Article

The Revenue Rule in the Cayman Islands and British Virgin Islands

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It is well established, under common law principles applicable in the Cayman Islands and the British Virgin Islands that claims for payment of foreign tax liabilities, or claims for the enforcement of foreign judgments for tax liabilities, will not be judicially recognized or enforced by the Cayman Islands courts or the British Virgin Islands courts[1].

These principles are known as 'the Revenue Rule'.

The Revenue Rule in other common law jurisdictions

The Revenue Rule is not unique to the Cayman Islands and the British Virgin Islands. It is also well established in other international financial centres and British Overseas Territories, such as Bermuda[2].

Indeed, the Revenue Rule applies with equal force in England and Wales and other common law jurisdictions, such as Canada, the USA, Australia, New Zealand, Ireland, and Singapore, subject only to certain legislative exceptions.

One recent application of the Revenue Rule has been in the high-profile English litigation of *Skatteforvaltningen* (The Danish Customs and Tax Administration) *v Solo Capital Partners LLP & Ors* [2021] EWHC 974 (Comm). In his recent judgment in that case dated 27 April 2021, Mr. Justice Andrew Baker dismissed a claim by the Danish National Tax Authority for repayment of Danish tax refunds in the region of £1.5 billion on the basis that the claim offended the Revenue Rule under English law.

It remains to be seen whether the Danish National Tax Authority will secure permission to appeal to the English Court of Appeal.

The Revenue Rule in summary

Under the Revenue Rule, the Cayman Islands and British Virgin Islands courts will carefully examine the foreign claim or foreign judgment debt to determine if it would, in substance, be directly or indirectly enforcing a foreign tax claim[3].

The primary basis for the Revenue Rule at common law is (in summary) to protect the Cayman Islands' and the British Virgin Islands' national sovereignty, as a matter of public policy. This is because the imposition of tax is an exercise of sovereign authority, and the exercise of that sovereign authority, directly or indirectly, within another sovereign state, is impermissible at common law.

The Cayman Islands and the British Virgin Islands court will not therefore aid an attempt by a foreign Government to act in excess of its jurisdiction by enforcing sovereign acts of that Government outside its own territory.[4]

This principle applies with equal force to the United Kingdom Government, notwithstanding the fact that the Cayman Islands and the British Virgin Islands are both British Overseas Territories.

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1 Following cases such as *Government of India v Taylor* [1955] AC 491.

2 Reflecting the common law position, section 2(1)(b) of Bermuda's Judgments (Reciprocal Enforcement) Act 1958 expressly provides that judgments to which it applies shall not be registered to the extent that they relate to sums payable '*in respect of taxes or other charges of a like nature*'.

3 In the Cayman Islands, see *Wahr-Hansen v Compass Trust* [2007] CILR 55; *Marada Global Group v Marada Corporation* [1994-5] CILR 546. In the British Virgin Islands, see *Gregson v Meribelle Investments Limited,* BVIHC COM 2020/0013, unreported judgment, 16 March 2020, and *gover*, BVIHC COM 2020/0138, unreported judgment, 12 November 2020.

4 *Tasarruf Mevduati Sigorta Fonu v Merrill Lynch Bank and Trust Co (Cayman) Ltd & others* [2008] CILR 267.

The Revenue Rule is not to be confused with the rules, under Cayman Islands and British Virgin Islands law, relating to international tax information exchange, whether on an automatic basis or on a requested basis, or the rules relating to mutual legal assistance in criminal and regulatory matters.

The fact that the Revenue Rule prevents the compulsory enforcement in the Cayman Islands or the British Virgin Islands of a foreign tax liability does not necessarily mean, however, that a Cayman Islands or British Virgin Islands entity (whether a company, a fund, a partnership, or a trustee) might not decide voluntarily to settle any foreign tax liability levied against it under applicable foreign law, if it is the entity's best interests to do so, taking into account the entity's ability to settle claims and contingent liabilities (and the extent of the entity's solvency or available assets), as well as the interests of the entity's stakeholders as a whole.

However, from the perspective of local Cayman Islands and BVI law, the directors, officers or trustees of a Cayman Islands or BVI structure could not properly be criticized by a Cayman Islands or BVI Court if they were to decide that the relevant entity is not liable, under Cayman Islands or BVI law, to pay (or to reserve for) a foreign tax liability, in light of the Revenue Rule, and in light of the fact that such a foreign tax liability would be unenforceable in the Cayman Islands or the British Virgin Islands, whether by way of Court proceedings or in the process of proving debts in a liquidation.

The Revenue Rule in liquidation

The point can be illustrated, and contrasted, by reference to the legal position that prevails after the commencement of a liquidation and the appointment of liquidators over a Cayman Islands company, whether on a voluntary or compulsory basis (bearing in mind that the powers of the directors of a company usually cease, upon the appointment of a Liquidator).

That is because, in the context of winding up proceedings, Part V of the Cayman Islands' Companies Act (2021 Revision) (the "Companies Act") expressly provides, by section 139(2), that in a liquidation, claims for foreign taxes are provable as debts in a liquidation "only if and to the extent that a judgment in respect of the same would be enforceable [under the Foreign Judgment Act] or any laws permitting the enforcement of foreign taxes", i.e. under the common law principles.

This particular section has been considered, to a limited extent, in the unreported case of *The Pepin Fund Limited (in Voluntary Liquidation)* (FSD 132 of 2014), in which the voluntary liquidators of a Cayman Islands fund company sought a direction from the Grand Court of the Cayman Islands as to whether or not they must notify a Spanish tax authority that the fund may be liable to the Spanish tax authority as a matter of Spanish law. By an Order dated 27 January 2015, the Cayman Islands' Grand Court held, however, that the fund company was *"not required to put Agencia Estatal de la Administración Tributaria Ministerio de Hacienda on notice that the Company may be liable to the Authority in respect of tax, interest and penalties as a result of the Company trading in securities in the Kingdom of Spain by reason of the fact that this claim is as a matter of law unenforceable and is therefore not admissible to proof in the liquidation of the Company"*, in light of section 139(2) of the Companies Act.

Although it was not accompanied by a fully reasoned written ruling, the Court's decision in the *Pepin Fund* case provides a persuasive statement of Cayman Islands law, which is consistent with an orthodox interpretation and application of section 139(2) of the Companies Act and the Revenue Rule at common law. In other words, the voluntary or compulsory liquidators of a Cayman Islands company would not, ordinarily, have any discretion as a matter of Cayman Islands law to voluntarily admit a foreign tax debt as a provable claim in the liquidation of the Company, on the basis that such a claim is unenforceable in the Cayman Islands. They would not, therefore, need to pay, account for, or reserve for, such a foreign tax liability in the process of the Cayman Islands liquidation.

The future of the Revenue Rule

There has been much discussion in recent months, by the G7, the G20, and the OECD, of international harmonisation of minimum corporate tax rates.

It seems unlikely, however, that the Revenue Rule at common law will be re-written on a wholesale basis any time soon, whether by multi-national international treaty, or by appellate reform of the common law principles.

That is not to say that bilateral treaties might not be negotiated and enacted between individual nations: indeed, the English Court of Appeal decision in *Ben Nevis (Holdings) Ltd & Anor v HM Revenue & Customs* [2013] EWCA Civ 578 offers an example of an exception to the Revenue Rule, in the case of the Double Taxation Agreements in force between the United Kingdom and South Africa. In that case, the English Courts recognised and enforced a South African judgment in the sum of £222 million against two BVI companies.

As the English Court of Appeal noted in that case, the Revenue Rule can certainly be varied or removed by international treaty or local legislation, and in recent years, substantial inroads into the Revenue Rule have been made by international agreements, such as the Council of Europe's and the OECD's 1988 Joint Convention on Mutual Administrative Assistance in Tax Matters.

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