[Studies in the History of Tax Law, ed Tiley, Hart, 2004, p.15]

Taxing Foreign Income from Pitt to the Tax Law Rewrite—the Decline of the Remittance Basis

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I. Introduction

Only in the United Kingdom could we still impose tax on foreign income by reference to the identical expressions originally contained in Pitt's 1799 Act[1]—"interest arising from foreign securities," and "income from foreign possessions." The courts have successfully adapted these expressions to encompass enormous business changes in the intervening 200 years. That is the most notable feature of our system of taxing foreign income. The second notable feature is that Pitt's two categories of foreign income treat foreign income as a separate type of income unrelated to the categories of domestic income, such as trading profits, interest etc (although one should add that since 1956 foreign employment income has been treated as a type of employment income). The third is the remittance basis, by which, in Pitt's Act most, and in Addington's 1803 Act[2] all, foreign income was taxed to the extent, and at the time, it is brought into the United Kingdom, the scope of which has subsequently been reduced but which still exists today as an important basis of taxation for some individuals.

As to the first feature, the unchanged wording of the charging provisions, it is, fortunately, a principle of statutory interpretation that a statute is "always speaking," meaning that the meaning of words should not be ossified the day the statute is passed.[3] That the provisions taxing foreign income have not changed over the past 200 years and still manage to work provides what must be the foremost illustration of this principle. The courts have had no difficulty in accommodating the industrial revolution and all the changes that have taken place since then by enlarging the meaning of "securities" from mortgages to include company securities (taking in the development of companies on the way); and by enlarging the meaning of "possessions" from estates in the Colonies (and then recently former Colonies of America[4]) to include all possible forms of income from foreign assets. That is not to say that there were no problems on this journey; there have been doubts whether some types of income could be derived from "possessions," and doubts about what made a possession foreign. As the 1955 Royal Commission said: "…it is not easy to find a category of income

[1] 39 Geo III c.13, although the Schedule is substituted by c.22, an act that also extended the time limit for making returns. For articles on the 1799 Act see B E V Sabine *Great Budgets* [1970] BTR 201; William Phillips *The Origin of Income Tax* [1967] BTR 103 and *The Real Objection to the Income Tax of 1799* [1967] BTR 177; Chantal Stebbings *The Budget of 1798: Legislative Provision for Secrecy in Income Taxation* [1998] BTR 651.

[2] 43 Geo III c.122. For an article on Addington's Act see William Phillips *A New Light on Addington's Income Tax* [1967] BTR 271. Pitt's Act had been repealed by Addington in 1802 on the short-lived Peace of Amiens by 42 Geo 3, c 42. That Act that was also "for the effectual Collection of Arrears of the said Duties."

[3] Cross *Statutory Interpretation*, Butterworths, 1976 p.45.

[4] See the reference to the British plantations in America in Addington's Act in the text at notes 15 and 29. The loss of the American colonies was in 1783.

that corresponds precisely with the idea of 'overseas income'."[5] It was nearly 100 years[6] later that it was determined whether a foreign trade could exist, the courts ultimately deciding that it could but only with an extremely narrow definition. And 150 years later the courts were still trying unsuccessfully to work out whether an employment was a possession, and, if so, what made it a foreign one; the obvious factor, that of working abroad, seemed to be largely irrelevant. The definition of what was foreign employment income had eventually to be settled by statute, but not until 1956.

As to the second feature, that foreign income is a type (or two types) of income in itself, had we started to tax income later we would probably have dealt with foreign income as a category of the same type of UK income. Even in Pitt's time foreign income was important; he estimated the amount of foreign income to be £5m out of a national income of £110m.[7] But no doubt to Pitt foreign income seemed to be unrelated to domestic income. This aspect is to be remedied by the Tax Law Rewrite[8] which proposes to integrate foreign income into the relevant category of income so that, for example, interest, whether domestic or foreign, will be dealt with together. With that will also end the first feature, the use of Pitt's wording to tax foreign income,[9] hence the reference to the Rewrite in the title of this paper, to which we shall return at the end.

We tend to think of the third feature, the remittance basis, as entirely different from taxing income on the arising basis and having to do with movements of money through the international banking system. Its origin was very different and, because of the business changes that have taken place since Pitt's time, the remittance basis may now seem even more different from the arising basis than it did originally. In Pitt's time most foreign trade was with the colonies. The dearth of any markets abroad coupled with rules requiring important colonial produce to be shipped to England in the first place meant that the remittance basis, so far as trading income was concerned (and there was probably little other foreign income), was essentially a basis that charged tax when the produce was sold, necessarily in England. Even in other cases, the system of payment necessarily by bills of exchange, rather than, as now, moving money through the banking system, meant that foreign

[5] Cmd.9474 para.631.

[6] One cannot say that the courts had the problem for this length of time because they had no jurisdiction in tax cases until Customs and Inland Revenue Act 1874 s.9 which permitted the General or Special Commissioners to state a case for the opinion of the High Court. One should also bear in mind that income tax was not in force between 1816 and 1842.

[7] Figures quoted by Sabine (see note 1) p.204. On that basis the tax should have yielded £10m but in fact it yielded only £6m. I have not found any Inland Revenue statistics of foreign income before 1875/76 when the total assessments of foreign income were £7m out of a total income assessed of £272m (1875 Report of the Board of Inland Revenue).

[8] The Rewrite project plans to rewrite the whole of the UK primary direct tax legislation to make it clearer and easier to use, without changing the law (apart from minor, identified, changes). For our purposes the relevant document is Exposure Draft No.13 *Foreign Income and Property Income,* March 2002 (ED 13) available on the Internet at http://www.inlandrevenue.gov.uk/rewrite/exposure/thirteenth/ed13.htm

[9] Although the Rewrite's use of "foreign source," the use of which is limited to remittance basis income, is identical to "foreign possessions" (ED13 (see note 8) para.1158) so one could regard it as merely a drafting change.

income would be remitted.[10] It merely meant that the tax was postponed until the income was received in money. It was therefore more of a timing provision than one where remittances were voluntary. When trading evolved and this ceased to be true, the Revenue's attack changed to disputing whether the trade was a foreign one, on which they were broadly successful in the courts. To which taxpayers countered by trading through non-resident subsidiaries, on which in turn taxpayers were broadly successful in the courts, although the courts developed a strict definition of non-residence for companies.

We shall first examine the original charging provisions and the difference between Addington's Cases IV and V, and then look at how the courts defined what income was foreign. Next, we shall examine the origins of the remittance basis and the subsequent reductions in its scope. Finally, we shall refer to the proposals for the removal of the remaining scope of the remittance basis from non-domiciled individuals and look at the Tax Law Rewrite's proposals for reforming the whole system of taxing foreign income.

II. Foreign securities and foreign possessions

THE ORIGINAL CHARGING PROVISIONS FOR FOREIGN INCOME

In historical articles on taxation one expects to find it said that Addington's 1803 Act[11] was an advance on Pitt's, but in respect of foreign income the credit must go to Pitt. Addington took Pitt's two categories of foreign income with some drafting changes[12] and introduced only one major difference: he extended the remittance basis to cover interest on foreign securities. The only difference between Addington's Cases IV (interest on foreign securities) and V (income from foreign possessions) was that income was measured by a single year in Case IV and by an average of the three preceding years in Case V,[13] a distinction also found in Pitt's Act. Had Addington designed the system from scratch there might have been only one Case for foreign income, which in practice is where we are today as Cases IV and V are difficult to distinguish for individuals and Case IV no longer applies to companies (although effectively there is

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[10] See text around note 125.

[11] Addington's tax at 1s in the pound raised £5,341,907; Pitts's at 2s in the pound raised £6,046,996 (Annual Report of the Commissioners of Inland Revenue 1875). The particular differences between the two Acts were first that Addington's required separate returns of income taxable under each Schedule so that no one official knew a person's total income. Sched G sets out 13 separate declarations and two accounts (annual value of property and list of public offices). The separate returns for each Schedule preserved the taxpayers' secrecy, which was then regarded as of prime importance, to a much greater extent than Pitt's, see Chantal Stebbings *The Budget of 1798: Legislative Provision for Secrecy in Income Taxation* [1998] BTR 651. The second main difference was the frequent use of deduction of tax at source, which he copied from earlier taxes. For the origins of deduction of tax at source see Piroska E Soos T*he Origins of Taxation at Source in England*, IBFD Publications, Amsterdam, 1998, and the same author's *Taxation at the Source and Withholding in England, 1512 to 1640* [1995] BTR 49.

[12] In relation to other types of income Addington refined Pitt's categories into the familiar Schedules A to E, the income of which could be taxed separately, rather than Pitt's list of 19 Cases, divided into four parts: Lands, tenements and hereditaments, Cases 1 to 14 (the number of cases demonstrating the importance of land even more clearly than Addington's Schedules A and B coming first); personal property, trades, professions, offices, pensions, allowances, stipends, employments and vocations, Cases 15 and 16; income arising out of Great Britain, Cases 17 and 18 (set out under the next heading); and other income not falling under any of the foregoing rules, Case 19. Thus Addington merged Pitt's 14 land Cases into two Schedules, and changed Pitt's remaining 5 Cases into three Schedules with Schedule D subdivided into 6 Cases, a total of 10 categories.

[13] For subsequent changes in the basis, see notes 27 and 45.

another Case for individuals since Schedule E now has its own foreign element; foreign employments were originally a foreign possession). In spite of reducing foreign income to virtually a single category of we have nevertheless managed to create many different sets of rules for different types of foreign income, so the single Case does not represent the reality. We shall start by setting out Pitt's and Addington's charging sections relating to foreign income and, for comparison, the provisions as they are still in force today.

Interest on foreign securities

> *Pitt's 18th case.*[14] "Money arising from Foreign Securities. The Annual Income of such Securities if the same were existing in the preceding Year, to be estimated according to the Produce of such Year, and if the same were not then existing, to be computed upon the expected Produce of the current Year."
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> *Addington's Case IV.*[15] "The Duty to be charged in respect of Interest arising from Securities in Ireland,[16] or in the British plantations in America, or in any other of His Majesty's Dominions out of Great Britain, and Foreign Securities,[17] [except such Annuities, Dividends, and Shares payable [out of the revenue of Ireland] as are directed to be charged under Schedule C[18] of this Act][19]. The Duty to be charged in respect thereof shall be computed on a Sum not less than the Whole and just Sum or Sums (so far as the same can be computed) which have been or will be received in Great Britain, in the current year, without any Deduction or Abatement."
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> *Case IV today.* "tax in respect of income arising from securities out of the United Kingdom."[20]

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[14] Note the numbering; in Pitt's Act foreign possessions came before foreign securities, and the reverse in Addington's Act, perhaps more logically as securities would otherwise be included in possessions, and so "possessions" coming second can cover the remaining possessions.

[15] 43 Geo III c.122.

[16] Ireland was integrated into the UK tax system by Gladstone's ITA 1853 s.5 (which imposed income tax until 1860 "and no longer" (s.59); it has been renewed annually since 1860, the first extension being by 23 Vict. c.14. By s.7 Irish income was excluded from Cases IV and V and the same rules applied as for the same type of income in Great Britain but these references to Ireland were not repealed until the Statute Law Revision Act (No.2) 1874. The arising basis for Irish income continued on the formation of the Irish Free State under FA 1926 Sched 2 Pt.II see now TA 1988 s.68.

[17] The consolidation in ITA 1918 dropped these descriptions in favour of "securities in any place out of the United Kingdom."

[18] Schedule C charged all profits arising from annuities, dividends, and shares of annuities payable to any person…out of any public revenue…. At that time the Government sold annuities.

[19] Added by the 1806 Act (46 Geo III c.65). By then Lord Grenville was Prime Minister and Lord Henry Petty Chancellor of the Exchequer and the rate of tax was increased to 10%, Pitt's original rate. William Phillips describes this Act as what Addington's 1803 Act would have been but for Pitt's opposition ([1967] BTR 271, 280). In particular, deduction of tax at source was extended to Schedule C (s.CV). The words in brackets about Ireland do not appear in the 1842 Act; the 1806 Act s.CVIII recognises the possibility of income from a Colony or Settlement being taxed under Schedule C and so the exclusion of only Irish income taxed under Schedule C may have been too narrow which is why the point was corrected in 1842. The 1806 Act was the model for the 1842 Act by which income tax was reintroduced for three years "and no longer" (s.193) when Sir Robert Peel was Prime Minister; ss.22 and 23 of that Act gave the right to appeal Schedule D assessments to the Special Commissioners (who had existed since 1805 with administrative functions) as an alternative to the General Commissioners. The expiry of the tax was extended on several occasions until 1853 (from which see note 16).

[20] TA 1988 s.18(3). The reference to "interest" became "income", as in Pitt's Act, in the 1914 consolidation, perhaps to include discounts.

"Securities," originally, were not securities issued by a company as we think of them today because there were then few foreign companies.[21] The original meaning can be seen from a contemporary explanation of interest arising from securities:

> "This is a species of interest payable on mortgage debts, bills of exchange, or other securities, and arising out of foreign profits whether from trade or property. As these remittances are generally received through mercantile houses who act therein as agents, the act is compulsory on them to deliver the following account, according to sect.65 [a list of names and addresses which is now TMA 1970 s.17]."[22]

Mortgage debts are secured in the true sense but bills of exchange are secured only if endorsed or "accepted" when there is security in the sense of something other than the original promise to pay. However, the reference to bills of exchange suggests that the courts have subsequently given too much prominence to security:

> "…the normal meaning of the word 'securities' is not open to doubt. The word denotes a debt or claim, the payment of which is in some way secured. The security would generally consist of a right to resort to some fund or property for payment; but I am not prepared to say that other forms of security (such as a personal guarantee) are excluded."[23]

> "the word 'securities' has no legal signification which necessarily attaches to it on all occasions of the use of the term. It is an ordinary English word used in a variety of collocations: and it is to be interpreted without the embarrassment of a legal definition and simply according to the best conclusion one can make as to the real meaning of the term as it is employed in, say, a testament, an agreement, or a taxing or other statute as the case may be….Securities in the Fourth Case of Schedule D appear to me to mean securities upon something as contrasted with the possession of something."[24]

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[21] See the quotation in the text to note 40.

[22] A Guide to the Property Act 46 Geo III, 2nd ed. Printed and published by Joyce Gold, 1807. I am grateful to Piroska Soos for bring this work to my attention. This contemporary evidence is important since the courts did not have jurisdiction in tax cases until 1874 and so we do not have any contemporary court decisions. For examples where the security was on land, see *Scottish Mortgage Company of New Mexico v McKelvie* (1886) 2 TC 165, *Butler v Mortgage Co of Egypt* 13 TC 803 and *Westminster Bank Executor & Trustee Co (Channel Islands) Ltd v National Bank of Greece* 46 TC 472, where the bonds were also guaranteed. Although not strictly speaking secured the debt for unpaid purchase money for land sold under a contract but not yet conveyed was effectively secured because the contract could be cancelled and the land restored to the seller in *Hudson's Bay Co v Thew* (1919) 7 TC 206 in which the interest was held to be on a security. On the other hand, the banking-type fluctuating advances made by a wool broker secured partly on real property and partly on stock, wool and other produce in *Smiles v Australasian Mortgage and Agency Co* (1888) 2 TC 367 was "not investment of money upon securities" (p.377) but trading income. A simple unsecured debt of a foreign company for which promissory notes were later substituted was held not to be a security in *Lord Manton's Trustees v Steele* (1927) 11 TC 549; this is odd since interest on bills of exchange was originally interest on a security. The case left open the status of debt instruments issued by a foreign country, colonial authority or Dominion. There were US government securities at the time. An estimate of £4m British capital invested in US "funds" in 1801 and £5.7m in 1805 is quoted in R W Hindy *The House of Baring in American Trade and Finance,* Harvard University Press, 1949, p.34. The rather nebulous concept of a security is also still found in "debt on a security" in capital gains tax, see now TCGA 1992 s.132(3)(b) and *W T Ramsay Ltd v IRC* [1981] STC 174. S.65 mentioned at the end of the quotation in the text did not require a statement of the amount but s. 51 of the 1842 Act required this.

[23] *Singer v Williams* (1920) 7 TC 419, 431. This is not to be confused with the trust case of *Williams v Singer* (1920) 7 TC 387 concerning foreign dividends paid through UK trustees to a foreign beneficiary. Both cases deal with dividends from the Singer Manufacturing Company of New Jersey, and the Inspector of Taxes is the same in both. The former case relates to Mr Singer in his personal capacity—"a member of a family which has done much to elucidate the law of Income Tax in England by its struggles to pay no more than the amount that it justly ought to pay in its view" (*per* Scrutton LJ at p.426).

[24] At p.435 and 436 *per* Lord Shaw.

> "A security…is a possession such that the grantee or holder of the security holds as against the grantor a right to resort to some property or some fund for the satisfaction of some demand, after whose satisfaction the balance of the property belongs to the grantor."[25]

> "…investment of money upon securities."[26]

One is left with some uncertainty about precisely what the courts subsequently regarded as securities. A reason for this is that the only distinction between securities and possessions was the difference in basis periods, the current year for securities and the average of the three preceding years for possessions, which ceased to matter when the basis periods became the same for both in 1926.[27]

Foreign possessions

> *Pitt's 17th Case*. "From Foreign possessions. The full amount of the actual Annual Net Income *received in Great Britain* either estimating such Receipt in the first Year of being charged at the Election of the Person charged, according to the Year ending the fifth day of February[28] immediately preceding such Estimate, or according to the Average of the three Years preceding such fifth Day of February, or on such Day in each Year on which the Account of such Income has been usually made up; and in all succeeding Years, the Annual Receipt to be reckoned in the same Mode which the Person charged shall have chosen to make in the first Year."

> *Addington's Case V*. "The Duty to be charged in respect of Possessions in Ireland, or in the British Plantations in America, or in any other of His Majesty's Dominions out of Great Britain, and Foreign Possessions"[29]…computing the same on an Average of the Three preceding Years,[30] as directed in the first Case, without [other][31] Deduction or Abatement."

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[25] At p.436 *per* Lord Wrenbury.

[26] *Smiles v Australasian Mortgage and Agency Co* (1888) 2 TC 367, 377 *per* The Lord President.

[27] For Case IV the current year basis was replaced by the preceding year basis by FA 1926 s.29, following the recommendations of the 1920 Royal Commission (Cmd.615), and reverted to the current year basis by FA 1994 s.207(1) for self assessment reasons; the 1955 Royal Commission had recommended this on practical grounds, such as the difficulty of applying double taxation relief to the preceding year basis (para.785), about which see *Imperial Chemical Industries Ltd v Caro* (991960) 39 TC 374, dealt with by FA 1961 s.18, now TA 1988 s.804. For corporation tax the current accounting period basis was applied by FA 1965 s.51(1), and Case IV ceased to apply for corporation tax by FA 1996 Sch.14 para.5. See note 45 for the changes of basis periods for Case V.

[28] This seems to be to give time for computation as the tax was based on the year to 5 April, s.LXXII. 11 days had been added to the year, which then started on 25 March, for land tax purposes on the (somewhat late) change to the Gregorian calendar in 1752. The position was complicated by leap years and the change to starting the legal year on 1 January, and is fully explained by John Jeffrey-Cook in [1977] BTR 68

[29] The consolidation in ITA 1918 dropped these descriptions in favour of the current "possessions out of the United Kingdom" see text at note 32. The words omitted here are dealt with in the text at note 121.

[30] See note 45 for the subsequent history of the basis of assessment.

[31] Words dropped in the 1805 Act (probably wrongly). The 1842 Act says: "without other deduction or abatement than is hereinbefore allowed in such case [Case I]. The Rewrite ED 13 (see note 8) para.1186 suggests that this applies deductions only to foreign trading income, the equivalent to Case I income, and not to Case II income. It proposes to change this. The intention of allowing deductions seems to be that if it is the sales from the foreign trade that are remitted, as was originally likely to have been the case, not more than the Case I profit can be taxed. However, there was a problem before the current year basis since capital allowances and losses were not deductible in computing a Case I profit. However, the Revenue did not assess more than what would have been taxable on the arising basis.

Case V today. "tax in respect of income arising from possessions out of the United Kingdom not being income consisting of emoluments of any office or employment."[32]

As with securities, the wording has effectively remained unchanged since Pitt's time. Today "possessions" has to cover every type of foreign income other than income from securities.[33] Originally its meaning was much narrower. An idea of what was meant by possessions can be seen from a contemporary explanation of a provision of Addington's Act setting out the various ways of making a taxable remittance to which we shall return:[34]

"The Act considers that the value of foreign property may be brought into Great Britain. 1st, By bills. 2d, From the produce of the *estate* which it calls property, (meaning personal property,) imported into Great Britain, and turned into money here. 3d, From the produce of the *estate* sold in other countries, the value of which is received here. 4th, From money received by the party either on the credit or the account of the produce of the *estate* converted in any of the ways mentioned."[35]

The reference to an "estate" in the second, third and fourth items demonstrates that the typical foreign possession of the time was immovable property, perhaps a plantation. The reference in Addington's Case V to the "British plantations in America" is to the same effect.[36] The estate in Antigua belonging to Sir Thomas Bertram of Mansfield Park[37] may have been a typical foreign possession of the time.

If foreign possessions originally meant estates abroad, suggesting tangible property, it might imply that intangible property like shares were securities rather than possessions. The distinction between tangible and intangible property may originally have been the practical distinction between the two Cases when securities were the main example of intangibles[38] but this was not the true distinction since it was only *interest*[39] on securities that was within Case IV, so that possessions must include everything else, including income from other intangibles. It is also relevant to whether intangibles are included that when the expression "possessions" was first used:

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[32] TA 1988 s.18(3). The exclusion of employment income dates from 1956, see the heading *What made a possession foreign?* under *Employment and pensions income.* We have not repeated the second sentence of Addington's Case V but it is still to be found in TA 1988 s.65(5)(b).

[33] Even such income as alimony paid by order of a foreign court (*IRC v Anderström* (1927) 13 TC 482) or by deed of separation executed abroad (*Chamney v Lewis* (1932) 17 TC 318).

[34] See text around note 121.

[35] Guide to the Property Act, 1807, see note 22 (our italics). The meaning of "remittance," which is a topic in itself, will not be dealt with in this article; this explanation is included here to explain the meaning of "possessions." The provision itself and this explanation are discussed in the text around note 121.

[36] See also *The Ormond Investment Co v Betts* (1926) 13 TC 400, 406: "…at the time when the Act of 1842 was passed, as has often been said before, the foreign possessions to be glanced at were foreign undertakings really mainly in the nature of plantations, and so on" *per* Rowlatt J.

[37] Jane Austen, published 1814.

[38] Patents have existed since Elizabeth I; copyright existed at common law and by statute since the Copyright Act 1709.

[39] Dividends are mentioned in relation to the exception from Case IV for Schedule C income (text at note 18), suggesting that interest on securities is limited to interest properly so-called. Note that Pitt's Act did not use the word *interest* but refers to *money, income and produce,* and it is interesting that ITA 1914 reverted to *income,* perhaps to cover discounts. It is unlikely that it was originally intended to have a wider meaning since there were no dividends from companies at the time (see note 40).

> "there were few incorporated companies, fewer which were foreign companies, and fewer still which were foreign companies having shares owned in Great Britain, so that, while the Legislature has used language which has been construed as wide enough to include all foreign species of property, what were principally in mind at the time were investments in lands, or in plantations or factories abroad."[40]

The distinction between securities and possessions was still being argued about in 1920,[41] although the courts had before this time consistently held that a share in a company was not a security.

The courts had no difficulty in enlarging the meaning of "possessions" to cover every kind of foreign asset because if they had not, there were no other charging provisions for foreign income:

> "'Possessions' is a wide expression; it is not a word of technical meaning; the Act supplies no interpretation of it. I cannot see why it may not fitly be interpreted as relating to all that is possessed in His Majesty's Dominions outside the UK or in foreign countries which is a source of income."[42]

Any apparent difficulty over the limitations of the four statutory ways of making remittances,[43] written with foreign estates in mind, was no obstacle to the courts finding a suitable intention of Parliament:

> "…I cannot think it was ever the intention of the Legislature to say in effect that…under Case V only those sums received were to be computable which were attributable to the specified operations or sources. I think therefore that these four sub-heads, as they have been called, should be treated as illustrations (no doubt intended to form a comprehensive list of illustrations) of the way in which, when foreign income is transmitted to this country, the transmission can be effected and the sterling sums obtained. These sub-heads, which are not all very clearly phrased, should accordingly be construed according to their general sense without too much nicety of language.[44]

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[40] *Per* Lord Phillimore in *Singer v Williams* 7 TC 419, 439. Scrutton LJ at p.427 also makes the point that there were no foreign companies before 1842 (the reintroduction of income tax) and so it was unlikely that the word "securities" was intended to cover shares, a non-existent form of property. Another problem caused by companies being introduced later than income tax is the interpretation of "public office or employment" in relation to employees, see note 98. Chartered companies existed, such as the Hudson's Bay Company, "service in which was a kind of aristocracy of employment with old traditions going back to the time of the Stuarts" (*per* Scrutton LJ in *Great Western Railway v Bater* 8 TC 231, 238).

[41] *Singer v Williams* 7 TC 419. This was probably a case of the taxpayer arguing against the effect of the 3-year average on the termination of the remittance basis on dividends in 1914 (see the heading *Cutting down the remittance basis* under *Investment income*), rather than any general doubt about the matter.

[42] *Per* Lord Herschell *Colquhoun v Brooks* 2 TC 490, 502. It was later held that possession as absolute owner was not required; an interest as beneficiary of a trust was sufficient: *Drummond v Collins* (1915) 6 TC 525, a point which led on to the long-running dispute in the *Archer-Shee* cases about the nature of the income of the beneficiary when the remittance basis was removed from certain types of income, see text at notes 143 to 150.

[43] This is dealt with in the text around notes 134 and in the explanation in the text at 35.

[44] *Thomson v Moyse* (1960) 39 TC 291, 337. Lord Denning says at p.342: "The four heads comprehend almost every conceivable way in which the income can be used to produce sums which are received in the United Kingdom."

It will also be seen that both Pitt's and Addington's provisions taxed foreign possessions on the remittance basis based on the average of the three preceding years.[45] The difference in the period used for measurement of the income reflects that interest is usually fixed and certain whereas other income is variable and uncertain.[46]

There is an overlap between Cases IV and V and other Cases. A trade within Case I or V may receive interest within Case IV. A trade controlled abroad consisting of making loans secured on land abroad, where the security was inherent in the trade, has been held to be within Case IV.[47] The Crown has an option to tax under another Case of the same Schedule[48] and may choose Case IV rather than I or V because expenses are not allowed against a Case IV assessment or, as will be seen, after 1914 most investment income was taxed on the arising basis while trading profits were taxed on the remittance basis.

WHAT MADE A POSSESSION FOREIGN?

Whether income was from a foreign possession does not pose much difficulty when one is dealing with rent from land abroad or dividends or interest paid by non-resident companies. The answer is much less obvious when dealing with trading and employment income. We shall next examine how the courts dealt with defining whether these were foreign.

Trading income

One of the difficulties in determining whether a trade is a foreign one is that control may be exercised in one place and operations take place in another.[49] The Act was not exactly helpful

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[45] The 3 year average became the preceding year basis by FA 1926 s.29, following the recommendations of the 1920 Royal Commission (Cmd.615), and then the current year basis by FA 1994 s.207 (1) for self assessment reasons. The 1951 Millard Tucker Committee (Cmd.8189) had concluded that the current year basis for trading profits was impracticable (para.66), and the 1955 Royal Commission, while agreeing if their terms of reference had been the same as that Committee, had recommended this for trading profits of companies (para.773-4) and for Case IV and V income on practical grounds such as the difficulty of applying double taxation relief to the preceding year basis (para.785). For corporation tax the current accounting period basis was applied by FA 1965 s.51(1), and Case V ceased to apply to income from loan relationships for corporation tax from 1996. In 1926 the House of Lords decided in *Whelan v Henning* 10 TC 263 that if there was no income from a foreign possession in a particular year there could be no assessment based on the 3 year average on the ground that there was no source of income in the year. This was reversed for all Schedules by FA 1926 s 22, now TA 1988 s.71.

[46] See *Singer v Williams* 7 TC 419, 436 *per* Lord Shaw.

[47] *Butler v Mortgage Co of Egypt* 13 TC 803. On the overlap with Case I, see *Scottish Mortgage Company of New Mexico v McKelvie* (1886) 2 TC 165 in which the Court upheld the Case IV assessment where the interest was secured on land and compare *Smiles v Australian Mortgage and Agency Co* (1888) 2 TC 367 where the business was that of wool brokers who advanced money; the Court decided against Case IV on the basis that the interest was on fluctuating balances secured partly on land and partly on stock, wool and other produce in the manner of a banker's loan and "not investment of money upon securities" (p.377). It was pointed out that this had the advantage that losses on one transaction could be offset against profits on another, although this is less serious since the remittance basis applied if it were taxed under Case IV. The same problem of assessment under Case III rather than Case I exists where the profits are lower than the interest received, see *Clerical Medical and General Life Assurance Society v Carter* (1889) 2 TC 437. See note 164 for the introduction of relief for management expenses of insurance companies.

[48] *Liverpool and London and Globe Insurance Co v Bennett* (1913) 6 TC 327, now incorporated in the statute in Taxes Management Act 1970 s.28A(7B). The Tax Law Rewrite has proposed to make the guidelines for exercise of the option into statutory rules, see cl.20 and 240 of the draft Income Tax bill in ED 13 (see note 8).

[49] See the 1955 Royal Commission Cmd.9474 para.631.

in distinguishing UK and foreign trades, because UK trades included any trade whether carried on in the UK or elsewhere[50] and so it was not clear whether a trade could qualify as a foreign possession.[51] Because the courts had jurisdiction in tax cases only from 1874 we do not know how these provisions were interpreted but material from 1880 indicates that it was thought that foreign trades did not exist.[52] The point was settled by *Colquhoun v Brooks*[53] (relating to 1884/85) in which the House of Lords decided on the construction of the Act that a trade controlled abroad was a foreign possession. One of the main reasons was that, if this were not the case, the assessing provisions for trades did not deal with trades carried on wholly abroad so that they could not be classed as UK trades.[54] It was explained by Lord Sumner in *Mitchell v Egyptian Hotels Ltd*[55] that the distinguishing feature of a foreign trade was that the trade was controlled from abroad[56] and the UK resident took no part in carrying it on. Confusingly, foreign control of the trade was described as the trade being carried on abroad, so that conversely the trade of the San Paulo (Brazilian) Railway which was controlled from England could be described as carried on in England.

> "A director does not get on an engine in America and drive it, but he can say what man shall get on the engine, and how many hours that man shall work and at what pace he shall drive the engine. Everything is done by the order of the directors. They make all the contracts; it is said that they buy all the materials, and it is said that they buy all the engines; and in the trade or business of a railway if you buy bad engines you are pretty certain to come to grief, and where will your whole trade go to? If you buy a series of bad engines your profits will never appear. Then no one in America according to the statement of this case, has any power to do anything but to obey orders. It is beyond discussion and beyond doubt that a great part of this

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[50] TA 1988 s.18(1), Sched D (a)(ii), originally in Sched D in s.LXXXIX of the 1803 Act (although then referring to Great Britain).

[51] As Lord Macnaghten points out in *Colquhoun v Brooks* (1889) 2 TC 490, 506, the specific reference to the British plantations in America, see text at note 29, would have been concerns in the nature of trade. The FA 1940 gave statutory recognition to the existence of a foreign trade when it generally removed the remittance basis from income other than trading or employment or pensions income, see the heading *Cutting down the remittance basis, Further reduction in the remittance basis in 1940.*

[52] See the Opinion of the Law Officers in Scotland (1880) (to be found at the end of 1 TC p.A1 (printed at the end of vol.1) (Indian partnership). This Opinion cites *Sulley v AG* (1860) 2 TC 149 (American partnership) where the main issue was the taxation of the US partners who were held not to be taxable, the only UK activity being purchasing, but the Revenue's question at p.A3 may be misreading the case in stating that the profits of the UK resident partner "coming home" were the whole profits not the remitted profits as this expression seems more appropriate to the remitted profits (the reason for the existence of a tax case in 1860, when the courts did not have jurisdiction until 1874, is that it concerned an information laid in the Court of Exchequer to enforce a penalty (three times the duty) for failing to deliver the return; this case is also mentioned in argument in *Colquhoun* 2 TC at p.495 and *Tischler v Apthorpe* 2 TC at p.91). The Revenue stated that the issue was one of very great importance particularly in such a mercantile community as exists in Glasgow (p.A. 4), suggesting that it was a matter of considerable dispute at the time. I have been informed by Gordon Reid QC that Scottish Inspectors would be bound to follow the Opinion of the Law Officers. It may be that the Revenue were attacking foreign trades on the basis that they lost if the remittance basis applied whereas earlier profits would be remitted anyway, see *III the Remittance Basis, the origins of the remittance basis*.

[53] (1889) 2 TC 490. Lord Macnaghten goes back to Pitt's 1799 Act in reaching his conclusion.

[54] See *Colquhoun* at p.501, 507-8. UK trades were assessed by the Commissioners for the parish or place where the trade is carried on, whether it is carried on wholly or in part in Great Britain (ITA 1842 s.106).

[55] (1915) 6 TC 542, 550.

[56] Statutory recognition of the place of control of the trade in relation to partnerships is found in TA 1988 s.112(1A)(c) in connection with non-domiciled partners.

business or trade is done in England by the masters of that trade who are the directors of the English company."[57]

Indeed the Lord Chancellor went further and said that the trade was *wholly* carried on in England.[58] This concentrates on the intellectual control of the trade, to the exclusion of the trading operations themselves. But the expression "carried on" could also mean where the trading operations took place;[59] the statutory provision "trade…whether carried on in the UK or elsewhere"[60] uses the expression in the latter sense. If there is no partnership and a UK resident can direct how his local agents carry on the trade, it is a UK trade even though the control does not "go beyond passive oversight and tacit control."[61] Thus the courts had effectively removed the remittance basis from trading income.

It seems strange that the result can be different where there is a partnership since in *Colquhoun* the Australian partner must have been acting as the UK partner's agent in carrying on the trade. The distinction is that a sole trader or company must control the trade because he or it is the only possible "head and brain of the trading adventure"[62] but with a partnership there are at least two heads and brains and one looks to which one actually controls the trade. Presumably this is a case of "the acts of every partner who does any act for carrying on in the usual way business of the kind carried on by the firm of which he is a member bind the firm and his partners."[63] One is concerned with who is actually directing the trade which in the case of the partnership controlled abroad is the non-resident partner and there is no reason to say that he is merely acting as agent for the UK partner.[64] The UK resident partner can even

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[57] *San Paulo (Brazilian) Railway Ltd v Carter* 3 TC 407 *per* Esher MR at 351.

[58] At 409.

[59] The distinction between the two meanings is made by the Lord Chancellor (Lord Halsbury) at p.410. For the same distinction see *London Bank of Mexico v Apthorpe* (1891) 3 TC 143: "It is true that part of the profits of that business which is carried on in England is earned by means of transactions carried on abroad. That is not carrying on the business abroad. It is carrying on the business in England by means of some transactions of it which are carried out abroad. But those transactions which are carried out abroad are carried out subject to the directions and at the pleasure and will of the masters and owners of that business resident in London." "Carried on" is used in the same sense in relation to the residence of a company: "That a company resides for the purposes of income tax where its real business is carried on…; and the real business is carried on where the central management and control actually abides." *De Beers Consolidated Mines Ltd v Howe* (1906) 5TC 198, 213 *per* the Lord Chancellor.

[60] See note 50. In relation to non-residents the charge is restricted to any "trade…*exercised* within the UK" which also refers to where the trading operations are physically carried out, now TA 1988 s.18(1), Sched.D (a)(iii), originally Sched D of the 1803 Act (although then referring to Great Britain). If therefore a partnership were controlled from the UK the non-resident partners would only be taxed on the profits of the trade exercised within the UK; the resident partners would be taxed on the worldwide profits.

[61] As was the case in *Ogilvie v Kitton* 5 TC 338. The words quoted are from Lord Sumner in *Mitchell v Egyptian Hotels Ltd* 6 TC 542, 551, referring to *Ogilvie v Kitton*.

[62] These words are used by the Lord Chancellor (Lord Halsbury) in *San Paulo (Brazilian) Railway Ltd v Carter* 3 TC 407, 408.

[63] Partnership Act 1890 s.5. The common law position would have been the same and the common law would have applied in Victoria.

[64] From 1940 (see the heading *Cutting down the remittance basis, Further reduction in the remittance basis in 1940*) the remittance basis was restricted to income immediately derived from the trade but this did not affect sleeping partners because there was no requirement for the partner to be "personally acting therein" as there is in the definition of earned income in TA 1988 s.833(4)(c) and relevant earnings in TA 1988, s.623(2)(c), see note 171.

take part in purchasing goods, which is not regarded as trading,[65] without affecting the treatment as a foreign trade.[66] In deciding this, the court was, as we now know unrealistically, trying to find one country in which the trade would be taxed rather than the real issue of whether the trade was UK or foreign: "If a man were liable to income tax in every country in which his agents are established, it would lead to great injustice."[67] If the head and mind controlling the trade is outside the UK there seems no reason in principle why there cannot be trading operations carried on (in the sense of physically carried on) in the UK, in which case that part will be taxed under Case I as a domestic trade.[68] It seems that this can no longer apply to UK domiciled partners, and the Rewrite makes clear that a non-domiciled sole trader must physically carry on the trade wholly outside the UK for the remittance basis to apply.[69]

A company is in the same position as an individual,[70] although there was one exceptional circumstance where a company has succeeded in carrying on a foreign trade on its own.[71] It carried on the business of running hotels in Egypt, including Shepheard's in Cairo, and appointed a local board in Egypt which under the Articles of the company controlled the trade

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[65] Perhaps some economic self-interest is behind this: "It would be most impolitic thus to tax those who come here as customers" *Sulley v A-G* (1860) abstract in 2 TC 149 (misleadingly not in the index to that vol.) *per* Cockburn CJ. Perhaps this is the origin of the provision in art.7(5) the OECD Model Double Tax Convention that "No profits shall be attributed to a permanent establishment by reason of the mere purchase by that permanent establishment of goods or merchandise for the enterprise."

[66] *Sulley v A-G* (1860) 2 TC 149.

[67] At p.149.

[68] This possibility is recognised in the statute today for non-domiciled partners where the control and management of the trade etc is situated outside the UK, see TA 1988 s.112(1A). This is achieved by first deeming the partner to be non-resident, with the result that the UK profits are taxable under Case I, and also deeming the non-UK profits to be from a foreign possession taxable under Case V on the remittance basis.

[69] Draft clauses in ED13 (see note 8), cl.220. The partnership provisions have not been rewritten yet.

[70] *London Bank of Mexico v Apthorpe* (1891) 3 TC 143 and *San Paulo (Brazilian) Railway Ltd v Carter* 3 TC 344 (CA) and 407 (HL, an unusual example of the proceedings being reported separately in TC) in which the distinction between *Colquhoun* and *London Bank of Mexico* is explored. This is so even though the board of the company delegate their powers to local managers, as in *The Frank Jones Brewing Co Ltd v Apthorpe* (1898) 4 TC 6.

[71] *Mitchell v Egyptian Hotels Ltd* (1915) 6 TC 152 (City General Comrs and High Ct), 542 (CA and HL, another example of the proceedings being reported separately in TC). That was an extremely borderline case with the House of Lords being equally divided, with the result that the Court of Appeal decision stood. The Revenue in International Tax Handbook at para.343 suggest that the company would now be regarded as non-resident (or rather would have been before the incorporation test was introduced in 1988). It was conceded in the case that the company was resident (para.11 of the Case Stated at p.159) and the Commissioners decided that the head and seat and controlling power of the company remained in England with the main board (para.14), so it is not clear that the company would be non-resident if the concession had not been made. In particular, the London board determined the remuneration of the Egyptian board and controlled the finances of the company such as the borrowing power. The Revenue's view is supported by Lord Cave (with whom Lords Dunedin and Sumner concurred) in *The Swedish Central Railway Co. Ltd v Thompson* (1925) 9 TC 342 at 374 who considered that the company would have been resident in Egypt, while Lord Atkinson, dissenting, pointed out that residence was not in issue. It is suggested that the facts do not support Lord Cave since there was a UK board of directors whose powers are summarised by Horridge J at 6 TC 161-2, and the *Swedish Central Railway* is a case which should have decided that the company was non-resident. The 1920 Royal Commission (Cmd. 615) para.40 recommended treating foreign boards of UK companies as being controlled in the UK. There is a somewhat similar Irish case where trustees delegated their powers to carry on business in Australia under an irrevocable power of attorney and were held to have Case V income: *Ferguson v Donovan* 1929 IR 489. A possible distinction from *Ogilvie v Kitton* 5 TC 338 is that the trustees would not have had the knowledge to direct the trade in Australia so they were not even exercising passive oversight.

in Egypt.[72] The UK board had no power over the local board in the running of the hotels and merely declared dividends out of the profits, although they could have starved the local board of funds. The trade was held to be a foreign one. The significant feature was that the UK board had no powers over the Egyptian board; the mere delegation of powers to them would not have achieved the same result.[73] That method of working may have been feasible in 1908/9 for the company running hotels in Egypt but it would not be a solution when communications improved. But what cannot be done with one company can be done with two.[74] The successor to this method of trading was to have a non-resident subsidiary under the control of its local board, with the parent company board exercising only shareholder control over the subsidiary.[75] The cases show an interesting transition, probably encompassing developments both in methods of trading and the understanding of the courts, from the foreign subsidiary being actually managed by the parent[76] to the separate trade of the subsidiary being accepted first for a 98% subsidiary (*Kodak*[77]), and ultimately for a wholly-owned subsidiary (*Deutsche Grammophon*[78]). Thus the courts, having removed the remittance basis for trading income in a single company, had effectively restored it so long as there was a non-resident subsidiary, but at the same time the courts developed a strict definition of non-residence. The dividends remitted to the parent company were taxed as income from a foreign possession. Even after the ending of the remittance basis for dividends from non-resident subsidiaries, the result was similar since the amount of dividends could be determined by the taxpayer, thus eventually leading to controlled foreign companies legislation.

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[72] See the articles of association quoted at 6 TC at p.154-5 which makes it clear that the Egyptian business was under the control of the Egyptian board to the exclusion of any other board. It would therefore have taken a third party, the shareholders, to change this.

[73] As was the case in *B W Noble Ltd v Mitchell* (1927) 11 TC 372 where the UK board delegated their powers to run the Paris branch to a French resident director. The UK board were still responsible for the running of the whole business of the company, and the French business was part of the whole.

[74] This is not to suggest that the only reasons for having foreign subsidiaries are tax ones.

[75] The 1920 Royal Commission (Cmd.615) para.40 recommended that the subsidiary should be deemed to be controlled in the UK in order to avoid differences between active and passive control. This was never adopted but CFC legislation effectively does the same in a more targeted way.

[76] *Apthorpe v Peter Schoenhofen Brewing Co Ltd* (1899) 4 TC 41 where a US subsidiary which had formerly carried on the trade continued merely to hold real property as required by local law; *St Louis Breweries v Apthorpe* (1898) 4 TC 111 where the UK company controlled the foreign subsidiary's trade. The difference between shareholder control and control of the subsidiary's trade does not seem to have been clearly understood by the UK parent company; the articles included power "to manage the affairs or take over and carry on the business of any such American Company." The US subsidiary in *Bradbury v the English Sewing Cotton Co Ltd* (1923) 8 TC 481 had formerly been controlled in the UK (and had been found to be resident in *the American Thread Co v Joyce* (1913) 6 TC 1 and 163); it changed its residence in 1917. The separate trade of the foreign subsidiary was recognised in *Bartholomay Brewing Co v Wyatt* (1893) 3 TC 213 and *Nobel Dynamite Trust Co v Wyatt* (1893) 3 TC 224.

[77] The distinction between shareholder control and control of the trade is clearly made in *Kodak Ltd v Clark* (1903) 4 TC 549 concerning a UK company which owned 98% of the shares in the American Kodak Company. UK holding companies seem to have been surprisingly common at the time (see also next note).

[78] The distinction between shareholder control and control of the trade was accepted where the foreign company (*Deutsche Grammophon AG*) was a 100% subsidiary of the UK company in *Stanley v The Gramophone and Typewriter Co* (1908) 5 TC 358.

The position was therefore reached that there was very little scope for a trade to be a foreign possession unless there was a partnership controlled abroad. Profits from carrying on, as opposed to controlling, a trade abroad were taxable in full and so the remittance basis had little application. This in turn led to a demand for double taxation relief for the foreign tax suffered on the same profits. Colonial income tax relief was introduced in 1916 although mainly as a result of the removal of the remittance basis for foreign investment income in 1914;[79] this became Dominion Income Tax Relief by the Finance Act 1920.[80]

When the remittance basis did not apply, there was the additional problem of measuring the foreign trading income. *Colquhoun* demonstrates the difficulty of doing this nearly a century later. The Revenue were arguing for the arising basis to apply to a share of income from an Australian partnership carrying on the business of window glass, oil, and colour merchants, and storekeepers in Melbourne, the City General Commissioners, who correctly found against the Revenue, and one would expect to be financially sophisticated, record that the profit measured on the arising basis was computed "by an estimate and valuation on taking of stock on a certain fixed date after deducting therefrom the estimate and valuation of the preceding year, but as a matter of fact only a portion of the amount had been actually realised."[81] This does not bear much resemblance to the method of measuring profit for tax purposes either then or now. The remittance basis avoided all such accounting problems; it was easy to measure remittances of cash.

Trading income: comparison with the rest of Europe

The only way to avoid tax being charged on an arising basis on foreign trading activities was to carry on the trade abroad through subsidiaries managed abroad. It is interesting to compare the result with the European exemption system for foreign trading profits. The mainland European approach is not to try to measure foreign trading profits and just exempt them, at least where the profits are attributable to a permanent establishment.[82] European countries did not, as we did, start an income tax from nothing, they had *impôts reels*, an untranslatable expression for a series of separate taxes imposed on different types of income on a source basis, such as a tax on land, and a tax on business profits etc.[83] The first income tax, the *dixième*, imposed in France by Louis XIV in 1710 was a tax on real property, salaries,

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[79] See the heading *Cutting down the remittance basis, investment income* below.

[80] FA 1916 s.43; FA 1920 s.27. Colonial income tax relief limited the rate in the UK to 3s 6d (17.5%), while dominion income tax relief (which also applied to territories under protection or mandate) was limited to half the UK rate. For the subsequent history of double taxation relief see *Double Taxation Relief for Companies,* a discussion paper, Inland Revenue, March 1999, and R. Willis *Great Britain's Part in the Development of Double Taxation Relief* [1965] BTR 270. The subject will not be included here.

[81] Para 6 of the Case Stated at p.491. This might be seen as a forerunner of the balance sheet approach in Accounting Standards Board's Statement of Principles for Financial Reporting issued in 1999.

[82] The expression used in the OECD Model Tax Convention and normally also in internal law in mainland European countries for something in the nature of a branch.

[83] This approach is found in the present tax in Hong Kong described in Michael Littlewood's paper *Tax Reform in Hong Kong in the 1970s* in Chapter ** of this book. It is interesting to speculate whether the European taxes influenced the UK colonial model income tax ordinance (1922) which existed in many territories until the 1930s and of which Hong Kong's tax is a surviving example.

securities and businesses.[84] No question of taxing foreign income arose. As late as 1923 *impôts reels* were the only form of taxation in Europe at the time of the League of Nations Report by Professors Bruins, Einaudi, Seligman and Sir Josiah Stamp, which report was the beginning of the search for a solution to the problems of double taxation. The Report has a section beginning: "In this section we shall discuss the income tax proper in its developed form, as found in Great Britain, the United States and the German Empire."[85] When European countries adopted an income tax, this also had some source taxation; this applied to income from immovable property, mortgages, an unincorporated industry or business, and earned income.[86] The existing tax and the new income tax fitted together by means of the income tax exempting anything covered by other country's source-based tax, leaving the income tax to apply to a residual category. Accordingly the European countries continued in their income taxes to exempt foreign earned, and property, income for both corporations and individuals, so the problems of measuring such income were avoided, and they had no need for the remittance basis. The measurement of foreign investment income (as opposed to making sure that taxpayers declared it[87]) was not a problem for European countries by the time they started to tax it by their income taxes in the 1920s. By then the UK had substantially removed the remittance basis for investment income.

The UK and the European approaches thus define foreign trading income differently: the UK concentrating on the person controlling the trade, which meant that a trade controlled from the UK would be taxed as a UK trade wherever it was physically carried on, and the European concentrating only on the geographical source of income probably because that was the basis for their *impôts reels*, and exempting income from a trade physically carried on abroad.[88] Geographical source is not important for residents in the UK system because they are taxed on worldwide income; source (in the UK sense) merely determines how one taxes it, traditionally on the remittance basis if it is foreign source. For a non-resident, in both systems, geographical source determines what income is taxed so that a branch in the country concerned is always taxed to whomsoever it belongs.[89] In the UK this result is achieved by

[84] William Phillips *The Origin of Income tax* [1967] BTR 113, 117 quoting Seligman *the Income Tax* (1911). I am assuming, without having verified it, that foreign income was not taxed by the *dixième*.

[85] Report on Double Taxation, League of Nations 1923 p.45. There is also a reference to an "Italian tax contemplated by the law of 1919, the enforcement of which has recently been postponed;" it was introduced in 1925.

[86] Double Taxation and Tax Evasion, Report and Resolutions submitted by the Technical Experts to the Financial Committee of the League of Nations, 1925 p.13.

[87] A debate that is still continuing in relation to the proposed EU Savings Directive.

[88] The distinction between the two approaches can be seen clearly in the territorial tax system of Hong Kong where in order to be taxable there must both be a trade carried on in Hong Kong (the same as the UK test) and also the profits must be "profits arising in or derived from Hong Kong." Thus profits made by a Hong Kong bank from trading in certificates of deposit on markets in London or Singapore did not arise in and were not derived from Hong Kong: *Comr. of IR v Hang Seng Bank Ltd* [1990] STC 733, particularly 736e. A similar Indian case was relied upon which decided that profits of an Indian commodity broker made on exchanges outside India were not profits "accruing or arising in British India", (p.739e)

[89] The UK taxes a branch in the UK as a UK trade because it is physically carried on in the UK. Control is not relevant since this is used to decide the type of income, UK or foreign, not whether to tax it.

using a different expression, that a non-resident is taxed on a trade *exercised within* the UK.[90] A non-resident is not taxed under Cases IV and V, presumably on the basis that they are unlikely to be controlling a foreign trade from the UK, although since 1965 a non-resident company is liable to corporation tax under those cases[91] in order to tax foreign income attributable to a UK branch.[92] The difference between the two approaches can be seen at its most extreme in relation to the profits of a foreign branch. These profits are part of the UK trading profit and taxed in full if the trade is controlled from the UK because we look at it from the standpoint of the UK resident trader; in Europe they are not part of a domestic source but are a source of income in the other country and accordingly the residence state exempts them from tax. Thus while the UK system favoured trading abroad through a non-resident subsidiary, the European exemption system allowed trading through a branch of the same company. The results are similar; exemption of the foreign profits from residence state taxation until distribution to the shareholders as dividends in the exemption system or until distribution to the parent company in the UK system with a foreign subsidiary. The UK admits of the possibility of a third category, the overseas controlled trade carried on outside the UK which is effectively limited to partnership cases. Here the remittance basis applied; in the European approach, it is just another case of a foreign branch and exempt. The results are again similar; exemption until distribution to shareholders in the exemption system, and until remittance to the head office in the UK system.

This main discrepancy between the UK approach of taxing foreign branch profits in full and the European system of exempting them where the trading was carried out in one company led the 1955 Royal Commission to look at exemption but they found it impossible to agree to adopt exemption. There were three camps, which we would now recognise as those favouring capital import neutrality, those favouring capital export neutrality, and the pragmatists. In the end the pragmatists won and the Commission recommend a special case where exemption might be used, the overseas trade corporation on the lines of the US Western Hemisphere trade Corporation or the Canadian foreign business corporation.[93] This recommendation was taken up in 1957[94] and provided a method of exempting trading profits from a trade carried on wholly abroad until the income was distributed. In that respect it is very similar to the remittance basis. The difference is merely that the remittance basis taxes income reaching the UK, while trading profits of an overseas trade corporation were taxed on distribution. The exemption for overseas trade corporations was abolished in 1965. The debate about exemption was revisited in a discussion paper on Double Taxation Relief for Companies[95] but no changes were made to the present system. Exemption was, however,

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[90] Now TA 1988 s18(1) Sched D (a)(iii).

[91] Case IV does not apply to companies after 31 March 1996, see TA 1988 s.18(3A).

[92] FA 1965 s.54(8), now TA 1988 s.70(3), now referring to Cases III and IV since Case IV no longer applies to companies, see previous note. Non-resident companies are liable to corporation tax on trading income arising directly or indirectly through or from the branch or agency in the UK and any income from property or rights used by, or held by or for, the branch or agency, s.11(2). There is no comparable provision for individuals.

[93] See Appendix III of the 1955 Royal Commission Report Cmd.9474.

[94] FA 1957 s.23 onwards.

[95] Inland Revenue, March 1999.

introduced for capital gains on the disposal of subsidiaries, including foreign subsidiaries, in 2002.

As we have seen, mainland European countries had no need for the remittance basis as they exempted foreign income. Accordingly it seems that Britain's use of the remittance basis was unique although no doubt it is still to be found in countries which based their tax system on ours. The only current example of the use of the remittance basis is in Japan which uses it for taxing a non-permanent resident, meaning an individual who has no intention of residing permanently in Japan and who has been resident there for 5 years or less.[96] The basis of taxation on foreign source income is the income paid within Japan or remitted to Japan from abroad.[97]

Employment and pensions income

The other difficult category for determining what constituted a foreign possession was employment income. The position here was complicated by the fact that some employments were taxed under Schedule E and some under Schedule D. Schedule E had its own territorial provision in taxing on a current year basis the emoluments of "every public office or employment of profit within the United Kingdom"[98]; other employments, both UK and foreign, were taxed under Cases II or V Schedule D on the average of the three preceding years, the latter effectively being the residual category. For Schedule E not only was there a problem of determining what offices or employments were "public", but it was also necessary to determine whether it was "within the United Kingdom": "The office of a director is something notional; its locality is one degree, if that is possible, even more notional."[99] Public offices with a UK resident body were treated as located in the UK.[100] Thus a non-resident director of a UK company, surprisingly even a private company was public for this purpose, performing all his duties outside the UK was deemed to hold a public office within the UK because the company was managed from the UK and he was entitled to attend board meetings in the UK. He was therefore taxable on the whole remuneration, an unusual example of a non-resident being taxed on work done outside the UK, which was another factor indicating that trade should be through non-resident subsidiaries.

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[96] Income Tax Law art.2(1)(iv). The existence of the remittance basis in Japan is mentioned in *Residence in the UK*, Inland Revenue Consultative Document, 1988, Annex D.

[97] Income Tax Law art.7(1)(ii).

[98] 1803 Act Sched E Third Rule. The term was originally derived from Land Tax, see note 114. The antiquity of the phrase made it difficult to apply to employees of the new class of companies which were then being formed, such as the fourth grade clerk in *Great Western Railway Co v Bater* (1922) 8 TC 231 in which the House of Lords departed from the practice that had grown up of virtually ignoring the word "public" (see Rowlatt J at p.235) and held that he did not hold a public office. The result was that tax could not be collected from the employer, leading to a change in the law by FA 1922 s.18 moving all UK employments to Schedule E but leaving foreign employments taxed under Case V.

[99] *McMillan v Guest* (1942) 24 TC 190, 203 *per* Lord Wright.

[100] *McMillan v Guest* (1942) 24 TC 190. One might be forgiven for thinking that Rowlatt J's dictum in *Proctor v Ryall* (1928) 14 TC 204, 214 that "the place of exercise governs" was more sensible. Although he was reversed by the courts, his test is the one Parliament later adopted for defining a foreign employment. This view seems to have been different from his decision on Schedule D in *Pickles v Foulsham* (1923) 9 TC 261, see next note.

The Schedule D position regarding foreign employments was no easier. There was still doubt as late as 1925 about whether an employment could be a possession at all, and if it could what made it a foreign one (the obverse of the Schedule E question of what made a public office one within the UK)?

> "It was argued by the Solicitor-General that this gentleman's (I can hardly state it) agreement, or his occupation, was a foreign possession….He really has not anything, if you use it as a word of possession. There is nothing he can sell; there is nothing he can leave; there is nothing which exists. He is *de facto* employed under a contract; he has a contractual right to keep on being employed, and I, for my part, cannot see how it is possible to say that he has got a possession; but if he has got a possession it is not a foreign one, because the only thing that is foreign is the place where his duties have to be performed. His rights are not foreign; they are as much British as anything else, if they have any locus, because it is a contract with a British company."[101]

Rowlatt J was on this occasion overruled by the House of Lords which looked for a possession and in doing so perhaps over-concentrated on the employment contract, just as the courts did in relation to sales contracts in deciding whether a non-resident was trading in the UK.[102] Having found a possession the more difficult question was what made a contract foreign:

> "The House of Lords…in *Foulsham v Pickles* have definitely decided that, in the case of an employment, the locality of the source of income is not the place where the activities of the employee are exercised but the place either where the contract for payment is deemed to have a locality or where the payments for the employment are made, which may mean the same thing."[103]

It may be said that the question of how one determined the locality of the contract was never settled by the courts and it was determined by legislation in 1956, some 150 years after Addington's Act. The Royal Commission of 1955[104] reported just before the question was determined by legislation in accordance with their recommendation. They said this:

> 297. "..it has been made plain to us that it is extremely difficult to say whether an employment which contains elements of a foreign character is or is not to be treated as a foreign possession for this purpose
>
> 298. There is no statutory rule. In the absence of one the Courts have had to treat each question as one of fact and to decide it according to the balance of what seem to be the relevant considerations. There is the nationality, domicile or residence of the employer. As the employer is normally a corporation, that test is likely to be somewhat artificial anyway. Then there is the country in which the contract of employment is made, which may or may not correspond with the national system of law by which it is to be governed. Thirdly, there is the country in which the moneys earned by the employment are paid, though it by no means follows that the whole salary will be paid in any one country. Lastly, there is the country in which the work is to be done: again two or more countries may be involved.[105]
>
> 299. We regard this state of affairs as unsatisfactory….

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[101] *Pickles v Foulsham* (1923) 9 TC 261, 276 *per* Rowlatt J. The House of Lords decision was in 1925. The same issue later arose over whether rights under an employment contract were assets for capital gains tax: *O'Brien v Benson's Hosiery (Holdings) Ltd* [1979] STC 735.

[102] See, *e.g. Balfour v Mace* (1928) 13 T C 539, 558.

[103] *Bennett v Marshall* 22 TC 73 *per* Romer LJ at 94 quoted with approval by Lord Normand in *Bray v Colenbrander* (1953) 34 TC 138, 157 as stating the ratio of *Foulsham v Pickles* 9 TC 261.

[104] Cmd.9474.

[105] The Income Tax Codification Committee 1936, Cmd.5131, set out the Revenue's practice at the time, which was to treat duties performed abroad for a non-resident employer, and also those for a UK resident employer which were paid abroad, as being within Case V. The 1920 Royal Commission (Cmd.615) para.26 had recommended that the former should be on the remittance basis.

> 300. We recommend therefore that a statutory rule should be enacted to the effect that (a) the income arising from an employment performed wholly abroad is income from a foreign possession, and (b) the income arising from an employment performed wholly in the United Kingdom cannot be a foreign possession."

This recommendation was immediately adopted in a slightly different form which moved all employment income to Schedule E so that one did not have to identify any employment income as a foreign possession but it could contain its own definition suited to employment income.

In 1922[106] following the recommendation of the 1920 Royal Commission, all employments, except those which were taxed as foreign possessions, were moved to Schedule E and so this change did not affect foreign employments so long as they were not from public offices or employments within the United Kingdom. The 1955 Royal Commission recommended that this distinction between public and other employments be abolished as no one knew what it covered.[107] This recommendation was accepted and as a result the remaining employments were moved to Schedule E in 1956 and the treatment of the foreign element was set out in the statute for the first time.

The rationalisation of foreign employments in 1956 resulting from the Royal Commission's recommendations was that the remittance basis applied to an employment all the duties of which were performed outside the UK. Secondly, and contrary to the Royal Commission's recommendation in paragraph 300 quoted above, an exception was introduced to continue the remittance basis for those domiciled abroad on "foreign emoluments," wherever the duties were performed, thus including duties in the UK. Foreign emoluments are emoluments of a non-domiciled employee from a non-resident employer.[108] This effectively continued the existing case law.[109] Thus non-domiciled persons retained their own provisions for the remittance basis, as they had done in the 1914 changes to taxation of investment income dealt with below. There was also a relief for non-ordinarily resident individuals which, in accordance with the Royal Commission's recommendation in relation to investment income,[110] was not limited to Commonwealth and Irish Citizens; they (and also non-residents) were taxed only on work done in the UK. For the first time one could identify what was a foreign employment.

There was no similar problem with identifying whether a pension was a foreign possession. The possession is the pension fund.[111]

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[106] FA 1922 s.18.

[107] Para.305.

[108] Technically "any person, body of persons or partnership resident outside, and not resident in, the UK," thus envisaging the possibility of dual residence: Schedule E as substituted by FA 1956, s.10. Irish resident employers are excluded: now TA 1988 s.192(1).

[109] *Bray v Colenbrander* (1953) 34 TC 138 concerning two foreign nationals, who would no doubt have been non-domiciled if that had been relevant, working wholly in the UK for foreign employers under contracts made abroad and who were paid abroad. They were held to have foreign possessions.

[110] See text at note 160.

[111] *Aspin v Estill* [1987] STC 723, *Albon v IRC* [1998] STC 1181.

III. The remittance basis

THE ORIGINS OF THE REMITTANCE BASIS

How did the remittance basis arise? The precedents available to Pitt for taxing foreign income were not helpful. The Land Tax did not attempt to tax land abroad which at that time would have been a breach of sovereignty[112] but it did, despite its name, at least in theory,[113] tax personal property abroad:

> "…all and every such Person and Persons…having any Estate in ready Money, or in any Debts whatsoever owing to them, within Great Britain , *or without,* or having any Estate in Goods, Wares, Merchandises, or other Chattels or Personal Estate whatsoever within Great Britain, *or without,* belonging to, or in trust for them…shall yield and pay unto His Majesty the Sum of Four Shillings in the Pound according to the true Yearly Value thereof for One Year; (that is to say), For every One hundred Pounds of such ready Money and Debts, and for every One hundred Pounds of such Goods, Wares, Merchandises, or other Chattels or Personal Estate, the sum of Twenty Shillings, and so after that Rate for every greater or less Sum or Quantity, to be assessed, levied, and collected in Manner herein-after mentioned;[114]

There is no attempt to do anything other than tax the full amount of the assumed yield of 1 per cent.[115] Indeed it would not be possible to apply the remittance basis to an assumed yield.

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[112] Estate duty was imposed on land abroad for the first time by FA 1962 s.28. The sovereignty argument was also unsuccessfully raised in Parliament when the remittance basis was removed from foreign rent in 1914.

[113] Martin Daunton, *Trusting Leviathan, the Politics of Taxation in Britain 1799 to 1914*, Cambridge UP, 2001, p.33 says "In theory, this tax [Land Tax] was a national rate of 1s, 2s, 3s, or 4s in the £ on the income not only of land but also of personal property and office….Reality was different, for the tax was confined to land…".

[114] Land Tax Act 1797 38 Geo III c.5 s.III (my italics). The Land Tax Perpetuation Act 1798 (38 Geo III c.60), which made land tax into a perpetual tax with a fixed quota for each town, parish etc, and moved the taxation of personal property into another Act which was not perpetual, and like income tax today, had to be renewed every year. The first of such Acts was 39 Geo III c.3, which covered the same assets and applied for the year beginning 25 March 1799 and therefore applied at the same time as Pitt's income tax of 1799. Notwithstanding the Perpetuation Act the land tax on the list of shares in s.57 of the 1797 Act was made redeemable by the Land Tax Redemption Act 1802 (42 Geo III c.116). See Piroska E Soos T*he Origins of Taxation at Source in England*, IBFD Publications, Amsterdam, 1998, p.140. The 1797 Act went on to tax: "all and every Person and Persons…having, using, or exercising, any publick Office or Employment of Profit in England, Wales, or Berwick, as aforesaid….and …all and every Person and Persons…having an Annuity, Pension, Stipend, or other Yearly Payment, either out of the Receipt of His Majesty's Exchequer in England, or out of any Branch of His Majesty's Revenue in England, Wales, or Berwick, or payable or secured to be paid, by any Person or Persons whatsoever, in England, Wales, or Berwick…"—which did not extend to foreign employments or annual payments. Note the Land Tax origin of "public office or employment" which was to be taken over into income tax. Section 57 also taxed shares in the New River Company (which was logical as they were regarded as realty), in the Thames waterworks, Marybone or Hampstead waterworks, in any office or stock for insuring of houses in case of fire, or in any lights, or in the stock of the king's printing house, and all companies of merchants in London and the Bank of England, all of which are clearly in the UK. Also of historical interest is the definition of land in s.IV, dating from 1688 (see William Phillips *No Flowers, by Request* [1963 BTR 285, 291) to include "quarries, mines…iron works, salt-springs, and salt-works, all allom-mines and works, fishings, tolls…" all of which are still to be found in TA 1988 s.55, having been moved to Sched D by FA 1926 s.28, having been subject to Sched D rules although taxed under Sched A by Customs and Inland Revenue Act 1866 s.8. The Tax Law Rewrite has preserved this in the draft Income Tax Bill in ED 13 cl. 9. On the history of land tax, see William Phillips *No Flowers, by Request* [1963] BTR 285.

[115] It is interesting that in 2001 the Dutch changed their income tax to tax an assumed yield of 4% from savings and investments in order to prevent interest deductions being claimed against the income. For an article in English describing the change, see Gerard T K Meussen *Income Tax Act 2001* 40 European Taxation (2000) p. 490. The US regards this as a substantially similar tax to the Netherlands income tax named in the treaty for the purpose of giving credit: Rev Rul 2002-16.

The immediate forerunner of Pitt's income tax, the Triple Assessment[116] of the year before, during the debates on which Pitt promised not to impose an income tax, allowed persons to elect to pay 10 per cent tax, with some lower rates for smaller incomes and nothing on an income of £60, on their total income as an alternative to paying a multiple (not always three times despite its popular name) of the amount of the previous year's tax on various luxuries, but it contained no provisions for computing such income. That the Triple Assessment yielded only half its expected yield[117] with large numbers of people declaring incomes of under £60, was the cause of Pitt having to go back on his promise and impose an income tax in 1799, which turned out to be not much more successful, collecting only £6m out of the estimated £10m. It seems likely therefore that there was no attempt to tax the actual income of foreign property before Pitt's 1799 Act.

Starting therefore with a blank sheet one might well come to the same answer as Pitt's advisers about the remittance basis. For Pitt, but not Addington, interest on foreign securities was sufficiently certain to be taxed in full, not on the remittance basis. The administrative problems of taxing any other type of foreign income, particularly foreign trading income required a practical solution effectively taxing goods received in the UK when they were turned into money, in other words, the remittance basis. The arguments in favour of such a system were not only practical ones. Lord Herschell in *Colquhoun*[118] made the argument of principle that the trade carried on in Australia did not enjoy the protection of the laws of this country.[119]

Although this article does not deal with the meaning of remittance, further understanding of the nature of the remittance basis can be obtained from the provisions of Addington's Case V setting out the methods by which taxable remittances were made:[120]

> The Duty to be charged in respect thereof shall be computed at not less than the full Amount of the actual Sums annually *received in Great Britain*, either [1] for Remittances[121] from thence payable in Great Britain, or [2] from Property imported from thence into Great Britain, or [3] from Money or Value received in Great Britain, and arising from Property [of any Person or Persons],[122] which shall not have been imported in Great

[116] 38 Geo III c.16. Simon's Taxes records that "it was associated with a scheme proposed by the Speaker, Addington, from an idea by John Bowles in 1796 (Two letters addressed to a British Merchant, 4th ed pp 31 and 76) that voluntary contributions in excess of the Triple Assessment might be made to the Bank of England; this scheme raised almost as much as the main tax itself had produced."

[117] The yield was £1,855,996 (1875 Report of the Board of Inland Revenue).

[118] (1889) 2 TC at p.492.

[119] The protection of English law was also relevant to making a company managed here taxable as a resident: "Otherwise it might have its chief seat of management and its centre of trading in England, under the protection of English law, and yet escape the appropriate taxation…" *de Beers Consolidated Mines Ltd v Howe* (1906) 5 TC 198, 213 *per* the Lord Chancellor.

[120] This comes immediately after the passage quoted in the text at note 29.

[121] Addington's Act used the word "remittance" for the first time. ITA 1918 changed *for* remittances to *from* remittances, which makes more sense. The numbers in square brackets added to the second sentence is to help tie the items into the explanation immediately following.

[122] Words dropped by Pitt's 1805 Act (45 Geo III c.49), Pitt having returned to office in 1804, which re-enacted Addington's 1803 Schedules and Rules with some amendments.

> Britain, [or [4] from Money or Value so received on Credit or on Account in respect of such Remittances, Property, Money, or Value, brought or to be brought into Great Britain][123]….

This is explained by the contemporary work from which we have already quoted and repeat again:

> "The Act considers that the value of foreign property may be brought into Great Britain. 1st, By bills. 2d, From the produce of the estate which it calls property, (meaning personal property,) imported into Great Britain, and turned into money here. 3d, From the produce of the estate sold in other countries, the value of which is received here. 4th, From money received by the party either on the credit or the account of the produce of the estate converted in any of the ways mentioned."[124]

The first item ("remittances from thence [abroad] payable in Great Britain") is explained laconically as "by bills." Suppose the British resident owner of the plantation wants profits in Great Britain. Moving money (necessarily bullion) internationally at the time was dangerous (storm, pirates, French warships) and expensive and was not in practice carried out. Instead bills of exchange were used. Here is an account from a book on the history of bills of exchange:

> Consider a hypothetical English merchant who has sold goods through his factor[125] in Flanders. Suppose that there is someone else in Flanders who wishes to buy goods for export to England, but lacks sufficient funds. ….The English merchant's factor in Flanders would deliver the money to the Flemish merchant, who would draw a bill of exchange on his factor in London, instructing him to repay the value to the English merchant. Needless to say, one would expect that the amount to be repaid in London would exceed the amount advanced in Flanders, the difference being the interest paid by the Flemish merchant on the loan.[126]

If one substitutes an English owner of a foreign[127] estate for the English merchant, the transaction would have been exactly the same. This example incidentally shows the dual nature of bills of exchange as a substitute for moving money and as a method of financing. Alternatively, bills of exchange could be used to match trade in opposite directions, again without moving money between countries:

> Suppose, for example, that an Italian merchant shipped spices from Italy to his representative in Flanders. Once the agent in Flanders had sold the spices, he would have funds in Flanders due to his principal in Italy. Suppose that another merchant in Flanders was in the business of buying English wool and shipping it to Italy. Once the Flemish wool merchant's agent in Italy had sold the goods, he would have funds in Italy due to his principal in Flanders. The problem of making returns could be solved by having the Italian spice merchant's factor in Flanders pay money to the wool merchant, and the Flemish wool merchant's factor in

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[123] Words added by the 1805 Act.

[124] Guide to the Property Act, 1807, see note 22.

[125] This was the customary way of doing business. The buyer was not concerned that this is an international transaction and merely paid the agent (factor or commission agent) either in cash or on credit probably by means of the issue of a bill of exchange. J S Rogers *The Early History of the Law of Bills and Notes,* Cambridge University Press, 1995, p.33-5. Quoting from another author he says "By the end of the sixteenth century, the commission system …was tending to become general. All merchants—in Italy or in Amsterdam for instance—worked on commission for other merchants, who did the same for them." Later London and Liverpool took over from Amsterdam. The commission agent was recognised in tax legislation that a non-resident was not taxable on transactions carried out through a broker (defined to include a general commission agent) in the ordinary course of his business as such in what was TMA 1970 s.82 deriving from FA 1925 s.17 (since repealed by FA 1995). For the history of this and its influence on art.5(6) of the OECD Model Tax Convention, see J F Avery Jones and D A Ward *Agents as Permanent Establishments under the OECD Model Tax Convention* [1993] BTR 341, 355.

[126] J S Rogers (see note 125) p.37. The interest on the bill would incidentally be taxed under Case IV.

[127] If the estate were in the colonies the second method of making a remittance was more likely to apply for the reasons given below.

> Italy pay money to the Italian spice merchant. In effect, the Flemish wool merchant's outward cargo would have become the Italian spice merchant's return cargo, and vice versa.[128]

The system becomes more sophisticated, as was beginning to happen at the time income tax was introduced, when a merchant banker accepts (or guarantees) the bill which makes it more marketable, and a bill broker brings the parties together. A remittance was essentially concerned with delaying the timing of taxation until the goods were turned into cash in Great Britain; it did not involve the voluntary element that it now has of choosing never to remit the income.

The meanings of the second type of remittance ("sums received from property imported from thence [abroad] into Great Britain"), and the third ("sums received from money or value received in Great Britain, and arising from property which shall not have been imported in Great Britain") are clarified, as so often with income tax, by the administrative provisions. Foreign income was assessed by commissioners in London, Bristol, Liverpool and Glasgow, the main ports, as if it arose from a trade carried on there. The assessment was to be made at such port at, or nearest to, which the property was first imported into Great Britain (the second method of making a remittance), or in the case of remittances, money or value arising from property not imported (the third method) at such port at, or nearest to, which the person resided.[129] This emphasis on the ports shows that much of the income from foreign possessions[130] was imported in the form of raw materials like cotton, and sold in Great Britain. Goods from the colonies were forced to come here by the "Old Colonial System" deriving from the Navigation Acts 1651 and 1660 which required exports of the main raw materials, sugar, tobacco and cotton from the colonies to be sent directly to England or to another colony in English or colonial ships. They could not be exported direct to any other country. Unless, therefore, the goods went to another colony, they had to pass through Great Britain. In practice that was where the market was to be found and so they were likely to be sold here. After Independence, America was a major supplier of raw materials, particularly cotton, and purchaser of English goods, and so in practice imports from America came here too. The trade with America increased at the time because of the difficulties of doing business in Europe during the war with France.[131] Effectively therefore most foreign trade or investment resulted in goods coming to England for sale with "sums received" here.[132] The third method of making remittances in money or value for goods not imported to be assessed

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[128] J S Rogers (note125) p.33-4.

[129] 1805 Act s.CVIII, 1806 Act as a proviso in s.CXVII, and reverting to a separate section again in the 1842 Act s.108.

[130] We shall see that later cases restricted the scope of trading income as a foreign possession, see the heading *Trading income*, but probably all foreign income derived from trade abroad was originally thought to be income from a foreign possession.

[131] R W Hindy *The House of Baring in American Trade and Finance,* Harvard University Press, 1949.

[132] For an example of the problems this caused, see *The King v The Kensington Income Tax Comrs ex p. Aramayo* (1915) 6 TC 613 in which Lord Wrenbury said "This case affords a striking illustration of the involved and almost unintelligible expression of the law contained in the Statutes relating to income tax." (at p. 621). The problem was that references in the provision relating to the normal place of assessment to a person engaged or not engaged in trade had to be impliedly restricted to trade in Great Britain. The charging provision for foreign income took precedence over the normal provisions. The decision was that the Kensington General Commissioners had no jurisdiction, contrary to the prevailing practice. This provision was repealed by F(No.2) A 1915 s.32(2), doubtless as a result of the case.

at such port nearest to the place where the person resided also suggests that such remittances were connected with ports. The reference to "money received" is the first reference to money itself (necessarily in the form of bullion) being moved, which would be through a port.[133] The reference to "value received" may have been from barter trade, with the resident sending the produce of his foreign estate directly abroad and receiving other goods here (through one of the ports) in exchange that are turned into money here.

Perhaps the fourth type of remittance ("sums received from money or value so received on credit or on account in respect of such remittances, property, money, or value, brought or to be brought into Great Britain"), which was added in 1805, reflects the change in banking practice that evolved around that time.[134] Previously transactions were financed by the financier buying goods for cash and selling the goods on credit, thus acting as a merchant; later, the financiers became merchant bankers, buying bills rather than the goods.[135] This would be a way of the owner of the foreign plantation receiving money in advance of the maturity of the bill of exchange.

Thus originally the remittance basis was more of a timing provision. The profits would be remitted anyway and tax was charged when money was received here. That ceased to be true when foreign trading was no longer restricted to plantations abroad, and this led to the Revenue disputing whether the trade was a foreign trade, on which, as we have seen,[136] they were generally successful, which in turn led to taxpayers successfully countering by trading through foreign subsidiaries. The subsequent history of the remittance basis is one of gradual reduction in its scope.

CUTTING DOWN THE REMITTANCE BASIS

Investment income

By 1914 some of the advantages of the remittance basis for taxpayers were being exploited. Accordingly a change was made designed to tax:

> "…the income that escapes taxation now owing to arrangements purposely made by men who are rich enough to leave their incomes abroad for reinvestment."[137]

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[133] For an account of how N M Rothschild financed Wellington's campaign from about 1811, which required movements of bullion, see Niall Ferguson *The World's Banker, the History of the House of Rothschild,* Weidenfeld & Nicolson, 1998 p.91. Again, bills of exchange were involved. Bullion was smuggled into France and used to buy bills of exchange on London at a discount which were redeemed in London at their full value.

[134] The Rewrite said that the examples did not add anything of great value to "sums received." It described the third and fourth examples as particularly obscure, ED 13 (see note 8) para.1184 and they have not been included in the draft Bill.

[135] For an account of contemporary practice, see *The World's Banker, the History of the House of Rothschild* (see note 133). The young N. M. Rothschild arrived in England in about 1798 at the age of 21 operating first by buying and exporting English textiles and by 1805 was diversifying into financing imported colonial goods: "Like his father, he was gradually shifting from being a merchant to being a merchant banker" (p.57).

[136] See *What made a possession foreign? Trading income.* See the Revenue's International Tax Handbook ITH209.

[137] Lloyd George HC Deb Vol.LXII col.89. See also vol LXIV col 1579 (Committee Stage) and vol LXV col 680 (Third Reading). See also *Singer v Williams* 7 TC 419, 430. The object of the income tax measures in the Bill was to raise a large additional sum of money without placing an undue burden on those with small or moderate incomes; this was not specifically stated to be for war, which broke out four days after Royal Assent.

This change removed the remittance basis from the easier types of income on which taxpayers could avoid tax and incidentally the easier income to compute: income from foreign securities, stocks, shares and rents.[138] Accordingly, we had now reverted to the position in Pitt's original tax but for a wider class of foreign income than for interest on foreign securities. The three-year average still applied to income from foreign possessions.[139] The rather vague expression "securities, stocks, shares or rents" may have been necessary because, apart from securities (Case IV) there were no Schedules or Cases that could be used to identify the type of income as they all fell within the single heading of foreign possessions. The benefit of being able to reinvest foreign trading profits without paying tax was not affected. The change meant that giving double taxation relief became much more important. Initially a deduction in computing the income was given for income tax paid in the place where the income arose.[140] "Colonial income tax relief" for tax paid under the law in a British possession was introduced two years later.[141] The removal of the remittance basis from foreign investment income was subject to the important exception dealt with in the next heading. Another consequence was that UK insurance companies were adversely affected which will be dealt with below.

The dividing line between income from securities, stocks, shares and rent, and other income may have seemed clear but like all dividing lines it led to what must be the longest running dispute in the history of tax, requiring two hearings in the House of Lords, three in the Court of Appeal, and four each in the High Court and the Special Commissioners[142] to determine whether the life tenant of a trust receiving underlying income from securities, stocks, shares or rent received the same type of income as the underlying income, which meant that the remittance basis no longer applied, or a different type of income, trust income, from which the remittance basis had not been taken away. The first time round the answer was that quite reasonably the life tenant received the same type of income as the income from the underlying securities: "[the life tenant] is, in my opinion, as a matter of construction of the

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[138] FA 1914 s.5. Irish income was already taxed on the arising basis, see note 16.

[139] *Singer v Williams* 7 TC 419. The average included years before the change when the income had been taxed on the remittance basis. But the average could not be for years before a company became non-resident: *Bradbury v The English Sewing Cotton Co Ltd* (1923) 8 TC 481. The three-year average did not apply when dividends were paid by a paying agent, see *Singer* at p.438. For subsequent changes in the basis of assessment see note 45.

[140] FA 1914 s.5.

[141] FA 1916 s.43. This limited the rate of tax after giving relief to 3s.6d (17.5%) and was thus not of benefit to those whose tax rate was below this. See note 80 for the history of subsequent reliefs from double taxation.

[142] HL 11 TC 764, 15 TC 729; CA 11 TC 756, 15 TC 6, 712; Rowlatt J 11 TC 753, 15 TC 5, 702, 710; Special Comrs 11 TC 749, 15 TC 3, 693, 703.

will, entitled in equity specifically during her life *to the dividends* upon the stocks…."[143] That was decided on the basis that New York law, which was the governing law of the trust, was the same as English law. When the case was remitted to the Special Commissioners to find the figures, the taxpayer tried to introduce evidence that New York law was different, which they refused to hear, resulting in the intermediate trip to Rowlatt J, whose judgment running just into the third line is short even by his standards, and thence to the Court of Appeal who agreed with the Commissioners.[144] This necessitated starting again before the Commissioners in relation to a later year.[145] Even that nearly did not succeed as the Commissioners initially decided the point was *res judicata*;[146] the point then came before Rowlatt J again when the Crown waived this contention and the matter was remitted to the Commissioners to determine the case on the basis that the matter was not *res judicata*,[147] following which the case proceeded via Rowlatt J and the Court of Appeal to the House of Lords again. This time in the light of expert evidence of a professor from Columbia University Law School, the House of Lords was able to find that position of the life tenant of a New York law[148] trust was different in that she had no property interest in the underlying income; she could only compel the trustees to carry out the terms of the trust,[149] which is perhaps surprising since New York trust law is derived from English law. Such a position is not supported by writers in the United States today.[150] The taxpayer was rewarded by her perseverance by remaining on the remittance basis.[151]

The exception to the 1914 change

The remittance basis was retained for resident foreigners, which gave rise to difficulties of definition. Although the remittance basis is now associated with non-domiciled persons this

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[143] *Archer-Shee v Baker* 11 TC 749, 779 *per* Lord Wrenbury (my italics). The same point had previously been decided by the Privy Council on Australian legislation under which the life tenant of a trust carrying on an unincorporated business was held to be in receipt of income derived from personal services in *Syme v Commissioner* [1914] AC 1013, which was not cited. This point is subject to considerable academic debate and differs from Maitland's view of trusts. It is, however, well established that it is a proper statement reflecting the substance of the matter, which is appropriate in connection with tax. See Donovan Waters *The Nature of the Trust Beneficiary's Interest* (1967) 45 Can Bar Rev 219. *Archer-Shee v Baker* was followed in relation to an Australian trust where the life interest was subject to an annuity in *Nelson v Adamson* (1941) 24 TC 36.

[144] 15 TC 1.

[145] *Garland v Archer-Shee* 15 TC 693.

[146] At p.700.

[147] Re-stated case at p.703.

[148] The same finding as for a New York trust was made for a New Jersey law in *Kelly v Rogers* (1935) 19 TC 692, and an Ohio trust in *the Marchioness of Ormonde v Brown* (1932) 17 TC 333.

[149] At p.729.

[150] Scott on Trusts 4th ed §130 p.406 says "The beneficiary of a trust has a property interest in the subject matter of the trust. He has a form of ownership. He has much more that a mere claim against the trustee, a mere chose in action. It must be remembered, however, that the chancellors at the beginning gave him no more than a claim against the trustee, and only gradually gave him proprietary rights. The growth of the trust has been a process of evolution." Situs for US federal estate tax is determined by the situs of the underlying assets rather than the situs of the trust, see *Comr v Nevius* 76 D 2d 109 (2nd Cir. 1935) reversing 30 BTA 70.

[151] But only until 1940, see the heading *Further reduction in the remittance basis in 1940.*

was not the original intention as can be seen from the following stages in the progress through Parliament of the section in the 1914 Finance Bill which, subject to the following proviso, removed the remittance basis for income from stocks, shares and rents, with the new material being shown in italics.

Original Bill	As amended in Committee	As amended on Report
Provided that this Section shall not apply in the case of a person who is not a British subject, nor in the case of a person who satisfies the Commissioners of Inland Revenue that being a British subject he is ordinarily resident in a British Possession.	Provided that this Section shall not apply […] in the case of a person who satisfies the Commissioners of Inland Revenue that *he is not domiciled in the United Kingdom.*	Provided that this Section shall not apply in the case of a person who satisfies the Commissioners of Inland Revenue that he is not domiciled in the United Kingdom *or that being a British subject he is not ordinarily resident in the United Kingdom.*

It will be seen that neither of the current limitations to non-domiciled persons and non-ordinarily resident British subjects (now Commonwealth and Irish citizens) was in the original Bill. The non-domiciled category was introduced at the Committee Stage because the original restriction to British subjects ordinarily resident in a British Possession would cover say a Canadian (who would have been a British subject) ordinarily resident in the United Kingdom, for whom the new wording continued the remittance basis.[152] This is the first time domicile became relevant for income tax, although it was then relevant for estate duty.[153] A further, possibly unforeseen at the time, effect of changing the exception from non-British subjects to non-domiciled persons is that companies could benefit from the exception because a company can have a foreign domicile, but not be a non-British subject. The domicile of companies was unknown territory. The Income Tax Codification Committee of 1936 records that there was then no judicial authority on the point but decided that defining the domicile of a company was going beyond codification.[154] The first case in the UK on the point was in 1940 and decided that domicile was the same as place of incorporation.[155]

Report Stage amendments are usually a disaster and this is no exception. The relief for the non-ordinarily resident British subjects (now Commonwealth and Irish Citizens) was introduced to deal with Anglo-Indians, such as officers or civil servants on leave, who were domiciled in the United Kingdom paying short visits, and becoming resident but not ordinarily resident. An MP had argued that the original clause "produced feelings of soreness and resentment in the Dominions beyond the seas." It was reported that the Chancellor had entered into negotiations with representatives of the Dominions and that the Report Stage

[152] HC Deb vol LXIV col.1622. There was no doubt some self-interest in this; those who were resident because they had houses here might otherwise have ceased to be resident.

[153] Foreign property was excluded if the deceased died domiciled outsider the UK, FA 1894 s.2(2) applying the (case law) rule for legacy and succession duty. The position was legislated in FA 1949 s.28 making the proper law relevant in addition to domicile.

[154] Cmd.5131 para.66.

[155] *Gasque v IRC* 23 TC 210, following a US decision, *Bergner & Engel Brewing Co v Dreyfus* 70 American State Rep 251.

amendment had put the clause into a form that did not produce resentment, and into a form which ensured that no such charge can fairly be made against it.[156] One may indeed agree that no such charge can fairly be made against it by the Dominions; it is merely that it discriminated against everyone else. The Royal Commission of 1955[157] later very reasonably recommended that the remittance basis should be applied to any non-ordinarily resident person as the reasons which made it fair to apply it to British subjects and Irish citizens applied just as much to persons who did not have such citizenship, but nothing was ever done.[158] This provision is plainly discriminatory and must be extended to EU citizens and to citizens of countries with which we have a tax treaty containing a nationality non-discrimination provision,[159] who are domiciled in the UK (because non-domiciled people benefit from the remittance basis anyway), and so the Royal Commission's recommendation may have been achieved by another route. One wonders how many people claim the benefit of this provision today.

One of the side effects of the change was to put UK life insurance companies at a disadvantage compared to non-resident life companies. It is difficult to tax insurance companies on their profits as this requires an actuarial calculation which cannot be carried out every year, and mutual companies cannot be taxed on their profits at all. Effectively they were taxed on their income;[160] accordingly relief for their expenses of management was introduced in 1915, subject to not reducing the tax below what it would have been under a Case I assessment,[161] thus introducing the I minus E method of taxing insurance companies. Relief for expenses of management compensated for their loss of the remittance basis for their foreign income, particularly when the foreign income represented reserves to meet liabilities to non-resident policyholders incurred through trading through foreign branches. A further exception was made in 1915 retaining the remittance basis for the income from foreign investments of a foreign life assurance fund of an insurance company, meaning a fund representing liabilities in respect of policies entered into through a branch or agency outside

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[156] Report stage, HC Deb vol.XLV col 473.

[157] Cmd 9474 para.296.

[158] Except perhaps that the relief for employment income for non-residents or non-ordinarily residents who are taxed only on work performed in the UK is not restricted by citizenship, see the heading *Employment and pensions income* below.

[159] On the lines of art.24(1) of the OECD Model Tax Convention: "Nationals of a Contracting State shall not be subjected in the other Contracting State [the UK] 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 [the UK] in the same circumstances, in particular with respect to residence, are or may be subjected." The normal treaty definition of UK national will include anyone who is a Commonwealth Citizen. See J F Avery Jones *et al The Non-discrimination article in tax treaties* [1991] BTR 359, 372. Personal allowances for non-residents are restricted to Commonwealth citizens and EEA nationals (TA 1988 s.278), thus preventing EU discrimination and this does not normally contravene tax treaty non-discrimination articles as personal allowances are specifically covered.

[160] See *Clerical Medical and General Life Assurance Society v Carter* (1889) 2 TC 437 where it is clear that at the time the assessment was on the interest with no relief for expenses. The effect on insurance companies of the removal of the remittance basis in 1914 was raised in Parliament: HC Deb vol.LXIV, col.1590.

[161] See now TA 1988 s.76(2). Originally this provision applied to investment companies generally but in *Simpson v Grange Trust Ltd* 19 TC 231 the House of Lords held that it could not be applied to investment companies that could never be taxed under Case I. Subsequently FA 1965 s.69(2) restricted the rule specifically to insurance companies.

the UK.[162] This survived the ending of the remittance basis for companies generally in 1965 and was eventually ended in 1990.[163] Non-resident life insurance companies could only be taxed on the profits from the UK branch and that was difficult in practice because of the difficulty in measuring profits from life insurance. Accordingly a method of taxing them had to be introduced in 1915.[164]

Further reduction in the remittance basis in 1940

A further reduction in the scope of the remittance basis was made in 1940,[165] which, like the first change of 1914[166] (and indeed, the introduction of income tax itself), was made in war time, perhaps because raising additional taxes at such times is easier. The remittance basis was restricted to trading income,[167] but only where the income was immediately derived[168] from carrying on the trade either alone or in partnership, and to employment (including offices) and pension income. This has the effect of removing the remittance basis for cases like the second *Archer*-Shee case which, according to the Parliamentary proceedings, was the main target of the change.[169] The Solicitor-General said:

> "The second category [foreign income not within the 1914 change] includes cases governed by the Archer-Shee case, which decided that income from trusts or settlements comes into the second category and therefore only income brought into this country is taxed. The hon Member is quite right in saying that the effect of the legislation to be introduced will be to put an end to that anomaly.[170]

Lady Archer-Shee, the life tenant, was an American and the trust was set up by her father's will but as she was married to an Englishman, Sir Martin Archer-Shee, she would have at the

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[162] FA 1915 s.16. A corresponding reduction in the expenses of management, introduced for insurance companies in s.14 of the same Act, was also made in respect of unremitted income.

[163] FA 1990 Sched.7 para.3 substituting a new TA 1988 s.441.

[164] For the history of taxing foreign life insurance companies see *Sun Life Assurance Co of Canada v Pearson* [1984] STC 461, 490. The interaction of the internal law charge on insurance companies with tax treaties has caused problems, see the *Sun Life of Canada* case and *Ostime v Australian Mutual Provident* 38 TC 492.

[165] FA 1940, s.19. This change had been recommended by the 1920 Royal Commission (Cmd.615) para.27.

[166] Strictly speaking, immediately before war time, see note 137.

[167] Or income from a profession or vocation; references to trade in the text should be taken to include these.

[168] The same words are used in the definition of earned income dating from the FA 1907 now in TA 1988, s.833(4)(c), and in the definition of "relevant earnings" for retirement annuities dating from the FA 1956 now TA 1988, s.623(2)(c). Later decisions showed that this excluded income in respect of compensation for the nationalisation of assets in *IRC v Parkhouse Collieries* Ltd 36 TC 675; an annuity to a retired partner in *Pegler v Abell* 48 TC 564; a share of profits paid to a retired partner in *Hale v Shea* 42 TC 460; interest paid under deduction of tax to a merchant banker in *Bucks v Bowers* 46 TC 267; interest received gross on a solicitor's client account in *Northend v White & Leonard & Corbin Greener* 50 TC 121. In such cases, the derivation of the income was the Act of Parliament providing for compensation in the first case, the contract with the continuing partners in the second, or the loan in the other cases. On the other hand, a short-term gain taxed as income on the sale of goodwill of a trade was immediately derived in *Peay v Newton* 46 TC 653. The words "immediately derived" will be dropped in the Rewrite Bill as not being necessary here, see ED 13 (see note 8) para.96.

[169] HC Deb vol.360, col.764 (budget speech); vol.361, col.1049 (Committee stage).

[170] HC Deb vol.360 col.764.

time automatically acquired his English domicile and would not therefore have been entitled to continue the remittance basis on that ground. Although not stated in the debates, a more serious anomaly than New York law trusts were trusts governed by Scots law to which the second Archer-Shee case also applied.[171] Much later, in 1993[172] in connection with the benefit of the lower rate of tax applied from that year[173] initially to dividend income, and extended in 1996 to all savings income, the life tenant of a Scots trust was deemed to have an equitable interest in possession in the underlying income, so as to be able to obtain the benefit of receiving dividend or savings income, thus bringing them into line with English trusts, just as the 1940 changes had removed the benefit of the remittance basis from Scots trusts receiving income from stocks, shares and rents as had been done for English trusts in 1914.

The change also removed the remittance basis generally for such foreign income as interest otherwise than on securities,[174] for example bank interest, and annual payments, particularly those on separation[175] or divorce.[176]

The introduction of corporation tax in 1965 and loan relationships in 1996

A company ceased to be taxed on the remittance basis on the introduction of corporation tax in 1965:

> "…corporation tax shall be assessed and charged for any accounting period of a company on the full amount of the profits arising in the period (whether or not received in or transmitted to the United Kingdom)….[177]

The second major change affecting companies was that the taxation of loan relationships from 1996 moved foreign interest to Case III so that Case IV no longer applied to companies and foreign interest otherwise than on securities is no longer taxable under Case V for companies. There are therefore now no separate rules for the taxation of foreign income from loan relationships.[178]

Trading income of individuals

As has been mentioned, the remittance basis ceased to apply to companies on the introduction of corporation tax in 1965.[179] It was not until 1974 (the only non-war time reduction in the

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[171] *IRC v Clark's trustees* 1939 SLT 2.

[172] FA 1993, s.118.

[173] FA 1993, s.77.

[174] For an example see *Lord Howard de Walden v Beck* 23 TC 384 where a series of promissory notes not carrying interest were dissected into a capital and interest element.

[175] For an example, see *Chamney v Lewis* 17 TC 318 relating to an annuity payable under an Indian separation deed.

[176] For an example, see *IRC v Anderström* 13 TC 482.

[177] FA 1965 s.51(1). This was subject to the exception mentioned above for foreign life insurance funds, see note 165. Corporation tax did not apply to income arising in a fiduciary or representative capacity so that a non-domiciled trustee company remained on the remittance basis for this.

[178] TA 1988 s.18(3A) inserted by FA 1996 Sch 14 para.5.

[179] See note 180.

remittance basis[180]) that the remittance basis was removed from trading income for the unincorporated sector subject to the same exception for non-domiciled taxpayers and not ordinarily resident Commonwealth and Irish Citizens as had been applied to investment income in 1914. As the Chancellor said in his budget speech:

> "As the House knows, it has been the law for many years that, where a man goes overseas to do a job, and all the duties of the job are carried out abroad, then the earning from the job are taxable on what is called the 'remittance basis'—that is, if and when they are brought back to this country. This was, perhaps, a reasonable approach before the days of air travel and multinational companies. But under modern conditions these provisions can be, and are, used by United Kingdom residents to avoid their proper tax liabilities. For the future, it is clearly imperative that we should put a stop to the avoidance of tax by artificial devices of the kind which received so much publicity last year."[181]

One might object to the Chancellor's reference to avoidance of proper tax liabilities when it was the law that laid down that the tax liabilities based on the remittance basis were the proper ones, but one cannot object to his reference to the remittance basis being a reasonable approach before the days of air travel and multinational companies. As a compensation for the loss of the remittance basis a reduction of 25 per cent in the tax base was given which was removed in 1984 by which time tax rates were much lower.[182]

Employment income

As with trading income there was a major reduction in the scope of the remittance basis for foreign employment income in 1974. The remittance basis no longer applied to work carried out wholly abroad, unless the income was foreign emoluments,[183] so that non-domiciled employees once again retained the remittance basis for working abroad. In addition, the remittance basis was taken away from non-domiciled employees working in the UK, the only time that the remittance basis has been removed for such persons. The Royal Commission's recommendation that working in the UK should not be a foreign employment was thus ultimately achieved.[184]

The losers, namely domiciled employees working wholly abroad and non-domiciled employees working in the UK for foreign employers, were given a reduction in the tax base. This was a 25 per cent reduction for domiciled employees, and initially a 50 per cent reduction non-domiciled employees but from 1976/77 this was reduced to 25 per cent once the employee had been resident for 9 out of the preceding 10 years of assessment.[185] These reductions were repealed in 1984 by which time tax rates were much lower.[186] Thus for UK domiciled resident employees there ceased to be any significant concept of foreign

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[180] It was a time of significant changes in taxation including the introduction of capital transfer tax with lifetime cumulation of gifts and the estate at death, and a proposed wealth tax.

[181] The previous year there had been a lot of publicity to what became known as the "Lonrho affair" during which the phrase "the unacceptable face of capitalism" was used, and in which the remittance basis for employment income played a part.

[182] The maximum rate of tax on earned income in 1974 was 83 per cent; in 1984 it was 60 per cent, so that the maximum rate had been reduced by more than 25 per cent for all top rate taxpayers.

[183] See text at note 108.

[184] Cmd.9474 para.300 quoted above.

[185] FA 1974 Sch 2 para.1, 3.

[186] See note 185.

employment, with one exception. A further 100 per cent relief was given for working abroad for 365 days in circumstances where because this spanned two tax years the employee remained resident.[187]

Foreign pensions have been easier to categorise as foreign possessions; they were pensions paid by non-residents. The 1956 changes to employment income did not affect pensions which left all foreign pensions taxable on the remittance basis under Case V. This was also changed in 1974. UK domiciled pensioners who lost the remittance basis were given a reduction of 10 per cent in the tax base, which still continues in spite of the abolition of similar deductions for employment income. Non-domiciled pensioners remain on the remittance basis but cannot claim the 10 per cent reduction, making them worse off than domiciled pensioners if they remitted the whole pension.

CAPITAL GAINS

It should be mentioned that capital gains tax had a remittance basis from the beginning for gains on foreign assets[188] by a non-domiciled resident and no change has been made to this.[189] There has never been a relief for non-ordinarily resident Commonwealth Citizens, and, unlike income tax, there are no special provisions for Irish assets.

PROPOSALS TO REMOVE THE REMITTANCE BASIS FOR NON-DOMICILED PERSONS

By 1974 the only persons benefiting from the remittance basis were non-domiciled individuals and trustees and, for income other than employment income, non-ordinarily resident Commonwealth and Irish Citizens. In 1974 a proposal was included in the Finance Bill[190] to take effect from 1976/77 to end the remittance basis completely for non-domiciled taxpayers who had been ordinarily resident for 5 out of the 6 previous years of assessment, by deeming such persons to be domiciled. On Second Reading the Chancellor proposed to change this to apply to those resident, instead of ordinarily resident, for nine out of the previous 10 years to meet the concerns that foreigners might be required to stay longer than 5 years for work, and also that the definition of ordinarily resident was less certain than that of resident.[191] A Government amendment to leave out the clause was agreed to without debate at the Committee Stage[192] following fierce debate outside Parliament.[193]

A second attempt was made in a Consultative Document issued by the Inland Revenue in 1988[194] suggested that a new intermediate basis of taxation between that of a full resident and

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[187] FA 1974 Sch 2 para.1(3).

[188] Now TCGA 1992 s.275. Short-term gains tax was the same FA 1962 s.10(6).

[189] Now TCGA 1992 s.12.

[190] Cl.18.

[191] HC Deb vol.873 col.611-2. Explanatory note by the Inland Revenue [1974] STI 225 on the difference between residence and ordinary residence.

[192] Standing Committee A, 24 June 1974, col.584.

[193] See M A Pickering and A R Prest *Some Aspects of the Remittance Basis for the Taxation of Overseas Income* [1974] BTR 340 at 353.

[194] Residence in the UK, Inland Revenue Consultative Document, 1988.

a non-resident should be introduced. This would apply to non-domiciled persons who had not been resident in the UK for 7 out of the previous 14 years, or, if it was not proposed to continue to use domicile as a criterion, the 7 out of 14 year rule should apply only to those who had been previously non-resident for a continuous period of 10 or 15 years. The form of taxation would be to replace the remittance basis with a graduated charge depending on how long the person had been resident, although a modified form of remittance basis including all receipts was also considered. Nothing came of these proposals.

There are no examples where the remittance basis has been removed from non-domiciled individuals apart from employment income for working in the UK. There are, however, two examples of the remittance basis being made less attractive, particularly where all the income is remitted. These are the 10 per cent reduction in foreign pensions already mentioned and that the remittance basis income does not qualify for the 20 per cent rate of tax for savings income.[195]

THE FUTURE

The first and second features of the system of taxing foreign income with which we started will change with the Tax Law Rewrite. Pitt's wording will be dropped as will any remaining distinctions between Cases IV and V, and foreign income will no longer be a type of income in itself.[196] This is sad from the historical point of view but it is amazing that the wording lasted so long and the courts were able to continue to make it fit all current types of foreign income. In the Rewrite where a type of income is considered, this includes the same type of foreign income so that, for example, there is no longer any distinction between UK and foreign source interest; the charge is on "all interest."[197] After enactment of the Rewrite's third Income Tax Bill in the 2004/5 session of Parliament[198] there will be very few separate rules for foreign income, an example of an exception being dividends from non-resident companies.[199] It is only necessary to define foreign income for the remittance basis and rules for unremittable income. For this purpose "foreign income" is defined to mean "income arising from a source[200] outside the United Kingdom which is chargeable under or by virtue of" a list of provisions, such as trading income, property income, interest etc, all of which deal with both UK and foreign income together.[201] Foreign source has the same meaning as foreign possession and so one could say that Pitt's single category of foreign income lives on under another name.

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[195] TA 1988 s.1A(4). Might these rules be discriminatory under EU law or tax treaties?

[196] ED 13 (see note 8), para.65.

[197] Draft Income Tax Bill in ED 13 (see note 8) cl.298. Similarly with all other types of income, see the list in cl.616.

[198] This date is given in the Rewrite's Plans for 2002/03, July 2002.

[199] Because the definition of distribution in part denies a deduction for various payments and so cannot be applied to non-resident companies: ED 13 (see note 8) para.883, and accompanying Draft Income Tax Bill cl. 322. The charge is on "dividends", an undefined expression both here and as a component to distributions of UK resident companies.

[200] ED 13 (see note 8) para.1158.

[201] Draft Income Tax Bill in ED 13 (see note 8) cl.616.

The 1955 Royal Commission approved of the remittance basis because of the large numbers of people working abroad or coming from abroad and working here in 1955 when its use was more widespread than it is today:

> "Although the remittance basis for persons not ordinarily resident or domiciled in the country seems to be peculiar to the UK, we think that its employment is appropriate having regard to the conditions that govern our trade and commerce. The large overseas connections of the UK do make a special tax problem for those persons who leave for or come back from service abroad for various purposes and for various periods: conversely, there are special problems with regard to those persons who, while truly belonging to another country, are led by business interests to centre in the UK for what may often turn out to be long periods of years."[202]

The remittance basis continues in full force for non-domiciled individuals and non-ordinarily resident Commonwealth Citizens (and those other citizens who can claim it on the basis of discrimination). As this article is written, a further consultative document is awaited. The Chancellor said in his 2002 Budget speech:

> The Government is reviewing the residence and domicile rules as they affect the tax liabilities of individuals. The Government believes that modernisation of these rules needs to be based on clear principles—the rules should be fair, clear, easy to operate, and support the competitiveness of the British economy. As this is a complex area, all those affected should have the opportunity to contribute to the discussion. The Government will report on this issue in time for the pre-Budget report.

How the remittance basis rates as a basis of taxing today in the age of air travel and multinational companies will be considered in relation to the promised consultative document. It will be interesting to see whether the outcome is any different from the previous two occasions that the issue has been raised. It is certainly a basis of taxation that is liked by foreigners working in the United Kingdom and it may be that their personal taxation is quite as important to decisions to work here as is corporate taxation. The original problems of the difficulty of measuring foreign income still continue but in different form. Probably the income needs to be measured for foreign tax purposes and so taxing it here on the arising basis would require computation on two different bases. That is particularly true of trading income but to some extent true of employment income where different methods of taxing benefits in kind, stock options etc. can apply.[203] For investment income fewer problems of measurement arise, but there are still problems of measuring non-traditional income such as zero-coupon bonds, accrued income on purchase and sale of securities, and gains on life insurance policies. Perhaps the administrative arguments are just as strong. Can a tax authority really find out what a foreigner does with his assets abroad?[204] Is it not better to accept defeat and tax what one can see, rather than say one is taxing worldwide income knowing that one is not?

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[202] Cmd. 9474 para.284

[203] Different countries tax options at different times and on different bases, see the OECD discussion draft Cross-border Income tax Issues Arising from Employee Stock-Option Plans, 2002.

[204] Even though the remittance basis means that these problems are limited there are still complications in operating that basis, as is illustrated by the Revenue's reasons for entering into a forward tax agreement in *Al Fayed v Advocate General for Scotland* [2002] STC 910. A minute from the Head of Special Compliance Office to the Board said that in the absence of the agreement "we would have very great practical difficulties in actually trying to establish what the reality was" (at 920a).