THE COMMISSIONER OF INLAND REVENUE

A

v.

COMMONWEALTH DEVELOPMENT CORPORATION

[COURT OF APPEAL, 1995 (Kapi, Thompson, Hillyer JJ.A), 22 May]

B

Civil Jurisdiction

Income Tax - liability of non resident enterprise in respect of profits derived in Fiji-whether having a "permanent establishment" in Fiji-whether activities of a "preparatory or auxiliary character"-Fiji/UK double taxation Convention (Cap. 201) Subs s69.

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The Respondent objected to a taxation assessment on the grounds that it was not carrying on business in Fiji and that the taxation was discriminatory. On appeal from the decision of the High Court upholding the objections. HELD: The High Court had correctly interpreted the relevant provisions of the Convention.

D

Cases cited

Hayes v. Federal Commissioner of Taxation (1956) 96 C.L.R.47
James Buchanan & Co. Ltd v. Babco Forwarding & Shipping (U.K.) Ltd [1978] A.C.141
Fothergill v. Monarch Airlines Ltd. [1981] A. C. 215
W.T. Ramsay Ltd v. Inland Revenue Commissioners [1982] A.C.300

E

Appeal against dismissal of appeal from the Court of Review by the High Court.

M.J. Scott with *Mr. I.W. Blakeley* for the Appellant
Mr. I.V. Gzell Q.C. with *Mr. R. Naidu* for the Respondent

F

JUDGMENT OF THE COURT

This appeal concerns the liability of an enterprise of the United Kingdom to pay income tax in Fiji in respect of its profits derived in Fiji. Article 8.1 of a Convention entered into between the governments of Fiji and the United Kingdom, entitled the Double Taxation Relief Arrangements with the United Kingdom, provides for the profits of such an enterprise to be taxable onlu in the United Kingdom unless it carries on business in Fiji through a permanent establishment situated in Fiji. The appellant issued an assessment inrespect of the profits of the respondent for the 1989 tax year on the basis that it was carrying on business in Fiji through a permanent establishment situated in Fiji.

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A The respondent objected to the assessment but the appellant disallowed it wholly. The first ground of the objection was that the respondent was not carrying on business in Fiji through a permanent establishment situated in Fiji. The second ground of the objection was that the taxation was more burdensome than the taxation levied on an enterprise of Fiji carrying on the same activities. The respondent appealed to the Court of Review, established by section 63 of the
B Income Tax Act (Cap 201), against the disallowance of its objection. The Court of Review decided that the Respondent had not carried on business in Fiji through a permanent establishment situated in Fiji and expressed the view also that the respondent would be entitled to succeed with its appeal also on the basis that the taxation was discriminatory. The appellant in these proceedings was not satisfied with that decision and referred the matter to the High Court for hearing and determination. In the High Court Scott J. dismissed the appeal,
C although his reasons for reaching the same conclusions as the Court of Review were somewhat different.

The respondent is a statutory corporation. It was established by an Act of the United Kingdom Parliament. Provision is made in section 1 of the Commonwealth Development Corporation Act 1978 (UK.) for it to continue
D to be a body corporate. Section 2(1) of that Act provides that the purpose of the respondent is to "assist overseas countries, in accordance with the provisions of this Act, in the development of their economies". Section 2(2) confers a number of powers on the respondent for the purpose mentioned in sub-section (1). Those powers are as follows:

E "(a) to investigate and formulate projects for the promotion or expansion in overseas countries of new or existing enterprises falling within section 3(1) below, and to carry out any such projects;

(b) to carry on undertakings in overseas countries which
F appear to the Corporation to be needed for or in connection with the promotion or expansion in those and other overseas countries of new or existing enterprises falling within section 3 (i) below;

(c) to carry on any activities incidental to a project falling within paragraph (a) above or to an undertaking falling
G within paragraph (b) above which appear to the Corporation to be requisite, advantageous or convenient for or in connection with that project or undertaking;

(d) to assist other bodies or persons, either financially or in any other way, to perform any functions which the

Corporation is empowered to perform by virtue of any of paragraphs (a) to (c) above; and

(e) to establish or expand, or promote the establishment or expansion of, other bodies to carry on (either under the control or partial control of the Corporation or independently) any functions which the Corporation is empowered to perform by virtue of any of paragraphs (a) to (d) above or to assist the Corporation to perform any of those functions."

Section 3 of the United Kingdom Act explains what are the enterprises referred to in section 2(2). They are specified as follows:

"(a) agricultural enterprises, including any enterprise concerned with the livestock industry, with horticulture, or with forestry;

(b) enterprises concerned with fisheries, including any enterprise relating to the taking of marine mammals;

(c) enterprises for the working or getting of minerals;

(d) industrial enterprises;

(e) enterprises for providing, maintaining or improving the supply of water, electricity or gas;

(f) enterprises for providing, maintaining or improving transport facilities or transport services, or for providing, maintaining or improving telegraph or telephone services, including wireless services other than broadcasting, but not including broadcast relay services;

(g) enterprises for the provision or improvement of houses or other dwellings;

(h) enterprises for the keeping of hotels;

(i) enterprises for processing, storing or marketing any products of one or more enterprises falling within and of paragraphs (a) to (h) above;

(j) enterprises for the carrying out of building,

engineering or other operations in, on, over or under land."

Section 9 of the United Kingdom Act confers borrowing powers on the respondent. Section 10 authorises the Minister responsible for the Act to make advances of money to the respondent. Section 11 authorises the United Kingdom Treasury to guarantee borrowings of the respondent. Section 12 requires the respondent to pay to relevant Minister of the United Kingdom government amounts required to repay advances made to it and amounts in respect of interest on any outstanding balance of advances. Section 15 requires the respondent to exercise and perform its functions in such a manner as to secure that its revenues are not less than sufficient to meet all sums properly chargeable to its revenue account. Any excess is to be applied by the respondent for such purposes as it may determine with the approval of the Minister.

In 1960 the respondent established in Fiji a wholly owned subsidiary, the Fiji Development Company Limited; that company still exists and operates from its own building in Victoria Parade, Suva. It is incorporated in Fiji; its directors are appointed by the respondent. That subsidiary, of course, is liable to taxation in Fiji. In 1973 the respondent was registered in Fiji as an overseas company; thereafter it had its own separate office in Fiji. In 1989 the respondent had an employee resident in Fiji, Mr. C.H.C. Seller. In an affidavit which was part of the evidence in the proceedings in the Court of Review, he described himself as the respondent's "Area Representative". He said that he had represented the respondent in the Solomon Islands and Vanuatu as well as in Fiji. We shall discuss later in this judgment the functions he performed in Fiji.

Article 5 of the Convention is concerned with the meaning of the expression "permanent establishment" for the purposes of the convention. Paragraphs 1, 2 and 3 of Article 5 are as follow:

> "1. For the purposes of this Convention, the term "permanent establishment" means a fixed place of business in which the business of the enterprise is wholly or partly carried on.
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> 2. The term "permanent establishment" shall include especially:
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> (a) a place of management;
> (b) a branch;
> (c) an office;
> (d) a factory;
> (e) a workshop;

(f) a mine, oil well, quarry or other place of extraction of natural resources;

(g) a building site or construction or assembly project which exists for more than six months;

(h) an agricultural, pastoral or forestry property.

3. The term "permanent establishment" shall not be deemed to include:

(a) the use of facilities solely for the purpose of storage, display or delivery of goods or merchandise belonging to the enterprise;

(b) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage, display or delivery;

(c) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of processing by another enterprise;

(d) the maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise, or for collecting information, for the enterprise;

(e) the maintenance of a fixed place of business, solely for the purpose of advertising, for the supply of information, for scientific research or for similar activities which have a preparatory or auxiliary character, for the enterprise."

It should be mentioned. that paragraph 5 of Article 5 has the effect that, if a person acts in Fiji on behalf of an enterprise of the United Kingdom (otherwise than as an agent with an independent status) and if he has; and habitually exercises in Fiji, an authority to conclude contracts in the name of the enterprise, he is to be deemed to be a permanent establishment of the enterprise in Fiji, unless his activities are limited to the purchase of goods or merchandise for the enterprise. It is not in dispute that in 1989 neither Mr. Seller nor any other person acting on behalf of the respondent in Fiji had authority to conclude contracts in its name other than for the purchase of and merchandise for its Fiji office.

Article 24 of the Convention contains provisions to prohibit taxation discrimination against nationals and corporations of the United Kingdom in respect of their activities in Fiji. Paragraph 2 is as follows:

> "2. The taxation on a permanent establishment which an enterprise of a Contracting State has in the other Contracting State shall not be less favourably levied in that other State than the taxation levied on enterprises of that other State carrying on the same activities:
>
> Provided that this paragraph shall not prevent the Government of a Contracting State from imposing on the profits attributable to a permanent establishment in that Contracting State of a company which is a resident of the other Contracting State an additional tax not exceeding 15 per cent of two-thirds of the profits of the permanent establishment after payment of the company or corporation tax on those profits."

The grounds of the present appeal are as follows:

> "1. That the Learned High Court Judge, and the Court of Review, erred in law in interpreting the prefatory words of Article 5(3) of the treaty between Fiji and the United Kingdom for the elimination of double taxation as excluding from the definition of "permanent establishment" items listed within the said Article 5(3);
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> 2. That the Learned High Court Judge and the Court of Review erred in law in holding that all activities carried out by the Respondent during the 1989 income year fell within paragraph 5(3)(d) or paragraph 5(3)(e) of the said treaty;
>
> 3. That the Learned High Court Judge and the Court of Review erred in law in holding that in the 1989 income year, the Appellant discriminated against the Respondent in a manner prohibited by Article 24(2) of the said treaty."

Essentially the issues which this Court is required to address are three. The first concerns the interpretation of the prefatory words in Article 3 of the Convention. The second concerns the interpretation of sub-paragraphs (d) and (e) of that Article, consideration of the facts of which Mr. Seller gave evidence in his affidavit and the application of sub-paragraphs (e) of Article 3 to those facts. The third issue concerns the interpretation of Clause 2 of Article 24. It is not in dispute that the rate of tax imposed on the respondent by the appellant

in making the assessment was higher than the rate of tax which would have been imposed on a company incorporated in Fiji and carrying on the same activities.

The Convention is based on a model treaty drafted in 1963 for the O.E.C.D. ("the 1963 O.E.C.D. draft model"). The O.E.C.D. subsequently developed that draft and in 1977 adopted a revised draft ("the 1977 O.E.C.D. model"). A commentary on the 1963 O.E.C.D. draft model was prepared by those who had drafted it ("the 1963 commentary"). Another commentary on the 1977 model was similarly prepared ("the 1977 commentary"). For the sake of completeness we mention that the 1977 O.E.C.D. model was revised in 1992 and the revised model was adopted by the O.E.C.D. ("the 1992 O.E.C.D. model"). As previously a commentary on that model was published ("the 1992 commentary").

We turn now to consider ground 1 of the appeal. It concerns the meaning of the prefatory words of Article 5.3 of the convention and in particular the phrase "shall not be deemed to include". Those prefatory words are identical with the words in an Article in the 1963 O.E.C.D. draft model in respect of the subject matter. However, in the 1977 O.E.C.D. model they are different. The words "shall not be deemed to include" have been replaced by the words "shall be deemed not to include."

The Court of Review, somewhat elliptically, observed:

> "... although I agree that "shall be deemed not to include" has a different, meaning from "shall not be deemed to include", I cannot see any difference in meaning in the present content."

In the High Court Scott J. observed that the ascription of a literal meaning to Article 5.3 would not be appropriate unless some purpose, negatived by the paragraph, could be served by "deeming", that is to say presuming, permanent establishments to include the activities specified in sub-paragraphs (a) to (e) of the paragraph. He could not discover any such purpose; so he found that the words had the same effect as those used in the O.E.C.D. model.

In coming to that conclusion his Lordship adopted the approach taken in the 1963 commentary, noting that it had received the approval of the majority of commentators who had considered the provision. Reference to *travaux preparatoires* is accepted in international law as one of the tools which can, in certain circumstances, be used to interpret treaties between countries. As Scott J. pointed out, it is expressly provided for in the Vienna Convention on the Interpretation of International Conventions (Article 32). However, as he noted, the Vienna convention also requires a treaty to be interpreted in accordance with the ordinary meaning to be given to its terms in their context

and in the light of its object and purpose (Article 31 (1)). Recourse to supplementary means of interpretation, including reference to *travaux preparatoires*, is permitted by Article 32 only to confirm the meaning resulting from applying Article 31 or to determine the meaning when interpretation according to Article 31 either produces a meaning which is ambiguous or obscure or leads to a manifestly absurd or unreasonable result. Article 31, of course, reflects the manner in which at common law the Courts have interpreted domestic legislation.

In this Court Mr. Scott submitted that there was no need to resort to any *travaux preparatoires* because the result of applying the normal common law principles of interpretation was not an ambiguity, obscurity or absurdity. The correct interpretation of the words in issue was that a fixed place of business was not to be conclusively presumed to be a permanent establishment merely because of the existence of any of the factual situations specified in sub-paragraphs (a) to (e). By contrast the words used in the 1977 model would require that to be conclusively presumed.

We accept - as apparently Scott J did - that the meaning for which Mr. Scott argued is one which could result from the application of the common law principles of interpretation. However, we agree with his Lordship that, in their context, that is to say in combination with Article 5.1, ascribing such a meaning to Article 5.3 would result in its serving no purpose. Each of the factual situations described in sub-paragraphs(a) to (e) is an example of carrying on in Fiji part of the business of the overseas enterprise. Prima facie it brings the fixed place of business where it is carried on within the terms of Article 5.1. There is no need for any presumption that it does so.

We are satisfied that his Lordship correctly proceeded to make reference to the 1963 commentary because to have accorded to the word in issue the meaning resulting from the application of the usual common law principles of interpretation would have led to an unreasonable result, that is to say that Article 5.3 was completely otiose. It was proper for him to refer to the commentary because, even though the Convention must be regarded as incorporated into the domestic law of Fiji by virtue of the Statutory basis by which the Minister was authorised to enter into it (Income Tax Act section 106), the international law obligations of comity require that, so far as is possible, its provisions be construed in the manner in which the other party to it might reasonably expect, in this instance that regard be had to the fact that it was based on O.E.C.D. draft model. This approach is consistent with that approved by the House of Lords in James Buchanan & Co. Ltd v. Babco Forwarding and Shipping (U.K.) Ltd [1978] A.C.141, per Lord Wilberforce at 153 and per Lord Salmon at 161.

Paragraph 10 of the 1963 commentary reads:-

"Paragraph 3

10. This paragraph contains, first, a number of examples of forms of business activity which should not be treated as constituting permanent establishments even though the activity is carried on in a fixed place of business and, secondly, in the last few words of sub-paragraph (e), a generalised exception to the rule laid down in paragraph 1 that a "fixed place of business in 1 which the business of the enterprise is wholly or partly carried on" shall be regarded a priori as a permanent establishment."

We are satisfied that the words in issue in respect of the first ground of appeal are capable of bearing the meaning which the 1963 commentary indicates the draftsman intended them to bear. That such had been the draftsman's intention was confirmed by the 1977 commentary. We have come to the conclusion, that Scott J. was correct in his decision as to the meaning of the prefatory words of Article 5.3. The first ground of appeal cannot, therefore, be upheld.

The second ground is concerned with the purpose for which the respondent maintained its fixed place of business in Fiji. The Court of Review and the High Court ascertained that purpose by reference to the activities which were carried on at and from that fixed place of business. As the appeal in these proceedings is from a decision of the High Court in the exercise of its appellate jurisdiction, any ground must be one involving only a question of law (Court of Appeal Act (Cap.12) section 12(1)(c)). The nature, extent and details of the activities carried on by the respondent at and from its Fiji office have never been in dispute. What has been in dispute, and what is put in issue in the second ground of appeal, is the categorisation of those activities in terms of the words used in sub-paragraphs (d) and (e) of Article 5.3, as well as the interpretation of those sub- paragraphs. Such categorisation is a question of law, just as much as the interpretation of the sub-paragraphs (see e.g. Hayes v. Federal Commissioner of Taxation (1956) 96 C.L.R.47).

The activities carried on at and from the respondent's Fiji Office were those of its Area Representative and his staff. They were described by Mr. C.H.C. Seller, who was the Area Representative in 1989, in an affidavit on which was cross-examined in the Court of Review. He also gave an account of the respondent's management structure; he said that authority to make decisions of any consequence was not delegated outside the head office of the respondent in the United Kingdom. He enumerated the Area Representative's duties under six heads. They were:

"(a) generally the representation of the respondent's interests in the area, i.e. in Fiji, the Solomon Islands and Vanuatu;

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(b) promotion of the respondent's services and facilities in the area;

(c) identification and development of new business opportunities for the respondent in the area;

B (d) monitoring the respondent 's investments in the area;

(e) establishment and maintenance of relations with the British government's representatives, Fiji ministers and officials and "commercial and political contacts", including international agencies.

C He described how the Area Representative looked for investment opportunities for the respondent and then passed information about them to the respondent's head office in the United Kingdom. If it was interested in following the matter up, it sent employees from the United Kingdom to investigate the situation in depth. It was only after those employees had made their report that a decision was made whether or not to invest; the decision was made in the respondent's D head office in the United Kingdom and the investment, if decided upon, made from there. Mr Seller said that, although his duties included monitoring investments once they had been made, he had no authority to take any action in the light of the information he obtained. He simply passed it on the head office in the United Kingdom where any decision to take action was made and any action decided upon was taken. Cross-examined, Mr. Seller acknowledged that, E when he gathered information about investment opportunities or the performance of an investment, he analysed it and sent comments and recommendations with it to the head office. He also agreed that he actively looked for investment opportunities.

It is not entirely clear whether the Court of Review considered that some of the F activities performed at and from the respondent's Fiji office fell within sub-paragraph,(d) of Article 5.3 and others within sub-paragraph (e) or that they all fell within sub-paragraph (e). In the High Court Scott J. expressly found that all of them fell within sub-paragraph (e). If they can all be properly categorised as having a preparatory or auxiliary character, we are satisfied that his Lordship was correct.

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However, it is necessary to consider what is meant by the words "have a preparatory or auxiliary character" mean in sub-paragraph (e). Further, to what

is it that the character of the particular activities must be preparatory or auxiliary? In deciding those questions it is necessary, we consider, because the words are in a treaty, to give them a purposive, rather than a literal,

interpretation, notwithstanding that the treaty has been incorporated into the

domestic law of Fiji (Fothergill v. Monarch Airlines Ltd. [1981] A. C. 215). A
That approach is required also by the fact that the legislation related to taxation (W.T. Ramsay Ltd v. Inland Revenue Commissioners [1982] A.C.300, per Lord Wilberforce at 323).

The natural meaning of the words appears to us to be that the activities must either be engaged in preparation for the main business, or core activity, of the enterprise or be engaged in to assist in that main business or core activity B
without itself constituting that main business or core activity. The terms of Article 5.1 make it necessary, in our opinion, to view the activities carried on by reference to their relationship to the business of the enterprise. The requirement that they be similar to the specific activities referred to in sub-paragraph (e) means that they must be preparatory or auxiliary in the same sense that those specific activities are preparatory or auxilliary. C
Of course, the specific activities would not be regarded as preparatory or auxiliary if they were themselves a core activity of the enterprise. In the 1963 commentary one example was given of advertising being carried on by an advertising agency.

When reference is made to paragraphs 12 and 13 of the 1963 commentary, it confirms that as the meaning which the words were intended to have. Those D
paragraphs read:-

> "12. It is recognised that a place of business the function of which is solely that of advertising, or the supply of information, or of scientific research may well contribute to the productivity of its parent enterprise. To assume so is once more axiomatic. But the E
> services it performs for its parent enterprise are so far antecedent to the actual realisation of profits by its parent body that no profits can properly be allocated to it; accordingly it does not constitute a taxable unit .....
>
> 13. The last words of sub-paragraph (e), or for similar activities F
> which have a preparatory or auxillary character for the enterprise, require a special explanation of their own. The purpose of these words is twofold. In the first place, since it would be unreasonable to seek to claim that the list of examples quoted in paragraph 3 is, or in the nature of things could hope to be, exhaustive, the last words of sub- paragraph (e) are intended , to cover any further G
> examples (such as the organisation maintained solely for the purposes of servicing a patent or 'know-how' contract) which are not listed among the exceptions in paragraph 3 but are nevertheless within the spirit of them .... In the second place, the words extend the principle underlying the examples in sub-paragraph (e) to provide a generalised exception to the general definition in

A paragraph 1. To a considerable degree they delimit that definition and exclude from its rather wide scope a number of forms of business organisation which, although they are carried on in a fixed place of business, should not be treated as taxable units. It will of course be the responsibility of the enterprise to prove that the activities in question are of a preparatory or auxiliary character within the framework of the whole activities of the enterprise. If, for example, the results of the research carried on in a laboratory are not only used by the enterprise but are also sold to a third party, the paragraph would cease to apply."

In an article on Permanent Establishment published in a Series on International Taxation (1991, Kluwer Law and Taxation – Publishers, Deventer, Boston, USA) Arvid A. Skaar gives the following description of a tax-treaty case decided by the German Supreme Court:

> "...the Court dealt with a US bank that was preparing to open a branch in Germany. Office space was rented, staff were hired, and capital transferred to Germany. An application to be allowed to engage in banking business in Germany was submitted, and later approved, and the branch was registered in Germany as a bank. The question was whether the sum of these activities amounted to a core business activity, even if each activity itself was merely of a preparatory nature. The Court held that the combination of these activities transcended the preparatory level, and thus constituted a "business activity." The US bank thus had a PE in Germany."

We would agree that sub-paragraph (e) should be construed so that it is the totality of the activities that are carried on that must be preparatory auxiliary.

We turn then to consider whether his Lordship erred in law in categorising the activities of the Area Representative, which the sole purpose for which the respondent maintained its Fiji office, as preparatory or auxiliary to the main business, or activity, carried on by the respondent. Mr. Scott submitted that because under the provision of section 2(1) of the Commonwealth Development Act the purpose of the respondent is to assist overseas countries in the development of their economics, and because section 2(2) includes among the powers conferred on it for that purpose the power to investigate and formulate projects for the promotion or expansion in overseas countries of new or existing enterprises, such investigation is a core activity. We are unable to agree with that. The respondent's annual report for 1989 shows that the manner in which it seeks to achieve its statutory purpose is mainly by the investment of money in enterprises in overseas countries. It also assists in the management of a number of enterprises in several countries. Those are the activities which

comprise its main business, its core activity, and by reference to which the activities carried on in and from its Fiji office must be categorised.

Scott J. observed that "the line between auxiliary and preparatory activities and activities forming part of the core activity of an enterprise is not one that is easy to draw". We should have preferred to use "may be" instead of "is" but otherwise agree with that observation. His Lordship also observed that many different tests and approaches had been devised by learned commentators. Mr. Scott criticised his Lordship's failure to explain why he concluded that the Court of Review had been right to draw the line where he did. We do not consider that the criticism is justified. However, even if it were, we should have upheld his decision because, when the method of categorisation of activities as preparatory or auxiliary which described above is applied to the factual situation of what the activities carried on in and from the Fiji office were, both individually and in their totality, there is no doubt that be categorised them correctly. Accordingly, the appellant does not succeed on the second ground of his appeal.

It is not necessary for us to deal with the third ground, the appeal having failed on the first and second grounds, no tax was payable. The matter was addressed very briefly by the Court of Review but rather more fully by Scott J. It would, we believe not be helpful for us to deal with it except by a full discussion of the arguments advanced to us by the parties. However, whatever views we expressed would necessarily be obiter dicta. The obiter dicta of Scott J. will serve as a starting point for argument should the issue have to be decided in future. We think it best, therefore, not to express any views on the merits of the third ground.

For the reasons given above, the appeal is dismissed. The appellant is to pay the respondent's costs of the appeal.

(Appeal dismissed.)