Article

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An offshore perspective: The English Commercial Court's decision in the SKAT "cum-ex" case and Dicey Rule 3

In April this year, Mr Justice Baker of the English Commercial Court dismissed proceedings brought by the Danish national tax authority (***SKAT***) against over 100 defendants in connection with more than DKK2.5 billion in tax refunds that SKAT alleged it had been induced to repay by misrepresentations: *Skatteforvaltningen (the Danish Customs and Tax Administration) v Solo Capital Partners LLP (in special administration) and others* [2021] EWHC 974 (Comm).

SKAT's claim failed, at the trial of a preliminary issue, on the grounds that it was offensive to "Dicey Rule 3", a rule which disallows claims for the enforcement, directly or indirectly, of the penal, revenue and public laws of foreign states. Our understanding, at the time of writing, is that SKAT has obtained permission to appeal the decision to the Court of Appeal.

This article considers the decision from an offshore perspective, by reference in particular to Cayman Islands and British Virgin Islands jurisprudence.

The SKAT decision: Background

Under Danish tax law, publicly listed companies are required to withhold 27 per cent of all dividends declared and pay them directly to SKAT, with the remaining 73 per cent being paid out to shareholders. However, under the terms of double taxation treaties entered into by the Kingdom of Denmark, certain foreign shareholders are then able to claim a full refund (from SKAT) of the 27 per cent originally withheld.

The refund system administered by SKAT in relation to this withholding tax (***WHT***) included more than one scheme. In issue in these proceedings was a scheme known as the "Forms Scheme", which operated by reference to a standard paper form: applicants for a refund would complete the form, submit it by post together with the relevant supporting documents, and SKAT would then either approve or reject the application. SKAT's central complaint was that it received and approved, in error, thousands of WHT refund claims that were not in fact valid claims.

The Danish tax authority is thought to have lost around US$2.1 billion from the "cum-ex" fraud, which it alleges was orchestrated in part by individuals operating out of London. As part of a multi-faceted recovery action spanning multiple jurisdictions, SKAT had therefore commenced a claim in the English High Court for the return of monies that it contended it had been wrongly induced, in some cases fraudulently, to pay out.

Dicey Rule 3: The relevant legal principles

Dicey, Morris & Collins, the leading legal textbook on the conflicts of laws, provides at Rule 3:

"English courts have no jurisdiction to entertain an action (1) for the enforcement, either directly or indirectly of a penal, revenue or other public law of a foreign state; or (2) founded upon an act of state."[1]

The rule differentiates between cases of direct enforcement and cases of indirect enforcement:

- Cases of direct enforcement, whereby a foreign state or its nominee seeks to obtain money or property or other relief in reliance on a foreign penal, revenue or public law, are not common and "present little difficulty" (see the

[1] *Dicey, Morris & Collins on the Conflict of Laws, 15th Ed., R5-019*

Cayman decision in *Wahr-Hansen v Compass Trust Company Ltd*, addressed below, at [10]).

- More frequent are claims concerned with indirect enforcement. These includes claims where a foreign state or its nominee seeks a remedy which is not in form based directly on the foreign penal, revenue or public law in question, but which is in substance designed to give that rule extra-territorial effect; or where a private party raises a defence based on the foreign law in order to vindicate or assert the right of the foreign state. These cases are apt to present more difficulty and to necessitate a fulsome factual enquiry.

The rule is a substantive rule of English law (and Cayman law, and BVI law) and applies irrespective of whether English (or Cayman, or BVI) law will govern the merits of the claim more generally. It is for the English (or Cayman, or BVI) Court to decide whether a claim falls within the rule. For example, in the SKAT proceedings, the issue of whether SKAT's claim fell within the rule was a question of English, rather than Danish, law.

The rule demands an analysis of the substance of the claim, rather than the form. The Court must look beyond the cause of action pleaded or even (to the extent necessary) the identity of the claimant, in order to consider the substance of the right that the claim seeks to vindicate.

Whether the rule applies on the facts of a given case will therefore involve a question of characterisation. If the claim is in substance a claim to enforce, directly or indirectly, the penal, revenue or other public laws of a foreign state, it will fall within the rule and so be inadmissible.

There is a distinction between an exercise of sovereign power (by way of enforcement of a penal, revenue or other public law) and an action brought by a sovereign state that might equally be brought by an individual to recover losses for damage to property. The second category of claim is sometimes referred to as a "patrimonial" claim. Patrimonial claims do not fall within the Rule 3 and are therefore not inadmissible on those grounds.[2]

There is also a distinction between the enforcement of an exercise of sovereign power, on the one hand, and the recognition of it, on the other. Recognition in this context includes recognising the past exercise of a sovereign power in the sovereign territory. Dicey Rule 3 is concerned with enforcement; it is not designed to preclude or prohibit recognition.

Ruling

The key issue in SKAT was the characterisation of SKAT's claims. SKAT argued that its claims were "patrimonial" claims to recover losses as a result of misrepresentation, which were no different in character from a claim that could have been brought by a private person. The Judge disagreed. He held that the claims were in substance claims to vindicate rights SKAT was entitled to under Danish tax law and double taxation treaties concluded by Denmark. The claims were therefore claims to indirectly enforce Denmark's underlying sovereign right, given effect by the relevant tax legislation, to tax Danish company dividends.

An offshore perspective

Dicey Rule 3 is capable of leading to harsh results, insofar as it may apply even where fraudulent or dishonest or wrongful conduct may be shown: "A plea to the character of the wrongful act, by reference to the nature or degree of fault involved in it, or to any consequent lack of sympathy the court might be invited to have for the defendant pursued abroad by the sovereign claimant, or sympathy for the claimant, has never been admitted as relevant"[3]. The SKAT proceedings themselves involved numerous allegations of fraudulent conduct.

Cayman Islands

It is suggested that the SKAT decision, which was made following a comprehensive review of authorities dating as far back as the 19th century, is neither surprising nor inconsistent with Cayman jurisprudence.

The nature of Dicey Rule 3 is such that it may arise in many different contexts: from cases ranging from the attempt by the New Zealand government to recover a Maori carving that had been illegally exported[4], to a claim by the President

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2 *Mbasogo v Logo* [2006] EWCA Civ 1370, [2007] QB 846; *Iran v Barakat Galleries Ltd* [2007] EWCA Civ 1374, [2009] QB 22

3 *SKAT* at [32]. See further *Buchanan v McVey* [1955] AC 516, where the rule was held to apply notwithstanding Mr McVey engaged in dishonest conduct by asset stripping a company in order to frustrate the revenue authority, and had thereby "*snap[ped] [his] fingers in the face of a disgruntled [foreign] revenue.*"

4 *Att-Gen of New Zealand v Ortiz* [1982] Q.B. 349, reversed [1984] A.C. 1 (CA and HL)

and Government of Equatorial Guinea that a former British Army officer turned mercenary was part of a plot to seize control of the country and kill or abduct the President[5]. In Cayman, somewhat less spectacularly, the cases have mostly been concerned with the issue of the enforcement of revenue laws. To take just three examples (the last of which concerns public or penal laws):

- *Wahr-Hansen v Compass Trust Company Ltd* [2007] CILR 55*,* in which, within the context of a tracing claim brought by the beneficiaries of an estate in relation to allegedly misappropriated assets, Henderson J considered the three essential elements of the so-called "tax-gathering defence" following a review of many of the same authorities that were considered in the SKAT proceedings. The elements to the defence are that: (i) first, there must be an unsatisfied tax claim; (ii) secondly, the entire proceeds of the litigation must go to the foreign revenue authority[6], on the basis that the rule is intended to prevent a state from asserting its authority within the territory of another, whereas a claim initiated to benefit ordinary creditors could not be seen as an extension of a sovereign power; and (iii) thirdly, the claim had to be, in substance not form, an attempt to collect foreign tax.

- *Northern Mariana Islands v Millard* 2014 1 CILR 342, which concerned the admissibility of foreign tax debts as evidence of insolvency and the indirect enforcement of such debts. The respondents were US citizens and had judgments against them for unpaid taxes, obtained by the Northern Mariana Islands Government (a US Commonwealth). The question for the CICA was whether those judgment debts could be considered for the purpose of the respondents' petition for their own bankruptcy. The CICA confirmed that foreign revenue debts were not enforceable[7]; accordingly, the US Commonwealth would not be able to prove for its debts in the respondents bankruptcies; and therefore, such debts could not be adduced as evidence of insolvency.

- *TMSF v Wisteria Bay Limited and Ors* [2007 CILR 310], in which the plaintiff, an agency of the Turkish government that had taken control of a bank in Turkey, sought a declaration that mortgages registered against two vessels on the Cayman Shipping Register, to which it had acquired title by operation of Turkish law, were fraudulent and invalid. The defendants sought, unsuccessfully, to strike out the claim on the basis that it was an attempt to enforce Turkish public or penal laws. The plaintiff submitted that that was not the case but instead, the claim was to enforce a private proprietary right that had already been previously acquired, in Turkey, by valid and effective operation of Turkish law. As such, the claim did not offend against Dicey Rule 3[8]. The strike out application was ultimately refused.

British Virgin Islands

Authorities in the BVI concerning Dicey Rule 3 are more limited. The two relatively recent cases *Michael James Gregson (as Liquidator of Meribelle Investments Limited (in Liquidation) v Meribelle Investments Limited (in Liquidation) and The Registrar of Corporate Affairs*[9] and *West Bromwich Commercial Ltd v Hatfield Property Limited*[10] suggested that might change, but a number of questions have remained unanswered.

Both *Meribelle* and *Hatfield* concerned a liquidator having been appointed in England and Wales over a BVI registered company following petitions from the UK tax authority, Her Majesty's Revenue and Customs (***HMRC***). The question in each case was whether recognising the English winding up order, or establishing a separate BVI liquidation, constituted the enforcement of HMRC's debt and therefore would fall foul of Dicey Rule 3.

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5 *President of the State of Equatorial Guinea et al v The Royal Bank of Scotland International et al* [2006] UKPC 7

6 As was the case in *Buchanan v McVey* [1955] AC 516, but not, for example, in the Australian decision of *Ayres v Evans* (1981) 39 ALR 129. In that case the assignee of an estate in bankruptcy in New Zealand sought to obtain control over property of the bankrupt in Australia. 56 per cent of the estate's debts were due to the New Zealand revenue authorities. The Dicey Rule 3 defence failed, on the basis that in the foreign country, the assignee was simply seeking to get in property for the benefit of the estate. The estate's debts were a separate issue. *Buchanan v McVey* was considered but distinguished as "*in some respects an anomalous case.*"

7 Applying *India (Govt.) v. Taylor,* [1955] A.C. 491 in which it was held that an Indian income tax liability could not be proved in the liquidation of a company registered in England.

8 Following, for example, the decisions in *Brokaw v Seatrain UK Ltd* [1971] 2 Q.B., 476 and *Att-Gen. (New Zealand) v Ortiz* [1984] A.C.1

9 *(*BVIHCOM) 2020/0013 (judgment dated 16 March 2020 and 23 April 2021)

10 (BVIHCOM 2020/0138)(judgments dated 12 November 2020 and 18 January 2021)

In *Meribelle*, when considering an application for recognition of an English winding up order, the sitting Judge (of his own volition) identified the potential application of Dicey Rule 3 in circumstances where HMRC was Meribelle's sole creditor. The application was adjourned to allow proper submissions on the point and the applicant was directed to serve the papers on the Attorney-General. However, the claim was discontinued before the issue could be fully addressed by the Court.

In *Hatfield*, the same Judge considered an application to appoint an English liquidator (who was already in office in England) and a local BVI insolvency practitioner as joint liquidators of the company in the BVI. At an initial hearing the Judge referred back to his decision in *Meribelle* and adjourned the matter, again inviting representations from the Registrar of Corporate Affairs and the Attorney-General.

On its return, the Judge approved the application, appointing both the English liquidator and the BVI liquidator. However, his judgment was based on Hatfield being so hopelessly insolvent that a distribution to HMRC was highly unlikely. As a result, the Judge did not have to grapple with the issue he had previously identified – namely whether appointing a liquidator in BVI in the knowledge that it would start a chain of events which would ultimately lead to a distribution to HMRC (in the company's English liquidation) constituted a breach of Dicey Rule 3.

While Dicey Rule 3 clearly applies in the BVI, its practical implications – particularly in terms of cross-border insolvencies – are unclear. The BVI will therefore be keenly watching how SKAT's appeal in England progresses.

Concluding remarks

The SKAT decision serves as a helpful reminder of an important rule of the conflict of laws. That rule, which has been overlooked before[11], is in effect in Cayman and the BVI just as it is in England and Wales. It will particularly be of interest to office holders seeking to enforce against property held offshore or to have their appointments recognised or mirrored, in circumstances where there may be revenue, penal or other public law claims against the estate domestically.

If you have any queries or require assistance with SKAT-related proceedings, please contact Jonathan Addo or Megan Elms in the BVI, or Nick Hoffman or James Eggleton in Cayman.

For more information and key contacts please visit **harneys.com**

[11] See the *Equatorial Guinea* case, where the Judicial Committee of the Privy Council expressed its "*disquiet"* that no argument was addressed as to whether the lower court had the jurisdiction to make the order that it did, given the existence of the rule.