TC02654

Appeal number: TC/2011/05225

INCOME TAX – Taxpayer a British national resident in the Republic of Ireland – taxed in the UK on a civil service pension by virtue of Article 18 UK/Irish Double Taxation Convention – taxpayer's wife an Irish national taxed on UK local authority pension in Ireland – taxpayer taxed less favourably in the UK than if taxed as his wife in Ireland – whether Article 18 DTC compatible with EU law – discrimination on grounds of nationality – whether Article 18 DTC compatible with Article 14 of the European Convention on Human Rights – construction of Article 23(1) of the DTC (non-discrimination clause) – appeal dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

MR KENNETH PERCIVAL **Appellant**

- and -

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

TRIBUNAL: JUDGE MALCOLM GAMMIE CBE QC
SONIA GABLE

Sitting in public at Bedford Square, London WC1 on 24 April 2012

The Appellant appeared in person

Ms Sarah Ford (instructed by the General Counsel and Solicitor to HM Revenue and Customs) for the Respondents

DECISION

Introduction

1. The Appellant (Mr Percival) is a British national but since January 2004 he has been resident in the Republic of Ireland. Since January 2006 Mr Percival has been in receipt of a British civil service pension in respect of his former employment with the Inland Revenue. In addition he has other sources of private pension and savings income in the UK.

2. Mr Percival submitted a claim to the Irish Revenue for double taxation relief under the UK/Ireland Double Taxation Convention of 2 June 1976 ("the DTC") in respect of his UK sources of income. The Irish Revenue certified the Appellant as being resident in Ireland for the purposes of Irish tax. As a result Mr Percival was granted an exemption from UK tax under the terms of the DTC in respect of his private pension and savings income. No exemption was granted in respect of his UK civil service pension.

3. Article 17(1) of the DTC provides that:

> *"Subject to the provisions of paragraphs (1) and (2) of Article 18, pensions and other similar remuneration paid in consideration of past employment to a resident of a Contracting State and any annuity paid to such a resident shall be taxable only in that State."*

4. Article 18(2), however, provides that:

> *"(a) Any pension paid by, or out of funds created by, a Contracting State or a political subdivision or a local authority thereof to an individual in respect of services rendered to that State or subdivision or authority, in the discharge of functions of a governmental nature, shall be taxable only in that State.*
>
> *(b) However, such pension shall be taxable only in the other Contracting State if the individual is a resident of, and a national of, that State."*

5. Initially, Mr Percival sought to challenge the refusal of exemption from UK tax for his civil service pension by appealing against his PAYE coding for the year. Having been informed of the correct way to challenge the refusal, Mr Percival made a formal claim on 5 March 2008 for relief in respect of his UK civil service pension. The Respondents ("HMRC") opened an enquiry into his claim and on 6 November 2008 closed their enquiry by disallowing his claim.

6. On 12 September 2009 Mr Percival sought to appeal HMRC's decision. HMRC accepted his reasons for appealing out of time and offered to conduct a review of the decision under section 49C Taxes Management Act 1970. On 15 February 2011 Mr Percival was notified of the review's conclusion to uphold the decision to refuse relief.

7. Mr Percival now appeals to this Tribunal.

Mr Percival's grounds of appeal

8. Mr Percival's principal ground of appeal, as set out in the Notice of Appeal to the Tribunal, is that Article 18 of the DTC contravenes various articles of the European Convention because the taxation of Government pensions is based on nationality. His grounds subsequently refer to the Human Rights Act 1998 and state that it forbids discrimination by nationality. It seems, however, that when referring to the "European Convention" in his grounds Mr Percival may have had in mind the treaties establishing the European Union because he goes on to mention Case C-279/93 *Finanzamt Köln-Alstadt v Roland Schumaker* concerning the interpretation of what was then Article 48 of the EEC Treaty.

9. The basis of Mr Percival's complaint, as envisaged in his grounds, is that his family circumstances and income means that he does not pay tax in the Republic of Ireland given the more generous tax allowances there. Evidently Mr Percival and his wife were entitled in the years in question to a joint income of around 36,000 Euros before they would pay income tax in Ireland. The UK income tax that he suffers on his civil service pension is not refundable there and does not reflect his family circumstances in the Republic. His grounds rely on the *Schumaker* case to make the point that the taxation of individuals is best carried out by the Member State of residence because that State is best able to determine the individual's family circumstances.

10. On the specific issue of discrimination Mr Percival makes the point that his wife, who is an Irish national and is resident with him in Ireland is exempt in respect of her UK local authority pension because she is an Irish national (see Article 18(2)(b) of the DTC).

11. In relation to discrimination, it is clear from the correspondence, if not from the grounds, that Mr Percival had also been seeking to rely on Human Rights arguments. He had also claimed to be discriminated against relative to a British national who was born in Northern Ireland and who could claim Irish nationality, relative to someone such as Mr Percival who was born in Great Britain.

12. In essence, Mr Percival's appeal was founded on the proposition that, as an Irish resident person for the purposes of the DTC, he was unfairly treated relative to another Irish resident person who was also an Irish national, because his public pension was taxed in the UK and exempt in Ireland whereas the same pension paid to an Irish national in his position would be exempt in the UK and taxed in Ireland.

13. In this regard, we believe that Mr Percival recognised that the relative balance of taxation might change over time (and, indeed, it may have done as a result of recent Irish budgets), so that UK taxation and Irish exemption would be more favourable. In that case a taxpayer might demand that both countries be held to their agreement. The question, however, is whether the UK can rely on its agreement with the Republic in the face of Mr Percival's challenge.

Mr Percival's case before the Tribunal

14. In his skeleton argument and in his submissions before the Tribunal Mr Percival did not advance any arguments based on the EU Treaties or on the European Convention on Human Rights. Ms Ford for HMRC noted that Mr Percival was no longer seeking to rely on these arguments, which HMRC said were unfounded for the reasons that Ms Ford had advanced in HMRC's Amended Statement of Case, and she referred to paragraph 4 of Mr Percival's skeleton argument. In paragraph 4 he states that he will "restrict my case to just an examination of [the DTC] in particular the DT article that appears to deal with discrimination by nationality".

15. This is Article 23(1) of the DTC, which provides that—

> *"The nationals of a Contracting State shall not be subjected in the other Contracting State to any taxation or any requirement connected therewith which is other or more burdensome than the taxation and connected requirements to which nationals of that other State in the same circumstances are or may be subjected."*

16. Mr Percival's argument was that, properly construed, Article 23(1) be taken to provide that, "the nationals of a Contracting State shall not be subjected [while] in the other Contracting State" etc. Thus, to take his circumstances, as a British national resident in Ireland he was subject to other or more burdensome taxation by the United Kingdom than his wife was in the same circumstances as an Irish national (or indeed as compared to any Irish national with similar UK income). Accordingly, his liability to UK tax should be restricted to the tax that would have been borne by an Irish national in his circumstances.

17. It was to this argument that Ms Ford directed her oral submissions, without addressing separately the European Treaty or Human Rights arguments that she had dealt with in HMRC's Statement of Case. As foreshadowed by his skeleton argument, Mr Percival in opening and in reply addressed the Tribunal clearly and carefully on Article 23(1) without raising any other issues.

18. A decision of this Tribunal would usually be restricted to the issues raised and the arguments addressed to the Tribunal. In the present case, however, we have before us a litigant in person who has not had the benefit of professional advice to assess the strength of HMRC's case on both the Community law and Human Rights issues that he has raised in correspondence with HMRC and in his grounds of appeal. This Tribunal ought not to dismiss Mr Percival's appeal just because Mr Percival has been persuaded to abandon certain arguments if the Tribunal believes that those arguments should properly be considered in arriving at a decision whether to allow or to dismiss his appeal. Although we did not hear submissions from Ms Ford on these issues, her Statement of Case on behalf of HMRC is a model of clarity. We have therefore taken that written case as representing her submissions for HMRC on the issues and have assessed them for ourselves.

The discrimination complaint: OECD Model Tax Convention

19. This is not a case in which the taxpayer complains that he is subject to double taxation. The treaty is clear: pension income is allocated to and taxed in one only of the two States and in Mr Percival's case this is the UK as regards his civil service pension. Ordinarily, a state is entitled to tax its public sector pensions without regard to the residence of the recipient because it always retains taxing rights as the source state. If the recipient takes up residence in another state, that other state ordinarily becomes entitled as the state of residence to tax his income. Article 18 of the DTC ensures that only one state may exercise its taxing right: the United Kingdom as the source state in the case of its nationals and Ireland as the residence state in the case of its nationals.

20. Their agreement to that effect accords with Article 19(2) of the OECD Model Tax Convention on Income and on Capital, which in its 2010 version provides—

> *"(a) Notwithstanding the provisions of paragraph 1, any pensions and other similar remuneration paid by, or out of funds created by, a Contracting State or a political subdivision or a local authority thereof to an individual in respect of services rendered to that State or subdivision or authority shall be taxable only in that State.*
>
> *(b) However, such pensions and other similar remuneration shall be taxable only in the other Contracting State if the individual is a resident of and a national of, that State."*

21. The OECD 1963 draft model convention originally dealt with both government remuneration and pensions in a single paragraph of Article 19 and provided that the source state retained taxing rights while saying nothing of the residence state's entitlement. The 1977 Model Convention adopted the current formulation and the DTC therefore reflects the state of debate in the OECD's Committee on Fiscal Affairs at the time. Article 18(2) of the DTC incorporates the words, "in the discharge of functions of a governmental nature", which were found in Article 19 of the 1963 Draft Convention but which were omitted from the 1977 Model Tax Convention.

22. The current commentary on the OECD Model Tax Convention explains that—

> *"… sub-paragraph (a) of paragraphs 1 and 2 are both based on the principle that the paying State shall have an exclusive right to tax the payments. … The principle of giving the exclusive right to the paying State is contained in so many of the existing conventions between OECD Member countries that it can be said to be already internationally accepted. It is also in conformity with the conception of international courtesy which is the basis of the Article and with the provisions of the Vienna Conventions on Diplomatic and Consular Relations. …*
>
> *An exception from the principle of giving exclusive taxing powers to the paying State is contained in sub-paragraph (b) of paragraph 1. It is against the background that, according to the Vienna Conventions mentioned above, the receiving State is allowed to tax remuneration paid to certain categories of*

personnel of foreign diplomatic missions and consular posts, who are permanent residents or nationals of that State. Given that pensions paid to retired government officials ought to be treated for tax purposes in the same way as salaries or wages paid to such employers during their active time, an exception like the one in sub-paragraph (b) of paragraph 1 is incorporated also in sub-paragraph (b) of paragraph 2 regarding pensions. … the only pre-requisite for the receiving State's power to tax the pension is that the pensioner must be one of its own residents and nationals."

23. As this indicates, the United Kingdom has the primary taxing right in respect of public sector pay and pensions and the exclusion of that right under Article 18(2)(b) of the DTC in the case of Mr Percival's wife and other Irish nationals is an exception to the general rule.

The discrimination complaint: EU law

24. The fact that Article 18 of the DTC reflects Article 19 of the OECD Model Tax Convention and that Article 19 follows established international practice do not guarantee the validity of Article 18 as a matter of Community law or under the Convention on Human Rights. The United Kingdom has agreed to exempt Irish nationals (including those who are also British nationals) in respect of income over which it has a primary taxing right but insists on taxing Mr Percival because he is a British and not an Irish national.

25. Article 18 of the Treaty on the Functioning of the European Union (TFEU), previously Article 12 of the EC Treaty, provides that—

"Within the scope of application of the Treaties, and without prejudice to any special provisions contained therein, any discrimination on grounds of nationality shall be prohibited"

26. Furthermore, under Article 20 TFEU (previously Article 17 EC Treaty), every person holding the nationality of a Member State shall be a citizen of the Union. This is additional to and does not replace national citizenship. Citizens of the Union enjoy the right to move and reside freely within the territory of the Member States, subject to the limitations and conditions laid down in the Treaties and any measures adopted to give effect to them (Article 20(2)(a) and 21(1) TFEU).

27. On the face of it, Mr Percival has exercised his Treaty right to reside in Ireland and the United Kingdom now discriminates against him by continuing to tax his civil service pension because he is a British and not an Irish national while exempting Irish nationals from tax in respect of the same income.

28. The Court of Justice in Case C-184/99 *Grzelczyk* has declared that—

"Union citizenship is destined to be the fundamental status of nationals of Member States, enabling those who find themselves in the same situation to enjoy the same treatment in law irrespective of their nationality, subject to such exceptions as are expressly provided for."

29. However, one can observe that the situation in which such statements have been made ordinarily concern the treatment within a Member State of nationals of other Member States. As the Treaties and the Court indicate, EU citizenship does not replace nationality generally. Indeed, nationality of a Member State is a fundamental requirement for EU citizenship. Mr Percival's complaint is not against the Republic's tax system, because the Republic exempts his income. His wife might complain that she is taxed by the Republic on her UK local authority pension when the Republic exempts her husband's UK civil service income. Community law, however, does not ordinarily assist a Member State's own nationals in a complaint that nationals of other Member States are treated more favourably.

30. If Mr Percival's wife, as an Irish national, cannot complain to the Irish authorities that she is less favourably treated in Ireland than her husband as a British national, it is not immediately clear why Mr Percival can complain that the United Kingdom treats him, as a British national, less favourably than his wife as an Irish national. On the other hand, if both can complain that they are discriminated against relative to the other, the effect of Article 18 of the DTC may be that neither jurisdiction can tax their pension income.

31. In this respect Mr Percival does not necessarily claim exemption from UK tax but asks that the UK tax should not be greater than if his civil service pension had been subject to Irish tax instead, as in the case of his wife or any other Irish national. In practice for the years in question this may mean that he should pay no UK tax on his civil service pension as a result of his Irish personal tax allowance (see paragraph 9 above). His Irish tax position, however, was not explored in evidence before the Tribunal. The assumption was that he would pay no tax in Ireland on the pension but this would require further investigation if we were to conclude that that was the correct answer.

32. The problem for Mr Percival here is that competence in respect of direct taxation remains largely a matter for each Member State. A Member State is not in breach of its Treaty obligations because it taxes differently and less favourably than some other Member State. Thus in Case C-177/94 *Criminal proceedings against Gianfranco Perfili* [1996] ECR I-161 the Court of Justice noted in paragraph 17 of its decision that—

> "*…the Court has consistently held that, in prohibiting every Member State from applying its law differently on the ground of nationality, within the field of application of the Treaty, [the relevant Treaty Articles] are not concerned with any disparities in treatment which may result, between Member States, from differences existing between the laws of the various Member States, so long as they affect all persons subject to them in accordance with objective criteria and without regard to their nationality…*"

33. Thus, the European Treaties do not require some form of 'back door' harmonisation or the application of a 'lowest common denominator' as a result of taxpayers being allowed to compare one Member State's taxation choices with those of another Member State. If Mr Percival had remained resident in the United Kingdom he would only be entitled to a UK personal allowance (an entitlement that he retains despite his move to the Republic). The fact that he has moved to the

Republic, which offers more favourable taxation through a higher personal allowance, cannot form the basis of a complaint by Mr Percival against the United Kingdom.

34. The question is whether the taxation choices made by a single Member State (in this case the United Kingdom) are compatible with Community law. The 'complication', if there is one, is that the UK's choice in this instance has been made in conjunction with another Member State as part of their agreement under a bilateral Double Taxation Convention. Thus, if Article 18 of the DTC had left taxing rights with the United Kingdom and had exempted his pension income in the Republic, without more, Mr Percival could not complain that he pays more UK tax than the Irish tax he would have paid had the reverse been true.

35. This is not, however, the basis of Mr Percival's complaint: his complaint is that the reverse is true for Irish nationals (including British nationals with dual nationality). He therefore claims that he is discriminated against by the United Kingdom on grounds of nationality, notwithstanding that he is in an identical position to his wife, having exercised his Community law right to leave the UK and reside in the Republic of Ireland. If on that basis Article 18(2) of the DTC is in breach of Community law, the proportionate response might be to limit UK tax to the tax that would have been paid had Mr Percival been taxed on his pension income on the same basis as his wife on her local authority income. That, however, is the remedy for the breach and not the breach itself; hence it falls outside the existing Court of Justice case law that states that the interaction of Member States' tax systems does not amount to a breach of Community law. The question therefore is whether the United Kingdom is in breach of its European Treaty obligations and Community law by reason of its agreement with the Republic of Ireland.

36. Ms Ford in HMRC's Amended Statement of Case referred us in particular to Case C-336/96 *Gilly v Directeur des services fiscaux du Bas-Rhin* [1998] ECR I-02793 as a case that was relevant to our consideration of this issue. *Gilly* has many similarities to the present case. Mrs Gilly was a German national who had acquired French nationality by marriage. She resided in France but worked as a teacher at a State school in Germany. Under the Franco-German Double Taxation Convention her salary was taxed in Germany because she was a German national, and it was also taken into account in France with credit equal to the French tax on her salary. As a result she paid more tax than if she had been taxed on her salary solely in France. Under the Franco-German Convention a teacher with French nationality and not a German national would have paid tax only France and would therefore have paid less tax than Mrs Gilly.

37. In delivering its decision the Court of Justice made the following points about the use of the criterion of nationality in the Franco-German Double Taxation Convention—

> *26. Although as a general rule workers are taxed in accordance with Article 13(1) of the Convention in the State in which the personal activity in respect of which the income is received is carried out, frontier workers are taxed in their State of residence, under Article 13(5)(a).*

27. However, the first sentence of Article 14(1) of the Convention provides that taxpayers receiving public-service remuneration are in principle to be taxed in the paying State. There is also an exception to the latter rule (hereinafter 'the paying State rule') in the second sentence of Article 14(1), under which remuneration paid to a person having the nationality of the other State without being at the same time a national of the first State is taxable in the taxpayer's State of residence.

28. In addition, Article 16 of the Convention lays down a special connecting rule applicable to teachers habitually resident in one of the Contracting States who, in the course of a short period of residence not exceeding two years in the other Contracting State, receive remuneration for teaching in the latter State. Taxpayers in that category are taxed in the State of original employment.

29. It is thus clear that Articles 13(1) and (5)(a), 14(1) and 16 of the Convention lay down different connecting factors depending on whether the taxpayer is a frontier worker or not, is a teacher in short-term residence or not, or is employed in the private or the public sector. Taxpayers in the latter category are in principle taxed in the paying State unless they have the nationality of the other Contracting State without being at the same time nationals of the first, in which case they are taxed in their State of residence.

30. Although the criterion of nationality appears as such in the second sentence of Article 14(1) for the purpose of allocation of fiscal jurisdiction, such differentiation cannot be regarded as constituting discrimination prohibited under Article 48 of the Treaty. It flows, in the absence of any unifying or harmonising measures adopted in the Community context under, in particular, the second indent of Article 220 of the Treaty, from the contracting parties' competence to define the criteria for allocating their powers of taxation as between themselves, with a view to eliminating double taxation.

31. Nor, in the allocation of fiscal jurisdiction, is it unreasonable for the Member States to base their agreements on international practice and the model convention drawn up by the OECD, Article 19(1)(a) of the 1994 version of which in particular provides for recourse to the paying State principle. According to the commentary on that article, that principle is justified by 'the rules of international courtesy and mutual respect between sovereign States' and 'is contained in so many of the existing conventions between OECD member countries that it can be said to be already internationally accepted'.

32. In the present case, the first sentence of Article 14(1) of the Convention reproduces the tenor of Article 19(1)(a) of the OECD model convention. It is true that under the second sentence the paying State principle is abandoned where the taxpayer has the nationality of the other contracting State without being at the same time a national of the first State, but the same type of exception, based at least in part on the criterion of nationality, is found in Article 19(1)(b) of the model convention in cases where the services are rendered in the other contracting State and the taxpayer is a resident of that

State who (i) is a national of that State; or (ii) did not become a resident of that State solely for the purpose of rendering the services.

33. In any event, even if the second sentence of Article 14(1), the legality of which is challenged by Mrs Gilly, were to be ignored, her tax position would remain unchanged because the paying State principle would still have to be applied to her income earned in Germany from teaching in the State education system.

34. Nor is it established in the present case that the choice of the paying State as the State competent to tax income earned in the public sector can of itself be to the disadvantage of the taxpayers concerned. As has been pointed out by the governments of the Member States which have submitted observations and by the Commission, whether the tax treatment of the taxpayers concerned is favourable or unfavourable is determined not, strictly speaking, by the choice of the connecting factor but by the level of taxation in the competent State, in the absence of any Community harmonisation of scales of direct taxation.

35. The answer to the first, second and fourth questions must therefore be that, on a proper construction, Article 48 of the Treaty does not preclude the application of provisions such as those in Articles 13(5)(a), 14(1) and 16 of the Convention, under which the tax regime applicable to frontier workers differs depending on whether they work in the private sector or the public sector and, where they work in the public sector, on whether or not they have only the nationality of the State of the authority employing them, and the regime applicable to teachers differs depending on whether their residence in the State in which they are teaching is for a short period or not.

38. This appears to provide substantial support for HMRC's contention that Mr Percival's claim that Article 18(2) of the DTC represents unlawful discrimination under the EU Treaties is misconceived. In particular, it endorses (1) the use of the criterion of nationality to allocate taxing rights between Member States to eliminate double taxation, even though that produces different outcomes for individuals of different nationalities, and (2) reliance on the OECD Model Tax Convention and in particular, on Article 19 of the Model.

39. As regards the first of these, however, we observe that Mrs Gilly had dual nationality. The resolution by agreement of two Member States as to which nationality should 'prevail' in such circumstances is an obvious example of the appropriate use of allocative rights retained by Member States. In Mr Percival's case the United Kingdom has created as part of its agreement with Ireland a straight forward distinction between British and Irish nationals in the way in which it exercises its taxing rights as the source state.

40. Ms Ford pointed out that differences in levels of taxation in different Member States are not (as we have already noted) a valid cause for complaint, citing as more recent authority Case C-240/10 *Cathy Schultz-Delzers and Pascal Schultz*, paragraph 41. This is evident from *Gilly* where, in effect, Mr Gilly's complaint was that she was paying more tax than would have been the case had France and Germany agreed to

allocate the taxing right solely to France. Having legitimately exercised their freedom to allocate the taxing right to Germany, however, Mrs Gilly could not complain in France that she was paying more tax in Germany.

41. It is plain, therefore, that Mr Percival would have no complaint as a matter of Community law against the Irish Republic, for example in claiming that his Irish personal allowances entitled him to repayment there of the tax charged in the UK. If there is a distinction between *Gilly* and Mr Percival's case it must lie in the answers to two questions: first, whether the freedom to allocate taxing jurisdiction endorsed by the Court in that case is limited to cases of dual nationality; and, second, whether Mrs Gilly would have been more successful in a complaint against Germany on the basis that Germany was discriminating between German and French nationals in her position by taxing the former and exempting the latter.

42. Mr Percival relied upon Case C-279/93 *Finanzamt Köln-Alstadt v Roland Schumaker* [1995] ECR I-0225 as the basis for his contention that the State of residence was better able to assess an individual's personal circumstances and therefore the appropriate level of taxation relative to his total income. *Schumaker*, however, is not authority for any principle of Community law that individuals should be taxed on their income only in their state of residence. As we have previously noted, Mr Percival would have no basis for his claim if there were no exception in Article 18(2)(b) of the DTC exempting Irish nationals from UK tax on their public service pensions, and all public service pensions suffered tax in the UK.

43. *Schumaker* is authority, however, for the general proposition that two persons who are in a comparable position in a Member State should be subject in that Member State to the same taxation rules. Thus, Mr Schumaker, a Belgian national who derived all his income in Germany but who was not resident there, was entitled to the same tax treatment as German nationals and residents. Although resident and non-resident persons are not ordinarily in a comparable position (and therefore need not be taxed the same), the fact that Mr Schumaker derived all his income from employment in Germany meant that he was in a comparable position to a German national and resident. The Belgian/German Double Tax Convention allocated the taxing right to Germany and Germany was therefore bound to exercise its right to tax Mr Schumaker in a manner that was in conformity with Community law.

44. In the present case the UK and the Republic of Ireland have agreed that the UK should be allocated the taxing right in respect of Mr Percival's civil service pension. At the same time, however, the UK has agreed to forego its right to tax Mrs Percival in respect of her local authority pension because she is an Irish national. Mr and Mrs Percival are both resident in the Republic of Ireland but are they in a comparable position for these purposes so that the taxation of one and the exemption of the other on grounds of their different nationalities can be said to be impermissible under Community law?

45. If the matter is viewed solely from the perspective of the United Kingdom, it is discriminating in favour of Irish nationals to the potential 'detriment' of its nationals, which is something that Community law does not as yet prohibit. This perspective is consistent with the basic analysis that the UK has the primary taxing right and Mrs Percival's treatment is an exception to the ordinary rule (see paragraph 23 above). It

is also clear as a matter of Community law that it does not found any basis for complaint by a Member State's own national. The simple reason is that 'discrimination' in favour of nationals of other Member States does not usually operate to impede or restrict the functioning of the single market but may be said to encourage the integration of the single market.

46. The situation in which this usually arises is one in which the national rules of a Member State regulating its own market discriminate in favour of nationals of other Member States, and may therefore be said not to discourage their entry into that market. In the present case, however, the discrimination of which Mr Percival complains relates to the United Kingdom's insistence on retaining its taxing rights as the source state notwithstanding his exercise of his Community law right to go and reside in another Member State and even though the United Kingdom is prepared to forego its taxing right in the case of an Irish national (or an individual with dual Irish/British nationality).

47. The United Kingdom naturally retains its right to tax income that has its source there. The fact that Mr Percival may become subject to tax on the same income by becoming resident in another Member State is a facet of the failure of the Member States to eliminate double taxation within the single market. Thus in Case C-379/92 *Criminal proceedings against Matteo Peralta* [1994] ECR I-3453, the Court of Justice said at paragraph 34—

> "*In the absence of Community harmonisation, a Member State may certainly impose, directly or indirectly, technical rules which are specific to it and which are not necessarily to be found in the other Member States on maritime transport undertakings which, like the undertaking employing Mr Peralta, are established on its territory and which operate vessels flying its flag. But the difficulties which might arise for those undertakings from that situation do not affect freedom of establishment within the meaning of … the Treaty. Fundamentally, those difficulties are no different in nature than those which may originate in disparities between national laws governing, for example, labour costs, social security costs or the tax system.*" (Emphasis supplied)

48. In the tax field the Court has confirmed that juridical double taxation that arises when two States tax the same income is not something that of itself causes either State to be in breach of its treaty obligations (see e.g. Case C-513/04 *Kerckhaert-Morres* [2006] ECR I-10967). The fact that both source and residence states tax the income in question may well operate to impede the functioning of the single market and discourage individuals and enterprises from moving or operating cross-border but it arises from the failure of the Member States to harmonise their tax systems rather than from the failure of either Member State to comply with its treaty obligations.

49. In this case the United Kingdom and the Republic of Ireland have resolved this issue through the Republic agreeing to exempt Mr Percival's UK civil service pension. We do not think that that their choice, by allowing the United Kingdom to retain its taxing right over Mr Percival's civil service pension while foregoing it over Mrs Percival's local authority pension, restricts the exercise by Mr Percival of his Community law right to reside elsewhere within the Union.

50. In Case C-513/03 *Heirs of M E A van Hilten-van der Heijden v Inspecteur van de Belastingdienst/Particulieren/Ondernemingen buitenland te Heerlen,* [2006] ECR I-01957 the Netherlands imposed inheritance tax on the value of all assets transferred on the death of a resident of The Netherlands. An individual who died within 10 years of ceasing to reside in The Netherlands was deemed to have been resident there on death. Mrs van Hilten ceased to reside in The Netherlands in 1988 and died in 1997. The Court of Justice concluded that an inheritance is a movement of capital protected by the EC Treaty unless the inheritance is confined to a single Member State. It nevertheless went on to conclude that the Dutch legislation in question was not in breach of the free movement of capital where it provided for relief in respect of the taxes levied in the State to which the deceased had transferred her residence.

51. This was because—

> *46. By enacting identical taxation provisions for the estates of nationals who have transferred their residence abroad and of those who have remained in the Member State concerned, such legislation cannot discourage the former from making investments in that Member State from another State nor the latter from doing so in another Member State from the Member State concerned, and, regardless of the place where the assets in question are situated, nor can it diminish the value of the estate of a national who has transferred his residence abroad. The fact that such legislation covers neither nationals resident abroad for more than 10 years nor those who have never resided in the Member State concerned is irrelevant in that regard. Since it applies only to nationals of the Member State concerned, it cannot constitute a restriction on the movement of capital of nationals of the other Member States.*

52. The Court also, however, reaffirmed the principle it had established in *Gilly*—

> *47. As regards the differences in treatment between residents who are nationals of the Member State concerned and those who are nationals of other Member States resulting from national legislation such as that in question in the main proceedings, it must be observed that such distinctions, for the purposes of allocating powers of taxation, cannot be regarded as constituting discrimination prohibited by Article 73b of the Treaty. They flow, in the absence of any unifying or harmonising measures adopted in the Community context, from the Member States' power to define, by treaty or unilaterally, the criteria for allocating their powers of taxation (see to that effect, as regards Article 48 of the EC Treaty (now, after amendment, Article 39 EC), Case C-336/96 Gilly [1998] ECR I-2793, paragraph 30, and, as regards Article 52 of the EC Treaty (now, after amendment, Article 43 EC) and Article 58 of the EC Treaty (now Article 48 EC), Case C-307/97 Saint-Gobain ZN [1999] ECR I-6161, paragraph 57).*
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> *48. Moreover, the Court has already had occasion to decide that, for the purposes of the allocation of powers of taxation, it is not unreasonable for the Member States to find inspiration in international practice and, particularly, the model conventions drawn up by the Organisation for Economic Cooperation and Development (OECD) (see Gilly, paragraph 31). As the Netherlands Government observed, the legislation in question in the main proceedings*

complies with the commentaries in the Model Double Taxation Convention concerning Inheritances and Gifts (Report of the Fiscal Affairs Committee of the OECD, 1982)…

53. Indeed, Case C-403/03 *Schempp* [2005] ECR I-6421 illustrates that the exercise of the Community law right to move cross-border may operate to affect adversely the taxation of a particular individual in the source State without that necessarily amounting to a breach by the source State of its treaty obligations. Mr Schempp paid maintenance to his former spouse following their divorce and was ordinarily entitled to a tax deduction for his payments provided the payments were taxable in his ex-wife's hands. In Germany she was taxable on them but she then moved to Austria where they were exempt and, as a result, he lost his entitlement to deduct the payments for tax purposes.

54. The Court accepted that Community law was engaged by Mrs Schempp's decision to exercise her right to reside elsewhere within the Union and that this did not depend upon Mr Schempp exercising his Community law rights. As regards the question whether Germany was in breach of its treaty obligations in denying Mr Schempp a deduction for the payments following his ex-wife's move to Austria, the Court concluded as follows—

"*32. …it is apparent that the unfavourable treatment of which Mr Schempp complains in fact derives from the circumstances that the tax system applicable to maintenance payments in his former spouse's Member State of residence differs from that applied in his own Member State of residence.*

…

34. It is settled case law that Article 12 EC is not concerned with any disparities in treatment, for persons and undertakings subject to the jurisdiction of the Community, which may result from divergences existing between the various Member States, so long as they affect all persons subject to them in accordance with objective criteria and without regard to their nationality (see, to that effect, Case C-137/00 Milk Marque and National Farmers' Union [2003] ECR I-7975, paragraph 124 and the case law cited there).

35. It follows that, contrary to Mr Schempp's claims, the payment of maintenance to a recipient resident in Germany cannot be compared to the payment of maintenance to a recipient resident in Austria. The recipient is subject in each of those two cases, as regards taxation of maintenance payments, to a different tax system.

36. Consequently, the fact that a taxpayer resident in Germany is not able … to deduct maintenance paid to his former spouse resident in Austria does not constitute discrimination within the meaning of Article 12 EC.

…

39. As to the undisputed fact that, if Mr Schempp's former spouse had resided in Germany, he would have been entitled to deduct the maintenance paid to her,

even though in such a case the maintenance would not have been taxed because his former spouse's income in Germany during the period in question was below the tax thresholds applied by German tax legislation, that cannot call into question the conclusion in paragraph 36 above. As the Commission of the European Communities rightly observes, the non-taxation of maintenance payments on those grounds in Germany cannot be equated to the non-taxation of the maintenance in Austria on the ground of its non-taxable character in that Member State, since the fiscal consequences which attach to each of those situations as regards the taxation of income are different for the taxpayers concerned.

40. Under Article 18(1) EC, '[e]very citizen of the Union shall have the right to move and reside freely within the territory of the Member States, subject to the limitations and conditions laid down in [the] Treaty and by the measures adopted to give it effect'.

41. As a national of a Member State and hence a citizen of the Union, Mr Schempp is entitled to rely on that provision.

42. In his observations, Mr Schempp submits that Article 18(1) EC protects not only the right to move and settle in other Member States but also the right to choose one's residence. He submits that, since the maintenance payments are not deductible from taxable income where the recipient resides in another Member State, the recipient could be subject to a certain pressure not to leave Germany, thus constituting a restriction on the exercise of the rights guaranteed by Article 18(1) EC. That pressure could materialise specifically at the time when the amount of the maintenance is determined, since that determination takes the tax implications into account.

43. On this point, it is clear that … the national legislation in question does not in any way obstruct Mr Schempp's right, as a citizen of the Union, to move and reside in other Member States under Article 18(1) EC.

44. As has been observed, it is true that the transfer of his former spouse's residence to Austria entailed unfavourable tax consequences for Mr Schempp in his Member State of residence.

45. However, the Court has already held that the Treaty offers no guarantee to a citizen of the Union that transferring his activities to a Member State other than that in which he previously resided will be neutral as regards taxation. Given the disparities in the tax legislation of the Member States, such a transfer may be to the citizen's advantage in terms of indirect taxation or not, according to circumstances (see, to that effect, Case C-365/02 Lindfors [2004] ECR I7183, paragraph 34).

46. The same principle applies a fortiori to a situation such as that at issue in the main proceedings where the person concerned has not himself made use of his right of movement, but claims to be the victim of a difference in treatment following the transfer of his former spouse's residence to another Member State.

47. In those circumstances, the answer to the questions referred must be that the first paragraph of Article 12 EC and Article 18(1) EC must be interpreted as not precluding a taxpayer resident in Germany from being unable, under national legislation such as that at issue in the main proceedings, to deduct from his taxable income in that Member State the maintenance paid to his former spouse resident in another Member State in which the maintenance is not taxable, where he would be entitled to do so if his former spouse were resident in Germany."

55. We think it clear, therefore, that the UK's insistence as the source state on taxing Mr Percival's civil service pension notwithstanding his choice to move to Ireland cannot be regarded as a restriction on the exercise of his Community law rights. And, indeed, it would be extraordinary if that were so in these circumstances because the United Kingdom has chosen to retain its taxing right in the context of the DTC under which it has secured for Mr Percival exemption from taxation in Ireland on the same income. Whether that works in Mr Percival's favour or not is, as the Court noted in paragraph 45 of its decision in *Schempp*, irrelevant.

56. We also think that that the fact that the United Kingdom gives up its taxing rights as the source state in favour of Ireland as the residence state in respect of public pensions paid to Irish nationals or dual British/Irish nationals cannot be the foundation of any complaint by Mr Percival. The principle of non-discrimination under Community law requires that comparable situations must not be treated differently unless such treatment can be objectively justified. In relation to direct taxes, the situations of residents and non residents are not, as a rule, comparable (Case C-279/93 *Schumacker*, paragraph 31). Furthermore, a resident of one Member State is not usually comparable to a resident of another Member State who is entitled to the benefit of a Double Taxation Convention with a third Member State (Case C-376/03 D v *Inspecteur van de Belastingdienst/Particulieren/Ondernemingen buitenland te Heerlen* [2005] ECR I-05821 paragraph 63).

57. We think that these basic principles are closely related to the Court's approach in dealing with the allocation of taxing rights. Irish and dual British/Irish nationals are not in a comparable position to Mr Percival as a British national because each is subject to a different tax system in respect of the income in question. It is true that that difference in taxation treatment derives from their different nationalities but they are nevertheless in objectively a different situation because they are subject to different tax systems: the United Kingdom's in Mr Percival's case and the Republic of Ireland's in Mrs Percival's case.

58. If the United Kingdom had as a unilateral measure under its domestic tax system chosen to retain its taxing rights over certain income of British nationals but to forego equivalent taxing rights in the case of non-British nationals, without regard to the comparability of their situation as residents of another Member State, further consideration might be required as to whether in the particular circumstances such a rule was compatible with the United Kingdom's treaty obligations or involved discrimination. That is not, however, the case here because the rule operates in the context of a DTC establishing the respective taxing rights of the United Kingdom and the Republic of Ireland and in doing so secures that Mr and Mrs Percival are not objectively in a comparable position.

59. We therefore conclude that Article 18 of the DTC is compatible with the United Kingdom's obligations under the European treaties.

The discrimination complaint: Human Rights

60. Mr Percival's complaint on human rights grounds is that he is discriminated against contrary to Article 14 of the European Convention on Human Rights read with Article 1 of Protocol 1, because as a British national resident in Ireland he is treated differently for tax purposes than an Irish national (or dual British/Irish national) in receipt of the same UK civil service pension. The discrimination is said to be on the grounds of national origin, in that he is of sole British nationality, or place of birth, in that if he had been born in Northern Ireland, he would be entitled to Irish nationality as a matter of right.

61. Article 14 is relevantly in the following terms—

> "*The enjoyment of the rights and freedoms set forth in this Convention shall be secured without discrimination on any ground such as … national or social origin … birth or other status*."

62. Article 1 of Protocol 1 provides that—

> "*Every natural or legal person is entitled to the peaceful enjoyment of his possessions. No one shall be deprived of his possessions except in the public interest and subject to the conditions provided for by law and by the general principles of international law.*
>
> *The preceding provisions shall not, however, in any way impair the right of a State to enforce such laws as it deems necessary to control the use of property in accordance with the general interest or to secure payment of taxes or other contributions or penalties*."

63. HMRC do not dispute that the right to receive a pension is capable of being a possession for the purposes of Article 1 of Protocol 1 (*R v Secretary of State for Work and Pensions ex parte Carson and Reynolds* [2006] 1 AC 173 per Lord Hoffmann at para 12). They say, however, that there is a sufficient relevant difference between Mr Percival as a British national living in Ireland in receipt of a UK civil service pension and Mrs Percival as an Irish national living in Ireland and in receipt of a British local authority pension to justify the different treatment. Alternatively, they say that any difference in treatment is reasonable and proportionate.

64. HMRC justify their conclusion by reference to *Gilly* and the fact that the UK and Ireland have agreed a different allocation of taxing rights in respect of Mr and Mrs Percival by reference to established principles of international law. In this respect we recognise that there is an important difference between Mr and Mrs Percival given that they are subject to tax on the income in question in different countries. Mr Percival might observe that the difference arises from the choice that has been made by reference to their respective nationalities, which is the source of his complaint. Nevertheless, the same answer could be given to this as we gave in relation to the Community law issue.

65. In any event, we do not believe that we need to analyse this aspect of the matter further from a human rights perspective because we are satisfied that even if Mr Percival's complaint under this head were well founded, he has no remedy. As HMRC point out, section 3(1) of the Human Rights Act 1998 provides that—

> "*So far as it is possible to do so, primary legislation and subordinate legislation must be read and given effect in a way which is compatible with Convention rights*."

66. The DTC itself is not primary or secondary legislation but it is given effect to for tax purposes through statutory provision (section 788 Income and Corporation Taxes Act 1988) and is incorporated in secondary legislation pursuant to that statutory provision. However, we think it impossible to construe or give effect to the DTC in a manner compatible with Mr Percival's human rights (assuming for the moment that there has been some breach of his human rights). The DTC unambiguously allocates the sole taxing rights in respect of this element of Mr and Mrs Percival's pension income to the UK and Ireland respectively. On the basis that the DTC is compatible with Community law (as we have concluded), the most that we could do, would be to issue a declaration of incompatibility under section 4 of the Human Rights Act 1998 but, as HMRC point out, this Tribunal has not been invested with the power to make such a declaration.

The discrimination complaint: Article 23 of the DTC

67. We pass on to the principal ground that Mr Percival advanced before us, namely that the non-discrimination Article of the DTC applies in this case to relieve Mr Percival of more burdensome UK taxation while he is resident in the Republic of Ireland than the taxation to which Irish nationals in the same circumstances are subjected. Mr Percival says that this construction of Article 23(1) has the effect of requiring that taxation of government pensions to take account of the individual's residence and family circumstances in the other state rather than charging tax solely by reference to the paying state's tax code. He goes on to point out that the UK and Irish tax codes were substantially similar when the DTC was agreed and that the Irish punt was fixed at parity with sterling. Accordingly, he says, it would initially have been of little moment whether the taxing rights were allocated to the UK or Ireland. As the tax systems (and exchange rates) have changed, so it has become a matter of more significance.

68. While we can admire Mr Percival's ingenuity in his particular reading of Article 23(1), we do not consider that it is correct. First, it would be very unusual for a source state (in this instance the United Kingdom) to agree to qualify the on-going taxing rights that the treaty has reserved to it (by Article 18 in this case) by reference to the general terms of the non-discrimination article and based on the future taxation choices made by the other state. In *UBS AG v HMRC* [2007] STC 588 Moss LJ suggested that it was "inconceivable" that having expressly provided a specific treatment under one article of the treaty, that treatment would be modified in certain cases by the general terms of the non-discrimination article. The same would appear to be true in this case.

69. Second, the language of Article 23(1) in referring to "shall not be subjected … to any taxation" is naturally referring to taxation imposed by "the other Contracting State", in this case Ireland. Even if Article 23(1) is read, as Mr Percival suggests, as "shall not be subjected [while] in the other Contracting State to any taxation", this would more naturally refer to the taxation of the Contracting State within which the foreign national currently is found or resides than the taxation of the Contracting State of which he is a national.

70. The same expression "shall not be subjected in [a Contracting State] to any taxation" is repeated in Article 23(3), which is the corresponding Article for companies and which provides that—

> "*Enterprises of a Contracting State, the capital of which is wholly or partly owned or controlled, directly or indirectly, by one or more residents of the other Contracting State, shall not be subjected in the first mentioned Contracting State to any taxation or any requirement connected therewith which is other or more burdensome than the taxation and connected requirements to which other similar enterprises of that first mentioned State are or may be subjected.*"

71. The Article plainly operates to constrain a State from applying more burdensome taxation to one of its enterprises because it is owned or controlled by residents of the other Contracting State. In this instance it is clear that "subjected in the first mentioned State to any taxation" is a reference to taxation imposed by the State in which the enterprise is formed (i.e. Ireland) and not the other Contracting State (the UK). The fact that Article 23(1) refers to "the other Contracting State" and that Article 23(3) refers to "the first mentioned Contracting State" reflect that Article 23(1) starts by referring to a foreign national who comes into the State in question whereas Article 23(3) starts with a national of the State in question (being one of its enterprises) that is owned or controlled by foreign residents. That different starting point does not, however, lend support to the idea that "subjected to any taxation" is referring to something different in each case: in both cases, it refers to any taxation of the State in which the enterprise is formed and in which the foreign national is currently found.

72. The scope of the equivalent provision to Article 23(3) in the UK/US and UK/Japan Double Taxation Conventions was considered by the House of Lords in *Boake Allen Ltd v HMRC* [2007] 1 WLR 1386. That case illustrates that the Article is concerned with the taxation provisions of the State in which the enterprise in formed. Lord Hoffmann described in paragraph 5 of his speech the function of the standard non-discrimination article as, "prohibiting various forms of discrimination by the tax laws of the one contracting state against nationals or residents of the other".

73. In referring to the equivalent provision to Article 23(1) he said (at paragraph 16) that—

> "*In relation to article 24(1) of the OECD Model Convention, the commentary says that the "underlying question" is whether two residents are being treated differently "solely by reason of having a different nationality". It does not repeat this observation in relation to article 24(5), but the principle must be the same.*"

74. Further on at paragraph 22 he also said—

> "*As the commentary on the OECD model says, the equality [a treaty] ensures is only that any enterprise [a company or individual resident in one country] owns in the other country will not be subject to taxation which discriminates on the ground of its foreign control.*"

75. Lord Hoffmann's analysis of the non-discrimination provisions has been subject to recent analysis by the Court of Appeal in *HMRC v FCE Bank plc* [2012] EWCA Civ 1290. In that case the Court of Appeal was able to reach a different conclusion on the application of the non-discrimination article to the UK group relief provisions as compared to the House of Lords' conclusion in *Boake Allen* regarding the group ACT provisions. We do not need to explain the analysis in either case as it is not directly relevant to Mr Percival's suggested construction of Article 23(1). Nothing in *FCE Bank* casts doubt on Lord Hoffmann's more general consideration of the function of the non-discrimination article of the OECD Model Convention. Furthermore at paragraph 38 of his judgment in *FCE Bank* Rimer LJ said this—

> "*The purpose and effect of article 24(5) are to outlaw the admittedly discriminatory tax treatment to which (but for the convention) FCE would be subject as the directly held subsidiary of a US-resident company as compared with the more favourable tax treatment to which it would be entitled if it were the directly held subsidiary of a UK-resident company. That shows, in my judgment, that the only reason for the difference in treatment in the [present case is the fact of FMC's US residence.*"

76. Ms Ford drew our attention to the commentary on the OECD Model Convention to which Lord Hoffmann alluded and its explanation of the discrimination against which the standard article is directed. Mr Percival produced an article by Professor Dr Michael Lang and Florian Brugger in (2008) 23 Australian Tax Forum discussing the role of the commentary in the interpretation of tax treaties. We find it unnecessary to discuss this material in more detail here because in our view a natural reading of the language of Article 23(1) in the context of the treaty as a whole indicates that the Article does not bear the meaning for which Mr Percival contends. The commentary and the authorities to which we have referred support that conclusion.

Our conclusion

77. As appears from this decision, the Community law questions that arise from Mr Percival's complaint have appeared to us the issue requiring more substantive consideration. We are uncertain why Mr Percival decided not to pursue his Community law arguments before us and to limit his submissions to the non-discrimination provisions of the DTC. We did not understand him to be abandoning his other arguments and we would in any event have advised him against that course given that he was unrepresented and that he did not have the benefit of professional advice to do so.

78. We have considered whether in the light of that we should invite further submissions from both parties before reaching a decision. In the event we have concluded against that course because we think that the answer to the Community law

questions is clear even if *Gilly* alone does not in our view provide the complete answer that HMRC suggested in their Statement of Case.

79. We accordingly dismiss Mr Percival's appeal. If in the light of our analysis Mr Percival believes that his complaint merits further consideration of the issues with the benefit of more detailed written and oral submissions on the matter, he may seek to take the matter further by applying for permission to appeal.

80. 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.

MALCOLM GAMMIE CBE QC
TRIBUNAL JUDGE

RELEASE DATE: 18 April 2013