THE COMMISSIONER OF INLAND REVENUE

A v

THE COMMONWEALTH DEVELOPMENT CORPORATION

[HIGH COURT, 1994 (Scott J), 14 June]

Appellate Jurisdiction

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Income Tax-double taxation-taxation discrimination-meaning of "permanent establishment"-Income Tax Act (Cap 201) Section 106.

On appeal against a decision of the Court of Review the High Court examined the meaning of the phrase "permanent establishment" as used in the Fiji/UK Double Taxation Convention; the distinction between auxiliary and care activities and whether there had been taxation discrimination.

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Cases cited:

CIR v United Dominions Trust Limited (1973) 1 NZTC 80003
Federal Commissioner of Taxation v Robinson 1992 ATR 364
D *Fothergill v Monarch Airlines Ltd* [1981] AC 251
Sunlife Assurance Co of Canada v Pearson [1984] STC 461 506

Appeal to the High Court from the Court of Review (taxation).

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

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Scott J:

This is an Appeal from the Court of Review (Hon. K.A. Stuart) brought pursuant to the provisions of section 69 of the Income Tax Act (Cap.201).

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As will be seen from paragraphs (2) to (4) and (5) of the Reference of Appeal filed on 24 November 1992 the two general areas of appeal are that the Court of Review misconstrued the meaning and effect of Articles 5 and 24 of the Fiji/ United Kingdom Double Taxation Convention (The Convention) (see Income Tax Act, section 106 and Cap.201, subsidiary legislation S-69).

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Paragraph 1 of the Reference of Appeal raises a third ground of appeal however after discussion with Counsel and acceptance by both sides that the evidence objected to could not be directly or finally probative of any issues before me this ground was not pursued. Both Parties, in addition to citing authorities, relied on numerous learned authors, most living, without objection. Insofar as I derived assistance from the evidence given by Mr. Avery Jones I did so to the same extent and on the same basis as I derived assistance from the various other learned authors relied upon by the Parties.

The following written submissions were filed:

1. Appellant - 26 October 1993.
2. Respondent - 17 November 1993.
3. Appellant's reply - 9 December 1993.
4. Respondent - Supplementary - 20 April 1994.
5. Appellant - Supplementary - 20 April 1994.

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I was much assisted by both Counsel: their industry, eloquence and good humour made the burden of resolving the rather technical questions raised by this appeal much more bearable.

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The stated purpose of the Convention is the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income. Articles 5 and 8 of the Convention deal with Permanent Establishments. It is not disputed that where a business enterprise has a Permanent Establishment (PE) in Fiji the profits derived from that PE are subject to tax. The principal purpose of Article 5, as is apparent from perusal of the Article itself, is to draw a distinction between a Fiji branch of a foreign enterprise through which the business or trade of that enterprise is carried out and a branch through which they are not. In the former case there is a PE and taxable profits, in the latter case there is not and there are not. The first area of appeal relates to the status of the Respondent's Suva office under Article 5. Was it or was it not a PE?

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Article 24 of the Convention is a provision against taxation discrimination. Article 24 (2) with which the second area of this appeal is concerned prohibits a PE of a foreign enterprise from being less favourably taxed then a local enterprise carrying on the same type of activity. The Respondent (CDC) successfully argued in the Court of Review that CDC had been unfairly discriminated against. Whether or not that is the case is the subject matter of the second area of appeal.

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The relevant parts of Article 5 of the Convention are as follows:

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"1. For the purposes of this Convention the term "permanent establishment" means a fixed place for business in which the business of the enterprise is wholly or partly carried on.

2. The term "permanent establishment" shall include especially:

(a) a place of management
(b) a branch
(c) an office

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

(d) The maintenance of a fixed place of business

solely for the purpose of purchasing goods or mechandise, or for collecting information for the enterprise.

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(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.

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4 A person acting in a contracting state on behalf of an enterprise of the other contracting state - other than an agent of an independent status to whom the provisions of paragraph (6) of this Article apply - shall be deemed to be permanent establishment in the first-mentioned Contracting State if he has, and habitually exercises in that Contracting State an authority to conclude contracts in the name of the enterprise, unless his activities are limited to the purchase of goods or mechandise for the enterprise."

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CDC's case before the Court of Review was that on the evidence, although CDC had an office in Fiji that office had no power to conclude contracts in the name of CDC and that the office's activities were confined to collecting information for CDC and/or to similar activities of a preparatory or auxiliary character. This submission was upheld by the Court of Review.

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The Appellant now submits (paragraphs (2) to (4) of the Reference of Appeal):-

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(i) that the Court of Review misconstrued the prefatory words of paragraph 3 of Article 5 namely "shall not be deemed to include";

(ii) that the Court of Review erred in holding that CDC's activities fell solely within either paragraph 3 (d) or 3 (e); and

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(iii) that the Court of Review erred in not holding that a combination of activities by CDC under both paragraphs 3 (d) and 3 (e) amounted to the existence of a PE.

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The detailed arguments of Counsel are set out in extenso in the written submissions which also referred to2 hefty volumes of authorities as well as to two lever arch files of exhibits. I can only reasonably deal with the arguments in outline.

The first question to be answered is the meaning of the phrase "shall be deemed not to include". Mr. Gzell's argument was that the purpose and meaning of the phrase was to exclude establishments which would otherwise by virtue of

paragraphs 1 and 2 of Article 5 have to be considered as PEs.

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Mr. Scott rejected this approach and instead maintained that the effect of the clear meaning of the phrase was not exclusive at all. Mr Scott laid heavy emphasis on the difference in wording between the Convention which was apparently based on an OECD 1963 Draft Double Taxation Convention and the wording of a later model dealing with the same matter namely the 1977 OECD Model Double Taxation Convention. He relied on a number of authorities and also quoted an article in the Australian Tax Review by Mr. F.G. Gurry in support of his argument.

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A comparison of the relevant paragraph in the Convention, the 1963 Draft and the 1977 Model is as follows:-

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Convention/1963 Draft

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

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

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1977 Model

"Notwithstanding the preceding provisions of this Article the term "permanent establishment" shall be deemed not to include:

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

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There are many, it might almost be said too many, aids available to assist the resolution of this issue. Regard must or may we had to other international Conventions such as the 1969 Vienna Convention on the Law of Treaties and to official commentaries on those Conventions such as the commentaries on the 1963 Draft and the 1977 Model. The approach adopted by overseas superior Courts will obviously be accorded great respect (see eg. authorities listed in paragraph 6.04 of page 55 of the Record) as will the works of the various eminent academics who have laboured in this field.

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Having taken all these sources of guidance into account the Court of Review concluded that "although the phrase "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 context" (page 99 of the Record, paragraph 1). With the greatest respect to the Court of Review I find that sentence hard to understand. I end up coming to the same conclusion as the Court of Review but prefer another approach.

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A The Convention is of course part of Fiji's law and therefore must be interpreted in accordance with the Law of Fiji but I am not aware that this Convention has before been the subject of legal proceedings in Fiji. The Court is therefore very much "thrown back on its own resources" (see Federal Commissioner of Taxation v. Robinson 1992 ATR 364). The Courts of Fiji have always accorded the highest respect to the decisions of the Superior Courts of England and Wales. The Court of Review followed this well established practice and so do B I. On pages 97 and 98 of the record the Court of Review, having referred to a number of decisions of the English Court of Appeal and of the House of Lords, concluded that we in Fiji should adopt the principles of interpretation of international Conventions embodied in the Vienna Convention and in particular the principles stated in Articles 31 (1) and 32 thereof. I agree.

C Article 31 (1) reads as follows:-

> "A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose."

D Article 32 reads:

> "Recourse may be had to supplementary means of interpretation including the preparatory work of the treaty and the circumstances of its conclusion, in order to confirm the meaning resulting from the application of Article 31 or to determine the meaning when the interpretation according E to Article 31 either (a) leaves the meaning ambiguous or obscure or (b) leads to a result which is manifestly absurd or unreasonable."

Applying these principles, two methods of testing the meaning of the phrase in contention immediately present themselves. The first is to examine what, on F Mr. Scott's analysis the phrase and paragraph literally mean. Is such a meaning absurd or unreasonable? What, on this analysis, is the literal purpose of paragraph 3? The second test is to consider the Commentary to the 1963 Draft (see Fothergill v. Monarch Airlines Ltd [1981] AC 251).

G Mr. Gzell in paragraph 2.07 of the Respondent's written submissions suggests that the interpretation placed on the paragraph by Mr. Scott would result in the paragraph serving no purpose at all. Mr. Scott's answer to that is contained in paragraph 10 of the second supplementary written submission filed on 20 April, a submission filed at my request. Paragraph 10 reads as follows:-

> "The phrase "not be deemed to include" means "not be held to include" (Canadian Law Dictionary).

> This entails that items referred to in paragraph 3 do not, simply by having the description given in paragraph 3, comprise a permanent establishment. They may however comprise a permanent establishment if they are fixed places of business in which the business of the enterprise is wholly or partly carried out under paragraph 1."

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With respect, I find this explanation somewhat forced and unconvincing. I cannot imagine why anyone would ever consider that an establishment merely by having the descriptions (a) to (e) in paragraph 3 would be a PE given that the primary definition of a PE is set out in paragraph 1. Paragraph 1 is clearly the starting point, not paragraph 3.

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The ascription of a literal meaning to paragraph 3 in my view results in equal obscurity since it suggests a situation in which there would be a purpose, negatived by the paragraph, to be served by deeming PEs to include the activities set out in (a) to (e). What such a situation or purpose could be I cannot imagine and Mr. Scott was really unable to come up with any circumstance in which it might arise. Put simply, unless it can reasonably be shown that someone is likely and regularly to want to deem a PE to include any of the descriptions in (a) to (e) no purpose is served by the paragraph.

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I agree with Mr. Gzell that the ultimate result of Mr. Scott's approach is to strip the paragraph of all application. Since that cannot have been the purpose of the paragraph I conclude that that approach is wrong.

In my opinion the approach adopted by the majority of learned commentators and the OECD Commentary is correct and should be followed in Fiji. That approach (see paragraph 2.07 of the Respondent's supplementary submissions) is:

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> "This paragraph contains first, a number of examples of forms of business activity which should <u>not</u> be treated as constituting permanent establishments, even though the activity is carried on in a fixed place of business ...." (emphasis mine)

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In my view the Court of Review was correct in interpreting the meaning of paragraph 3 in the way it did and accordingly ground 2 of the Reference of Appeal fails.

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Grounds (3) and (4) of the Reference of Appeal may conveniently be taken together since they raise similar and related points.

The Appellant submits that the Court of Review was wrong to hold that CDC's activities in Fiji all fell within paragraph 3 (e) of Article 5 of the Convention (see final paragraph, page 98 of the Record). Mr Scott argued that the activities of the Suva office, on the evidence, fell partly within 3 (d), partly within 3 (e)

and partly without both. He further argued that even if all the activities fell within a combination of 3(d) and 3(e) (which was not admitted) then the result of that combination was that the activities in total fell foul of the requirement that they be carried out "solely" under one or other of the sub-paragraphs and accordingly a PE had to be found to exist.

Mr. Gzell was of course content to rely on the Court of Review's finding since if all the Suva office's activities were within 3 (e) the problem of combination did not arise. But even if the Court had been wrong and in fact the activities fell within both 3(d) and 3(e) then he submitted that since the combined activities had not "led to the emergence of a facility which would be economically viable if separated from the enterprise (CDC) to which it belongs" (see page 24 of the Respondents submissions) no PE had come into existence. As to the suggestion that any of the Suva office's activities fell outside the two sub-paragraphs, this was rejected as simply not being borne out by the evidence.

Once again both Counsel relied on eminent academics, commentators and authorities in support of their submissions. I have examined each with interest but I do not think it would be practical or useful to attempt to summarise each twist and turn of the arguments so comprehensively set out in the written submissions and volumes of authorities.

The Court of Review, having heard the evidence held that the activities of CDC's Suva office amounted to no more than advertising, the supply of information and similar activities of a preparatory or auxiliary nature. It held that it was "certainly clear" that the Suva office had no power to make any decision on behalf of CDC.

This latter finding caused me a little difficulty since as is apparent from the evidence of Mr. Charles Seller, a former area representative for CDC and the head of its Fiji office, and in particular from paragraph 17 of his affidavit, a number of decisions were indeed made locally on behalf of CDC. The identification of new business opportunities is but one example. Mr. Gzell had argued that the Suva office was merely the "eyes and ears" of CDC in Fiji but surely the Suva eyes decided what to look at and the ears what to listen to, at least to some extent. Having however re-read the Court's judgment and studied the Court's finding both in the full context of the judgment and the context of the submissions made to it I am satisfied that what the Court meant to refer to was the absence of any power by the Suva office to conclude contracts (see Article 5, paragraph 5), a point which had been repeatedly stressed by Mr. Gzell.

Having reviewed the evidence I am satisfied that the Court reached the right conclusion. It must be admitted that the line between auxiliary or preparatory activities and activities forming part of the core activity of an enterprise is not one that is easy to draw. That is why so many different tests and approaches

such as those devised by learned authors referred to by both Counsel have been suggested. I have considered the various approaches and the authorities cited and have re-evaluated the evidence in their light. In my view the Court of Review was right to draw the line where it did. I also think the Court was right to find that all CDC's Fiji activities fell within sub-paragraph 3(e), even though some could also be described as falling within 3(d). That is because I agree with Mr. Gzell that the narrow approach advocated by Mr. Scott is not the right one.

For similar reasons to those already set out above my view is that paragraph 3 should be construed in a broadly liberal manner. Support for this approach may, in particular and in my view especially usefully, be found in the Commentary to Article 5 of the 1963 OECD draft, the relevant part of which is set out in the Respondent's submission, paragraph 3.08. With respect, I found the Appellant's arguments on the meaning of the word "solely", set out on pages 12 and 13 of the first written submission hard to reconcile with the broad range of alternatives explicitly provided for by the wording of paragraph 3(e). To my mind it makes little sense to suggest that a combination of activities which all happen to fall within 3(e) is protected whereas should one of those activities also happen to fall within 3(d) then the protection of the combination is lost. Grounds 3 and 4 of the Reference of Appeal must fail.

The remaining ground, ground 5, involves the question of discrimination and Article 24 (2) of the Convention.

Mr. Scott's basic argument was that discrimination could not arise and was indeed impossible since it had not been established by the Respondent that there was a resident purely domestic enterprise carrying on the "same activities" as CDC and with which CDC could be compared. (See pages 17 and 18 of Appellant's written submission).

Once again Mr. Gzell, in answer, referred to the OECD 1963 Commentary, the relevant part of which is set out at page 24 of the Respondent's submission. Pointing out, surely correctly, that there would always be <u>some</u> differences between the activities of similar enterprises Mr. Gzell suggested that Mr. Scott's narrow approach would lead to the purpose of the Article being thwarted and could therefore not be correct.

The portion of the Court of Review's Judgment on this issue was rather brief (see page 99 of the Record) possibly because the principal issues had been decided in favour of the present Respondent. It also appears that the Court wrongly focused on the words "same circumstances" referred to in Article 24 (1) rather than on the words "same activities" which are to be found in the paragraph of the Article at issue. But the ratio of the Court's judgment is still clear: it is that discrimination occurs if a PE is taxed more unfavourably then a notional domestic enterprise carrying on the same or closely similar activities

to those under consideration if in fact no actual domestic enterprise carrying out such activities can be found.

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In support of his argument Mr. Scott cited Sunlife Assurance Co of Canada v. Pearson [1984] STC 461, 506 (Appellant's list of authorities Volume II N0.45) but I did not find, upon reading that case, that it dealt with the impossibility of comparison as was being suggested. Mr. Scott also referred to an article in the British Tax Review (list of authorities Volume II N0.43) but on my reading, although reference is made to examples of impossible comparisons, the article does not directly exclude the possibility of making a comparison with a notional enterprise if the circumstances warrant it.

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I must confess that I did not find this remaining issue before me quite as straightforward as Mr. Gzell suggested it was. If I did not find the authorities cited by Mr. Scott to be particularly helpful then neither did I find that CIR v. United Dominions Trust Limited (1973) 1 NZTC 80003 (Lever Arch File Volume II - Item 30) upon which Mr. Gzell relied was of as much direct assistance as suggested. However the interpretation of the words "same circumstances" and the words "same activities" seem to me to raise broadly similar considerations and from the passage by White J. quoted by Mr. Gzell in his submission on page 27 it is clear that an approach involving comparison with a notional enterprise has been adopted and accepted, at any rate by the New Zealand Court of Appeal. Such an approach seems to me to be wholly consistent with the object of the paragraph as explained by the Commentary. It also seems to me to be particularly relevant in an emerging small nation such as Fiji where actually existing local enterprises involved in the same activities as the PE are unlikely to be found. In my judgment the Appellant has not shown that the Court of Review erred in following the approach it did and accordingly this ground of appeal also fails.

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In the result the Appeal is dismissed.

(Appeal dismissed.)

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