed, it is conceded that the income tax upon which the Revenue seeks to collect by PAYE, is chargeable under Schedule E. Residence of the taxpayer is, of course, one of the factors determining chargeability to tax. But the present case is concerned with the territorial limitation to be implied into a section which establishes a method of tax collection. The method is to require the person paying the income to deduct it from his payments and account for it to the Revenue. The only critical factor, so far as collection is concerned, is whether in the circumstances it can be made effective. A trading presence in the United Kingdom will suffice.
>
> Upon the facts of this case a trading presence is made out. For the purposes of corporation tax Oceanic, it is agreed, carries on a trade in the United Kingdom which includes its operations in the United Kingdom sector of the North Sea. For the purpose of this trade it employs a work force in that sector, whose earnings are assessable to British income tax. Finally, Oceanic does have an address for service in the United Kingdom. It is not the least surprising that the Special Commissioners concluded that in Oceanic's case there would be no practical difficulties in operating PAYE. For these reasons I conclude that Oceanic by its trading operations within the United Kingdom and in the United Kingdom sector of the North Sea has subjected itself to the liability to operate PAYE in respect of those emoluments of its employees which are by s 38(6) of the 1973 Act chargeable to British income tax. Oceanic must, therefore, operate PAYE in respect of those emoluments."

128. Lord Wilberforce reached the view the foreign employer would only be liable if the company was within provisions which made it liable to corporation tax if it carried on a trade in the UK through a branch or agency. He regarded the provision (s38(4) Finance Act 1973) which deemed profits or gains arising to a person not resident in the UK from exploration or exploitation activities be treated as profits or gains of a

trade carried on by that person in the UK through a branch or agency as critical in the appeal (pg 18).

129. The question arises whether it is critical as to whether Cathay Pacific has a branch or agency for corporation tax purposes given Lord Wilberforce's opinion? There was no evidence before us on this point which would enable us to make a finding on this point.

130. Our view is that although the issue of whether the employer has a branch or agency for corporation tax purposes is something which may be taken into account in ascertaining whether the employer has a tax presence, and its presence is a factor which points towards there being such a tax presence, the absence of a finding on that point does not mean there is no tax presence. It is true that Lord Scarman's opinion included the fact that for the purposes of corporation tax the agreed fact that the employer carried on a trade in the UK which included its operations in the UK as one of the facts which made out a trading presence but there was no indication that its presence was determinative.

131. In any case Lord Wilberforce's view that the matter was critical has to be viewed in the context of the particular legislation relating to the North Sea sector at issue in that case. It was only because there was a provision (s38(6) of Finance Act 1973) which deemed emoluments from duties performed in the North Sea area (not a part of the United Kingdom) in connection with exploration and exploitation to be emoluments in respect of duties performed in the UK that there were duties performed in the UK which meant the employees were chargeable to tax. Where there was a similarly framed deeming provision in relation to profits and gains (s38(4)) which latched onto a branch or agency it can be appreciated why his Lordship considered that the presence of a branch or agency was critical to the operation of PAYE in relation to the deemed emoluments.

132. The principle underpinning "tax presence" is encapsulated in Lord Scarman's opinion set out at [127] above, namely whether the foreign employer has subjected itself to the UK's jurisdiction. HMRC drew attention to the speech of Lord Scarman at pg 148. The crux was a question of practicality and whether the employer has offices, operations, and staff. They say that was the conclusion in *Oceanic Contractors* and that the position is the same here. They emphasise the fact that PAYE was in fact operated on the appellant's remuneration.

133. Of course the fact that PAYE has been operated on the appellant's remuneration as a matter of fact does not necessarily mean that PAYE ought to have been operated as a matter of law. But, the fact that PAYE has been actually operated on the appellant's remuneration is we think a strong indicator to there not being practical difficulties in the operation of PAYE on the remuneration. In addition we note from the appellant's evidence that Cathay Pacific does have an operation in Hammersmith, London with some 100 workers, and a call centre. The appellant's evidence was that Cathay Pacific entity in Hong Kong supplies his pay figures to Morepay. This enables PAYE to be operated on his income. The actual operation of PAYE on the appellant's remuneration with no practical difficulty and the existence of the Hammersmith

operation are prima facie evidence that if there is a foreign employer then the employer has a tax presence in the UK. Cathay Pacific in Hong Kong sanctions and plays a part in the actual operation of PAYE on the appellant's pay. This indicates to us that even if there is no UK employer, Cathay Pacific in Hong Kong has subjected itself to UK PAYE liability.

134. The appellant says he has no employment relationship with the Hammersmith office and also that HMRC cannot rely on the appellant's completion of the P46(expat) form. Does it matter that the appellant does not have anything to do with the operation in Hammersmith? In our view *Clark (HMIT) v Oceanic* suggests it does not. There the employer was contesting the PAYE obligation, but despite the fact that the operations in the UK had nothing to do with the relevant platform and pipeline workers, the decision was that there was a tax presence and PAYE was operable on the remuneration of the platform / pipeline workers. (Lord Edmund-Davies' dissenting opinion indicated otherwise.)

135. In reaching this view we do not place any reliance on the completion of the form P46 (expat). We did not receive any evidence as to who had completed the section to be completed by the employer. It was clear however from Mr Fryett's evidence that his pay was being subjected to PAYE and that Cathay Pacific had an operation in the UK (although Mr Fryett had nothing do with it and was instructed not to deal with.)

136. In summary, the fact that PAYE as a matter of fact is operated on Mr Fryett's remuneration tends to suggest that his employer has submitted itself to the UK's jurisdiction. The presence of a significant Cathay Pacific operation in the UK also indicates that Cathay Pacific has a tax presence in the UK for the purpose of the applicability of the PAYE regulations. The fact that Mr Fryett has nothing to do with that operation does not prevent Cathay Pacific from having such a tax presence.

137. In his witness statement the appellant makes the argument that "given no work was performed in or for [the UK branch]…PAYE should only be operated on the duties performed in UK airspace".

138. This argument appears to merge two distinct issues which is what tax is chargeable on the appellant's earnings and the applicability of the PAYE machinery to collect the tax. Neither the provisions on chargeability or the applicability of the PAYE provisions applicable to the appellant make a distinction as to what is charged, or what is collected by reference to where the duties are performed.

139. Part 11 of ITEPA deals with PAYE. Section 684 ITEPA requires the Commissioners to make PAYE regulations with respect to the assessment, charge, collection and recovery of income tax in respect of all "PAYE income". Section 683 ITEPA defines "PAYE income" to include PAYE employment income, and this is defined s683(2)(a) as consisting of "any taxable earnings from an employment in the year (determined in accordance with s10(2)…". Section 10(2) ITEPA sets out "taxable earnings" are to be determined in accordance with Chapters 4 and 5. Under

s15 ITEPA the appellant's general earnings (his salary which under s62(2)(a), are earnings) are his taxable earnings.

140. As explained above, the issue of where the duties are performed is not relevant to the chargeability of those earnings where the employee is UK resident as the appellant is. Being a UK resident he is taxable on his salary worldwide.

141. The PAYE Regulations envisage that obligations may be placed on and fulfilled by someone who is not the employer (see for instance Regulation 12 which states that for the purpose of the regulations other payers are treated as employers). So long as there is a tax presence in the UK to ensure the practical collection of the tax chargeable, there is no additional territorial limitation on the liability to operate PAYE. The PAYE obligation is not delineated by where the appellant's duties are performed but applies to all of the appellant's remuneration.

142. Whether the employment is, in the terms the appellant uses, "Hong Kong based", or "UK based", the remuneration of the appellant as a UK resident, is subject to PAYE. For the purposes of this appeal we are satisfied, given the tax presence of Cathay Pacific in the UK that the issue of determination of PAYE codes is relevant and there is therefore a matter which can form the subject of an appeal before us under the PAYE Regulations.

143. It follows from what we have said above that we agree that HMRC could not have been satisfied that no tax was chargeable. They were correct not to issue an NT (nil-tax) code. The issue remains as to what code should be issued. The parties are asked to seek agreement on the correct code for the appellant for 2011/12. If agreement cannot be reached the parties are at liberty to revert to the Tribunal to determine a code in accordance with the PAYE Regulations.

144. Although not necessary for our decision we should mention that in relation to HMRC's suggestion that s689 ITEPA could provide a basis for explaining why PAYE is applicable to the appellant's remuneration we are not persuaded s689 ("employee of non-UK employer") is relevant. Section 689(1)(a) applies if during any period a person works for a person who is not the employer of the employee. Our difficulty with the relevance of this provision is that even if the UK operation of Cathay Pacific Airways could be regarded as a "person" (which seems doubtful because the UK operations were not a corporate entity), and while acknowledging that the term "work" is specifically defined in s689(6), there was no evidence before us which indicated that the appellant worked "for" any such person.

Appellant's application after the hearing to consider a further case

145. On 30 September 2013, following the hearing the appellant made an application to put a "2012 EU International Tax Case" before the Tribunal on the grounds it was directly applicable to compliance with the OECD protocol. The decision was one of the German Federal Court and the appellant says it determines that the DTA was intended to override domestic law.

146. The appellant included a translation of the case the appellant had obtained, Mr Mills' commentary/ explanations and a comparison between the Ireland/Germany and UK/Hong Kong DTAs on "Dependent Personal Services (Income)". The appellant suggests that the wording of the Ireland / Germany DTA follows the wording of Article 15 of the OECD model convention and that its paragraph 3 uses the same formulation of "may be taxed…" as paragraph 3 of Article 14, the only difference being that instead of allocating the taxing right to the state of enterprise the right is allocated to the state in which the place of effective management of the enterprise which operates the ship, aircraft or boat is situated.

Should we consider the German Federal Court decision sent in after the hearing?

147. HMRC were given the opportunity to make representations on the appellant's application and if appropriate provide submissions. No representations were made on the application.

148. Although no response has been received from HMRC which suggests they do not object to the appellant's application we do not think it follows that the application to consider the case is to be granted. Typically by the time proceedings have culminated in a substantive hearing both parties will have had sufficient opportunity to put forward any relevant authorities. The need to properly consider the issues before making a determination has to be balanced against the added costs and delays involved with dealing with matters post-hearing and there would we think need to be a good reason why it was fair and just to allow further representations to be made once the hearing was over for example if a decision which was highly material to the matter under appeal had been issued shortly after the hearing.

149. We are not satisfied the appellant has provided a good reason for why the decision could not have been put before the Tribunal at the hearing or that in any case it would be material to the determination of the issue before us. The application referred to a tax alert from June 2013. The judgment dates from 1 November 2012. There is no apparent reason why, if the appellant thought the decision was relevant, it could not have been included the authorities before the Tribunal at the hearing.

150. The case is of a court of another jurisdiction in relation to another double taxation agreement. As discussed above the issue of whether DTAs override domestic law is not relevant to the extent that the DTA has effect in the UK through domestic law. It is not clear in any case that an argument that DTAs override domestic law would help the appellant given our conclusions on the DTA's interpretation. Putting aside any issue of the translation of the judgment not being verified it appears from the translation provided by the appellant that the facts concerned a pilot resident in Germany with Irish source income. The year in question was 2007 and it is not clear that the article in the Ireland/ Germany DTA the appellant states as being in similar terms to Article 14 was applicable in 2007. Furthermore, the decision appears on the face of it to turn on the particular German domestic law provisions covering the situations when the right to tax reverted to Germany. It does not suggest that by virtue of a treaty provision worded similarly to the one in issue in this appeal that Germany is excluded from taxing the income.

Conclusion

151. HMRC were correct to refuse to issue an NT (nil-tax) code. The appeal is determined in principle. The parties are to agree the correct code to be applied but if the code cannot be agreed may revert to the Tribunal for the code to be determined.

152. 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.

SWAMI RAGHAVAN
TRIBUNAL JUDGE

RELEASE DATE: 24 February 2014