United Kingdom*

I. Recent United Kingdom Tax Developments

A. Payments of Interest to Nonresidents

A new Extra-Statutory Concession was introduced on June 11, 1991. The concession treats certain payments of interest made by banks and similar institutions to overseas companies as deductions when computing profits, even though the interest payments would normally be treated as distributions and would not, therefore, qualify for tax relief. To qualify for this concession the interest must be payable by a bank (or other company authorized to take deposits under the Banking Act 1987) in the ordinary course of its business. The concession is restricted to the amount of interest that would have been payable if the parties to the transaction had been independent parties acting at arm's length.

The Inland Revenue has also extended Extra-Statutory Concession B13, which applies where a non-U.K. resident receives untaxed interest that cannot be assessed in the name of a U.K. trustee or a U.K. branch or agent that manages or controls the interest. The concession has been extended to apply to income from deep gain securities and to payments relating to deposits held in general client accounts with building societies. Therefore, no action will be taken to pursue this income tax liability.

B. Unilateral Relief from Double Taxation

The Inland Revenue issued a Statement of Practice (SP 7/91) on July 26, 1991, concerning unilateral relief from double taxation. The availability of unilateral relief for a foreign tax under the terms of the Income and Corporation Taxes Act 1988, section 790, is determined by examining the tax within its legislative context in the foreign territory and deciding whether it serves the same function as income and corporation tax serve in the United Kingdom in relation to the profits of the business. This new determination policy affects all foreign taxes levied after February 13, 1991.

C. Abolition of Stamp Duty

The introduction of paperless share trading on the London Stock Exchange (TAURUS), originally scheduled to have started in October 1991, will not now begin before April 1993. As a result of the delay investors may have to pay £1.2 billion in additional stamp duty, which is due to be abolished when TAURUS comes into operation. The government may now consider, in the light of the revised schedule, whether to bring forward the stamp duty and stamp duty reserve tax abolition dates.

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II. Application of EC Law by National Courts

This section outlines recent developments in the case law of the European Court of Justice (ECJ) dealing with the enforcement of rights derived from EC law in national courts. The cases resulted from references made by national courts to the ECJ for preliminary rulings.

Regina v. Secretary of State for Transport ex parte Factortame Limited and Others[1] deals with the enforcement in national law of rights derived from the EEC Treaty. *Marleasing S.A. v. La Commercial Internacional Alimentación S.A.*[2] and *Francovich and Bonifaci v. Italian Republic*[3] concern rights of individuals and businesses under EC directives that have not been implemented in national law.

A. Recent Developments in the Case Law of the ECJ to Safeguard EC Law Rights in National Law

Regina v. Secretary of State for Transport ex parte Factortame Limited concerned whether a national court must suspend national legislation that may be incompatible with EC law until a final determination on its compatibility has been made. The *Factortame* case applies existing EC law (that is, the law requiring a provision of EC law to be implemented as effectively as possible) to a procedural issue, in this case the grant of interim relief. In addition, the case shows the extent of the Member States' obligation to implement EC law as effectively as possible, since a national law had to be suspended while it was determined whether that law was compatible with EC law. The ECJ held that failure to grant interim relief by suspending the national law in this case would prevent the most effective application of EC law (because the application of domestic legislation could prevent the plaintiffs from exercising their EC law rights until the time when a final determination on the compatibility of the national law with EC law was made).

B. Recent Developments in the Case Law of the ECJ Concerning the Direct Effect of Directives

EC directives set out objectives that must be implemented in national law within a specified time limit, although Member States do have discretion in the way in which these objectives are achieved. Individuals and businesses cannot generally exercise any rights conferred by EC directives until they have been implemented in national law. In practice, Member States have often failed to implement directives. This has caused doubts as to the status of rights conferred by directives that have not been implemented in national law.

1. Case C-213/89, R. v. Secretary of State for Transport ex parte Factortame Limited and Others, 3 C.M.L.R. 375 (1990).
2. Case C-106/89 (not yet published).
3. Joined Cases C-6/90 and C-9/90 (not yet published).

The seriousness of the failure to safeguard EC law rights (particularly marked by the failure to implement EC directives in national law) has long been recognized. Expressions of political intent to improve the situation have been numerous. In practical terms, however, the case law of the ECJ has had a more significant impact in giving effect to the rights conferred by EC law. This has been principally through the doctrine of "direct effect" adopted by the ECJ in the very early days of the EC and consistently refined since. This doctrine provides that EC measures may have a direct impact on the relations between Member States and individuals or businesses without the need for national measures (vertical direct effect). An EC measure may have direct effect where it is sufficiently clear and precise and imposes an unconditional obligation on the Member States that have no real discretion in transposing it into national law.

Marleasing S.A. v. La Commercial International Alimentación S.A. concerned the application of a provision of an unimplemented directive between two companies. The ECJ referred to its previous case law that said that an unimplemented directive cannot be relied upon in actions between private parties (that is, it cannot have "horizontal direct effect"). However, the ECJ held that the national court must interpret national law in the light of the words and objectives of the directive. The ECJ's reasoning was based on the obligation of Member States to achieve the results set out in directives and to take all appropriate measures to fulfill their obligations under EC law. This obligation applies to all national authorities including judicial authorities.

The case is notable for the question mark it raises over the possibility of allowing horizontal direct effect. The ECJ has clearly stated that directives cannot have horizontal direct effect. However, it must be questioned whether the effect of the ECJ's judgment is limited to requiring a national court to interpret national law in the light of a directive or whether this amounts to requiring an unimplemented directive to be applied in proceedings between private parties.

Francovich and Bonifaci v. Italian Republic concerned the liability in damages of a Member State for loss caused by its failure to implement a directive. The ECJ first considered whether the relevant provisions of the directive satisfied the conditions for producing direct effect and concluded that it did not. Accordingly, the provisions could not be relied on if they had not been implemented in national law.

The ECJ then went on to recognize explicitly the principle of Member States' liability for damages caused to private parties by violations of Community law on two grounds. First, liability was "inherent in the system of the Treaty." The ECJ again noted that national courts must apply EC law as effectively as possible—this would not be the case if private parties were not given the possibility to obtain damages for losses incurred by breaches of Community law by a Member State. Second, liability results from the Member States' obligations under article 5 of the EEC Treaty to take all appropriate measures to ensure the fulfillment of

obligations under EC law. The ECJ laid down three conditions for the implementation of the Member State liability principle, namely: (1) the result to be achieved by the directive must include granting rights to private parties; (2) the extent of these rights must be identified by the provisions of the directive; and (3) there must be a causal link between the Member State's breach of Community law and the loss suffered by private parties.

The ECJ also discussed the role of national law in exercising the principle of Member State liability. It said that national law will determine the forum and procedure for dealing with this issue. National law must not discriminate against EC law rights by applying less favorable conditions for the exercise of those rights and that those conditions must not be such as to make it "impossible" or "excessively difficult" in practice to obtain damages for breaches of EC rights.

C. Conclusion

The ECJ has interpreted the Treaty and measures adopted under it widely to ensure as far as possible that EC law rights are enforceable before national courts. Its action to apply EC rights contained in directives can be seen as frustration at Member States' failure to implement directives in national law. This frustration is leading to more radical judgments such as those outlined above, which are based on a broad interpretation of EC law.

III. Arbitration

The ECJ has made an important decision concerning the application of the 1968 Brussels Convention on Jurisdiction and the Enforcement of Judgments in Civil and Commercial Matters[4] (the Convention) to arbitration. The case is of significance because it affects the jurisdiction of courts in contracting states in relation to arbitration. Generally, it is presumed that the courts at the place of arbitration will have jurisdiction in relation to legal proceedings associated with the arbitration process. Should the Convention apply to such proceedings, a court at the place of arbitration may have to decline jurisdiction in favor of another state's courts.

The case of *Marc Rich & Co. AG v. Societa Italiana Impianti PA*[5] was referred to the ECJ by the English Court of Appeal for a preliminary ruling on the interpretation of the exclusion of arbitration from the Convention under article 1.[6] For the first time a United Kingdom court has made a reference to the ECJ on the Convention,

4. 1990 O.J. (C 189) 1 (as revised and updated).

5. Case C-190/89, Marc Rich & Co. AG v. Societa Italiana Impianti PA, [1991] I.L. Pr. 524.

6. Article 1 of the Convention states: "This Convention shall apply in civil and commercial matters whatever the nature of the court or tribunal. . . . The Convention shall not apply to- . . . 4. Arbitration."

and it is also the first occasion on which the ECJ has been asked to rule concerning the scope of the Convention's applicability to arbitration.[7]

The case arose from a contract for sale of a cargo of oil. In January 1987, Marc Rich & Co. (Marc Rich) telexed Societa Italiana Impianti (SII) offering to purchase a cargo of Iranian crude oil, which offer was accepted subject to certain further conditions. Marc Rich telexed accepting those further conditions and two days later telexed once more, this time forwarding the contractual terms, including a law and arbitration clause. This clause nominated English law as the governing law and stated that any disputes would be referred to a panel of three arbitrators in London, one each to be chosen by the parties and a third by agreement between the two arbitrators so chosen. SII made no reply to this last telex. Marc Rich then proceeded to load the cargo of oil, which was completed on February 6, 1987. That day, Marc Rich alleged that the oil had been seriously contaminated, causing a loss in excess of U.S. $7 million.

In February of 1988 SII sought a declaration from a court in Italy that it was not liable to Marc Rich. Later that month Marc Rich commenced arbitration in London. When SII did not nominate an arbitrator, Marc Rich applied to the High Court in London pursuant to the Arbitration Act 1950 for the appointment of an arbitrator. The High Court granted leave to serve an originating summons on SII in Italy. SII applied to the High Court for that leave to be set aside. SII argued that the real dispute was whether the arbitration clause had been incorporated in the contract. As such, it contended, the matter was covered by the Convention rules on jurisdiction under which the matter should be heard by the Italian courts. The judge at first instance held that the Convention did not apply, that the putative proper law of the contract was English, and that leave to serve on SII in Italy had been properly granted. SII appealed, and the Court of Appeal referred the following question to the ECJ: "Does the exception in Article 1(4) of the Convention extend: (a) to any litigation or judgments and, if so, (b) to litigation or judgments where the initial existence of an arbitration agreement is in issue?"

The ECJ considered the purpose of the Convention and the report by Mr. Jenard, prepared in connection with the drafting of the Convention.[8]

The Jenard Report stated that arbitration had been excluded from the Convention because there are already many international agreements on arbitration, such as the 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards.[9] The ECJ stated:

> It follows that, by excluding arbitration from the scope of the Convention on the ground that it was already covered by international conventions, the Contracting Parties intended to exclude arbitration in its entirety, including proceedings brought before

7. [1991] I.L. Pr. at 532.

8. Report by Mr. P. Jenard on the Convention of 27 September 1968 on Jurisdiction and the Enforcement of Judgments in Civil and Commercial Matters, 1979 O.J. (C 59) 1.

9. *Id.* at 13.

> national courts. . . . [T]he appointment of an arbitrator by a national court is a measure adopted by the State as part of the process of setting arbitration proceedings in motion. Such a measure therefore comes within the sphere of arbitration and is thus covered by the exclusion contained in Article 1(4) of the Convention.[10]

The ECJ then considered whether a preliminary issue as to the existence or validity of an arbitration agreement would also be excluded from the scope of the Convention. The ECJ ruled:

> In order to determine whether a dispute falls within the scope of the Convention, reference must be made solely to the subject-matter of the dispute. If, by virtue of its subject-matter, such as the appointment of an arbitrator, a dispute falls outside the scope of the Convention, the existence of a preliminary issue which the court must resolve in order to determine the dispute cannot, whatever that issue may be, justify application of the Convention.[11]

The ECJ answered the question referred by the English Court (set out above) as follows: "Article 1(4) of the Convention must be interpreted as meaning that the exclusion provided for therein extends to litigation pending before a national court concerning the appointment of an arbitrator, even if the existence or validity of an arbitration agreement is a preliminary issue in that litigation."[12] Thus the ECJ did not decide whether the issue of the existence or validity of an arbitration agreement is within the scope of the Convention due to the procedural analysis of the case before it. The Advocate General, however, had stated in his very detailed written opinion that, although he did not consider that the ECJ needed to decide the issue, in his view, "a dispute as to the existence of an arbitration agreement falls outside the scope of the Convention."[13] The Advocate General argued strongly that the question of the existence or validity of an arbitration agreement should not be covered by the Convention rules as to jurisdiction in order that such proceedings may be heard before the courts at the place of the arbitration. However, as contended by SII, the potential outcome of this situation is that irreconcilable decisions may arise as between the Member States—something the Convention aims to prevent.

Hence, until such time as the ECJ is called upon to decide whether, as a main issue in the proceedings, the question of the existence or validity of an arbitration agreement is within the scope of the Convention, the matter remains unresolved. However, the problem may be avoided by framing any such question as a preliminary issue in proceedings clearly involving arbitration and thus outside the scope of the Convention.

10. [1991] I.L. Pr. at 559–60.
11. *Id.* at 560–61.
12. *Id.* at 561.
13. *Id.* at 538.