Neutral Citation: **[2023] UKUT 120 (TCC)**

Case Number: UT/2022/000010

UPPER TRIBUNAL
(Tax and Chancery Chamber)

Rolls Building, London

INCOME TAX – whether FTT correct that obligation to withhold tax under ITA 2007, s 874 arose on interest payments – yes – appeal dismissed

Heard on: 8 March 2023
Judgment date: 26 May 2023

Before

MRS JUSTICE BACON
JUDGE SWAMI RAGHAVAN

Between

HARGREAVES PROPERTY HOLDINGS LIMITED

Appellant

and

THE COMMISSIONERS FOR HIS MAJESTY'S REVENUE AND CUSTOMS

Respondents

Representation:

For the Appellant: Patrick Way KC and Dilpreet K. Dhanoa, counsel, instructed by BDO LLP

For the Respondents: Richard Vallat KC and Calypso Blaj, counsel, instructed by the General Counsel and Solicitor to His Majesty's Revenue and Customs

DECISION

INTRODUCTION

1. This is an appeal against the FTT's decision in *Hargreaves Property Holdings Limited v HMRC* [2021] UKFTT 390 (TC) (the "**FTT decision**").

2. Section 874 of the Income Tax Act 2007 ("**s. 874**") imposes an obligation on an interest payer to deduct tax if "a payment of yearly interest arising in the United Kingdom is made". The FTT decision concerned the application of these withholding tax provisions to loan interest payments made by the appellant.

3. The appellant was the parent company of a property investment, development and construction group in the UK, which financed its activities with loans from various lenders. Following tax planning advice, the loan terms were changed with a view to ensuring that the loan interest no longer had a UK source. In addition, rights to the principal and/or interest on the loans were assigned for consideration to third parties, namely a Guernsey company or Guernsey trusts. The interest and principal on the loans was then repaid using sums advanced by the lender, which in turn were funded by the proceeds of the assignment. The cycles of assignment, repayment and re-advance were repeated. In later years, interest was further assigned from the Guernsey entity to a UK resident company.

4. HMRC disagreed with the tax planning advice, considered that the appellant should have withheld income tax under s. 874 and issued tax assessments accordingly.

5. The appellant appealed to the FTT raising four grounds:

(1) As regards interest payments to the UK tax resident company which took place in later years, these fell within the statutory exception to the withholding tax obligation (s. 933 of the Income Tax Act 2007, "**s. 933**"). That applied where the resident was "beneficially entitled" to the interest income.

(2) Payments to the Guernsey company were protected by the double taxation agreement between Guernsey and the UK.

(3) Some of the interest payments, which were for loans of less than a year or close to a year, were not payments of "yearly interest" and thus not caught by s. 874.

(4) The source of the interest under the relevant case-law principles was outside the UK. The interest was not therefore interest "arising in the United Kingdom" under s. 874.

6. The FTT rejected the appellant's appeal. With the permission of the FTT, the appellant now appeals to the Upper Tribunal maintaining, in substance, all four grounds. The tax at stake on the interest payments over the period relevant to this appeal (October 2010 to March 2015) is approximately £2.79 million.

LAW

7. The basic obligation to withhold (or as set out in the words of the legislation, "deduct") tax stems from s. 874.

"**Duty to deduct sums representing income tax**

874. Duty to deduct from certain payments of yearly interest

> (1) This section applies if a payment of yearly interest arising in the United Kingdom is made –
>
> > (a) by a company,
> >
> > (b) by a local authority,
> >
> > (c) by or on behalf of a partnership of which a company is a member, or
> >
> > (d) by any person to another person whose usual place of abode is outside the United Kingdom.
>
> (2) The person by or though whom the payment is made must, on making the payment, deduct from it a sum representing income tax on it at the basic rate in force for the tax year in which it is made.
>
> (3) But see –
>
> > (a) sections 875 to 888 as to circumstances in which a duty to deduct a sum under this section is disapplied."

8. As explained by the Court of Appeal in *HMRC v Lomas* [2017] EWCA Civ 2124, §9, the duty to withhold tax under s. 874 is "a collection mechanism in respect of tax payable by the recipient of the statutory interest". The Court noted that the compulsory deduction of the tax "gives HMRC the assurance that it will be collected and in most cases imposes on recipients of the statutory interest who are non-resident for UK tax purposes an obligation to pay tax which they would not otherwise have" (§6).

9. Section 933 provides an exception to the above obligation in respect of certain payments to UK resident companies. That section provides:

> "**933. UK resident companies**
>
> A payment is an excepted payment if the person beneficially entitled to the income in respect of which the payment is made is a UK resident company."

10. We set out the case-law relevant to the interpretation of particular aspects of the above provisions when dealing with the grounds of appeal below.

BACKGROUND

11. The FTT recorded that there was no dispute as to the relevant facts, and recorded these extensively at §§16(1)–(15) of its decision together with tables detailing the loans (§17). It also made further findings in its discussion of the appellant's grounds. As there is no challenge to the facts found by the FTT, we focus here on the matters necessary to understand the grounds of appeal.

12. The appellant's group acquired property primarily for property investment purposes. In the relevant period the properties held were in the UK, such that the income and capital gains of the group were made in the UK (§16(1)). Some of the group's loan funding took the form of unsecured borrowing from directors of the group, founder family members, Gibraltar-resident trusts of which they were settlors and/or beneficiaries, and the group's FURBS (funded unapproved retirement benefit scheme) ("**the lenders**") (§16(3)). Before 2004 the loans were provided "somewhat informally". In November 2004 the group restructured its loans with the intention that the loan interest

would not be subject to UK tax, but would still generate relief for the UK group companies (§16(6)–(7)).

13. The new arrangements involved the following steps (§§16(7) and (9)):

(1) Shortly before the interest was paid by the group borrowing company, the relevant lender assigned for consideration the right to interest to a third party. This was initially a Guernsey-resident company ("**Storrier**"), run by Mercator, a group providing trust and corporate administration services. In subsequent years, this role was fulfilled by one of two Guernsey resident trusts also managed by Mercator (the "**Guernsey Trusts**").

(2) At the same time, the lender assigned the principal to another company within the appellant's group. In later years after 2009 this step was omitted and both the principal and interest were assigned to the same third party.

(3) One or two days after the assignment, the appellant paid the interest and principal to the relevant third party.

(4) Arrangements were made for the relevant lender to advance an amount generally at least as large as the original loan amount principal to fund the above payment.

14. Interest and principal on the lender's new advance were in turn assigned as in step 1 above. The above process of assignment, repayment by the appellant and re-advance by the original lender continued throughout the period relevant to the appeal (October 2010–March 2015). In relation to interest payments made from 2012 onwards, Storrier assigned the right to interest to a UK-resident company, Houmet Trading Limited ("**Houmet**"), also managed by Mercator, with the result that the appellant made interest payments to Houmet.

15. The loan documentation also changed to contain terms that (i) the loan was repayable on 30 days' notice by the lender or any time by the appellant; (ii) all payments were to be made in Gibraltar from a source outside the UK; (iii) no assets in the UK were secured; and (iv) Gibraltar law was the governing law and Gibraltar courts had exclusive jurisdiction. The revolving facility agreement with the FURBS contained similar terms, but referred instead to Jersey law and the Jersey courts (§16(12)).

16. We will outline the FTT's analysis of these arrangements under the relevant grounds of appeal.

GROUNDS OF APPEAL

Ground 1: Applicability of s. 933 exception to withholding obligation

FTT decision and the appellant's arguments

17. This ground relates to interest paid from 2012 onwards. As noted above, from that date the appellant paid interest to Houmet, a UK resident company, Houmet having been assigned the right to that interest from Storrier (or in later periods from the Guernsey Trusts). Houmet paid what appeared to be very similar sums to Storrier (and later the Guernsey Trusts) by way of contractual consideration for the assignment.

18. The appellant submitted that the interest income fell within the exception in s. 933, on the basis that Houmet was beneficially entitled to all of that income. The term "beneficially entitled" was, the appellant argued, to be understood by its ordinary English law meaning as given by Evans Lombe J in *Indofood International Finance v JP Morgan* [2005] EWHC 2103 (Ch), §§46–50. That case

considered the tax treatment of a proposed restructured loan transaction. Under the existing structure the claimant, a subsidiary of an Indonesian parent company, issued debt to noteholders. It lent the proceeds to its parent company in return for interest payments which the claimant then paid on to noteholders. The proposed restructuring involved the claimant assigning the benefit of the loan (to the parent company) to a newly-constituted Netherlands company. The Indonesian parent company borrower would then pay interest to the Netherlands company, which would then make payments on to the claimant (which in turn would pay the noteholders). The relevant issue, for present purposes, was whether the Netherlands company would be regarded as the "beneficial owner" of the interest received from the Indonesian parent company under the provisions of various double taxation agreements. At first instance, Evans Lombe J found that the Netherlands company would be the beneficial owner of the interest, as long as it was not receiving the income as a fiduciary (such as where it was acting as a nominee or trustee for another person).

19. On that basis, the appellant said that it was irrelevant to the question of "beneficial entitlement" that Houmet was contractually obliged to pay sums to Storrier, by way of consideration for the assignment to Houmet of the right to receive the interest. In *Indofood* Evans Lombe J had specifically noted that a contractual obligation to pay on income to a third party should not preclude beneficial ownership of the income when originally received.

20. The FTT rejected that submission, finding instead that Houmet was only "beneficially entitled" for the purposes of s. 933 to the amount of interest which exceeded its obligation to pay the assignment consideration on to Storrier or one of the Guernsey Trusts. The person beneficially entitled to the part of the interest representing the assignment consideration was, the FTT found, Storrier or the relevant Guernsey Trust. (Due to the incomplete information before the FTT the parties were left to calculate the excess retained by Houmet, but the FTT indicated that the amount of the difference was likely to be minimal or even nil: §§145–157.)

21. In reaching that decision the FTT found as a fact that there was no business purpose for the involvement of Houmet. The only reason that it was involved was to ensure that a UK resident company received interest instead of the Guernsey resident thereby providing an alternative argument based on s. 933 if the appellant's other arguments for avoiding withholding tax failed (§§140–142). The FTT referred to the House of Lords' decision in *IRC v McGuckian* [1997] 3 All ER 817, as a case where an artificial step of assigning a right to dividend was disregarded. In line with that decision, it considered that "once the artificial step comprising the assignment of the right to receive the interest is identified and disregarded, the inevitable result is that, to the extent of that amount, the person beneficially entitled to the payment of the interest was instead Storrier or the relevant Guernsey Trust" (§§133 and 143–145).

22. Before us, Mr Way KC for the appellant argued that the FTT was wrong not to adopt Evans Lombe J's definition of beneficial entitlement, and was also wrong to look at the composite effect of the transactions. Although the appellant did not challenge the FTT's factual findings regarding the lack of business purpose for the involvement of Houmet, Mr Way said that this was irrelevant by analogy with the House of Lords' reasoning in *MacNiven v Westmoreland Investments* [2001] UKHL 6.

Discussion

23. Ground 1 turns on a short question of statutory interpretation on the meaning of "beneficially entitled" in s. 933. Is the scope of that term circumscribed by the meaning given by Evans Lombe J to "beneficial ownership" in *Indofood* (as Mr Way submitted), or is it relevant to take account of the

fact that the majority or all of the interest income was paid away by Houmet under the assignment contract (as Mr Vallat KC submitted for HMRC, and the FTT found)?

24. The starting point is to construe the words in their statutory context and with regard to their purpose. In that regard, the immediate difficulty with the appellant's argument is that it starts and ends with a judicial description of the phrase "beneficial ownership" in a general legal sense. But the definition of "beneficial ownership" adopted by Evans Lombe J in *Indofood* cannot simply be transplanted into s. 933 without any analysis of whether that fits with the statutory purpose and context of the provision. The principles set out in the line of cases starting with *Ramsay v Inland Revenue Commissioners* [1981] 1 All ER 865 require the court or Tribunal to give the relevant statutory provision a purposive construction in order to determine the nature of the transaction to which it was intended to apply, and then to decide whether the actual transaction, viewed realistically, falls within the ambit of the provision: see e.g. *Barclays Mercantile Business Finance v Mawson* [2004] UKHL 51, [2005] 1 AC 684, §§32 and 36.

25. As both parties and the FTT recognised, the definition of "beneficial ownership" adopted by Evans Lombe J was not upheld by the Court of Appeal on appeal: [2006] EWCA Civ 158. The Court of Appeal held instead that the term was to be given "an international fiscal meaning not derived from the domestic laws of contracting states". It found that in interpreting and applying the phrase "beneficial owner" it was necessary to have regard to the commercial and practical substance of the transaction. It also considered the purpose of the relevant double taxation agreements (§§42–45). Although that case concerned the interpretation of international instruments, the approach of the Court of Appeal emphasises the importance of considering the particular context in which the relevant words appear.

26. The FTT was accordingly right to consider that Evans Lombe J's "general position" as a matter of English law could not displace the requirement to adopt a purposive approach to construing the relevant provisions, in accordance with the well-established *Ramsey* principles (§132).

27. What then is the statutory context to s. 933? The provision is an exception to a rule. In addressing the scope of the exception, it is relevant to look at the purpose of the rule to which it provides an exception, namely s. 874. There is no dispute that the purpose of the obligation to deduct is as explained in *Lomas* (as set out above). Both parties described the rationale in terms of capturing or collecting tax on UK-source interest paid to non-residents. Section 933 disapplies that rule when a UK resident is beneficially entitled to the income. It can readily be seen why that should be the case: in that situation there is not the same tax collection concern of having no-one in the UK to pursue. The premise of the exception is therefore that there is not someone else outside the UK who is in fact beneficially entitled to the income.

28. The exception in s. 933 thus looks to the practical reality of whether there are sums that can readily and fairly be collected from a UK resident company. That function suggests that the term "beneficially entitled" in s. 933 does not only exclude situations where the recipient is a fiduciary, but may also (depending on the particular circumstances) exclude situations where the commercial and practical reality of the matter is that the interest, once received by the UK resident company, is then paid on to an entity outside the UK, because in that situation there is the same underlying concern that tax on the income will not in practice be able to be collected.

29. We also agree with Mr Vallat that it would be extraordinary if one could avoid the imposition of the s. 874 collection mechanism simply by interposing a company such as Houmet, which has no commercial function other than to sidestep the withholding provisions. Purposively construed, the exception is drawn for the benefit of UK companies who are substantively entitled to receive and

enjoy the income, not those who are beneficially entitled only in the narrower technical sense used to distinguish between legal and equitable interests in English common law.

30. We therefore reject Mr Way's submission that the phrase "beneficially entitled" must be given the meaning adopted by Evans Lombe J in *Indofood*. The FTT accordingly made no error of law in adopting an approach that was not so constrained.

31. We also disagree with Mr Way's submissions based on the *Westmoreland* judgment, to the effect that s. 933 is not a provision where the courts are permitted to look at the composite effect of transactions. In that case the House of Lords upheld the appeal of the taxpayer, Westmoreland, in respect of a corporation tax deduction for interest paid by it to pension trustees, through a series of transactions using money which the pension trustees had loaned to Westmoreland. Mr Way, noting that the case involved circular money flows, relied on Lord Hoffman's comment that:

> "59. ... one cannot disregard a transaction which comes within the statutory language, construed in the correct commercial sense, simply on the ground that it was entered into solely for tax reasons."

32. Mr Way also referred us to a passage in Lord Nicholls' speech (at §15) to similar effect. However, as Lord Nicholls acknowledged at §8, "the paramount question always is one of interpretation of the particular statutory provision and its application to the facts of the case". *Westmoreland* is simply an example of a situation where, construing a different statutory provision (s. 338(3) of the Income and Corporation Taxes Act 1988), there was a "payment" of interest, the proper statutory construction for that term being that the source of payment, the use to which the payment was put and its lack of business purpose did not matter.

33. The analysis of s. 933 is different, because (for the reasons given above) a purposive construction of "beneficial entitlement" in that provision *does* engage the practical substance of a UK resident company's entitlement. Section 933 is therefore a provision for which the lack of business purpose for the company's involvement in receiving the interest is relevant in considering whether the company is beneficially entitled to the sum.

34. Mr Way's answer was to suggest that the approach taken in *Westmoreland* is of more general effect, and is not limited to the particular statutory provision at issue in that case. We disagree. The extract from Lord Hoffman's speech set out above itself refers to "a transaction which comes within the statutory language", correctly construed. In the present case, we have found that the transaction (the receipt of money which is shortly afterwards paid away) does not fall within the statutory language of "beneficial entitlement", properly construed.

35. Mr Way also relied on Lord Nicholls' comments at §54 of *Westmoreland*, that in *McGuckian*

> "The fact that the assignment had no commercial purpose did not mean that it had to be disregarded. But it failed to perform the alchemy of transforming the receipt of a dividend from the company into the receipt of a capital sum from someone else."

36. Contrary to Mr Way's submissions, that comment does not suggest that the FTT was wrong to rely on *McGuckian*. All that was being said was that the lack of commercial purpose, by itself, does not mean that the transaction falls to be disregarded in its entirety; rather, its effect will depend on the fiscal issue in question.

37. That is entirely consistent with the approach of the FTT in this case. Reading the FTT's reasoning as a whole, we do not consider that the FTT was suggesting that *McGuckian* stood for the proposition

that an assignment without a commercial purpose had to be disregarded whatever the circumstances. As the FTT itself emphasised (at §145), the *McGuckian* case concerned different statutory provisions to those at issue in the present case. What the case showed was simply that, in an appropriate case, the fact that an assignment has no commercial purpose may be a relevant fact in determining the application of a taxing provision to the payments made pursuant to that assignment.

38. Insofar as the FTT considered itself compelled to reach the decision it did by virtue of the reasoning in *McGuckian,* we do not think that was correct given the different statutory provisions at issue in that case. Ultimately, however, that does not assist the appellant because it is clear that the definition of beneficial entitlement adopted by the FTT was correct.

39. We therefore reject this ground of appeal.

Ground 2: The UK/Guernsey double taxation agreement

FTT decision and the appellant's arguments

40. Double taxation agreements allocate taxing rights between the contracting states. This ground of appeal concerns the interest which the appellant paid to the Guernsey company, Storrier, and whether the application of the UK/Guernsey double taxation agreement meant that the UK taxing authorities could not collect tax in respect of those payments, such that (according to the appellant), no obligation to deduct tax could arise.

41. The appellant argued that although there was no provision in the UK/Guernsey double taxation agreement dealing specifically with interest, the interest payments to Storrier fell within the business profits article of that agreement (Article 3(2)) which provided that the:

> "… industrial or commercial profits of a Guernsey enterprise shall not be subject to United Kingdom tax unless the enterprise is engaged in trade or business in the United Kingdom through a permanent establishment situated therein".

42. There was no suggestion that Storrier fell within the proviso above: it was not engaged in trade or business in the UK through a permanent establishment there.

43. HMRC's primary position was that the interest did not fall within the scope of that article. In any event, however, HMRC contended that two important procedural requirements for the appellant to claim relief from s. 874 were not met:

(1) The recipient of the interest, Storrier, did not make any claim for relief. (There is no issue between the parties that any obligation to make a claim fell on the recipient of the interest, and this point was noted by the FTT. The FTT's references to the claim obligation falling on the appellant as payer of the interest therefore appear to be an inadvertent error.)

(2) The interest payer (i.e. the appellant) was not issued with the relevant statutory notice by HMRC directing it to make payments of interest gross.

44. The first procedural requirement, to make a claim, stems from s. 6(6) of the Taxation (International and Other Provisions) Act 2010 ("**TIOPA**"), and arises in the context of the following subsections (emphasis added indicating the provisions in issue here):

"**6. The effect given…to double taxation arrangements**

[…]

(2) Double taxation arrangements have effect in relation to income tax and corporation tax so far as the arrangements provide –

(a) for relief from income tax or corporation tax,

(b) for taxing income of non-UK resident persons that arises from sources in the United Kingdom

(c) for taxing chargeable gains accruing to non-UK resident persons on the disposal of assets in the United Kingdom,

(d) for determining the income or chargeable gains to be attributed to non-UK resident persons,

(e) for determining the income or chargeable gains to be attributed to agencies, branches or establishments in the United Kingdom of non-UK resident persons,

(f) for determining the income or chargeable gains to be attributed to UK resident persons who have special relationships with non-UK resident persons, or

(g) for conferring on non-UK resident persons the right to a tax credit under section 397(1) of ITTOIA 2005 in respect of qualifying distributions made to them by UK resident companies.

[…]

(6) Relief under subsection (2)(a) ... requires a claim."

45. As regards the second procedural requirement relied upon by HMRC, even if the appellant had made a claim for relief for the purpose of s. 6(6) TIOPA, the obligation to withhold tax under s. 874 could only be overridden where directed by HMRC pursuant to Regulation 2 of the Double Taxation Relief (Taxes on Income)(General) Regulations 1970 ("**the DTR Regulations**"). That provides:

"2. –

(1) The following provisions of these Regulations shall have effect where, under arrangements having effect under section 497 of the Income and Corporation Taxes Act 1970 [now s. 6 TIOPA], persons resident in the territory with the Government of which the arrangements are made are entitled to exemption or partial relief from United Kingdom income tax in respect of any income from which deduction of tax is authorised or required by the Income Tax Acts.

(2) Any person who pays any such income (referred to in these Regulations as 'the United Kingdom payer') to a person in the said territory who is beneficially entitled to the income (such person being referred to in these Regulations as 'the non-resident') may be directed by a notice in writing given by or on behalf of the Board that in paying any such income specified in the notice to the non-resident he shall –

(a) not deduct tax, or

(b) not deduct tax at a higher rate than is specified in the notice, or

(c) deduct tax at a rate specified in the notice instead of at the lower or basic rate otherwise appropriate; and where such notice is given, any income to which the notice refers, being income for a year for which the arrangements have effect, which the United Kingdom payer

> pays after the date of the notice to the non-resident named therein shall, subject to the following provisions of these Regulations, be paid as directed in the notice …”

46. The appellant submitted that no claim was required, because Article 3(2) of the UK/Guernsey double taxation agreement did not provide a relief under s. 6(2)(a) TIOPA above, but rather a determination of the income to be attributed under s. 6(2)(d).

47. As regards the requirement for a direction notice under the DTR Regulations, emphasising the use of the word “may” in Regulation 2(2) (“Any person … may be directed by a notice …”), the appellant contended that that the provisions of Regulation 2(2) were effectively voluntary, and that gross payment could therefore be made despite no direction by notice under that Regulation having been given.

48. Three main issues accordingly arose for the FTT to decide on this point: (i) whether the interest payments fell within the business profits article of the UK/Guernsey double taxation agreement; (ii) the necessity for a claim for relief to be made; and (iii) whether a payer could make a gross payment even if no direction had been made under Regulation 2(2).

49. The FTT assumed issue (i) in the appellant’s favour, but rejected the appellant’s case on (ii) and (iii), finding that a claim to relief was required (§§117–119) and that a direction under Regulation 2(2) was also a prerequisite for relief from the withholding obligation under s. 874 (§§123–125).

50. Before us, the appellant’s grounds of appeal included points which went to issue (i). In that regard, the appellant relied in particular on a Kenyan tax appeals tribunal decision in the case of *McKinsey v Commissioner of Legal Services* (No.199 of 2020), which had not been cited in the FTT. Mr Way accepted at the hearing, however, that the Upper Tribunal did not need to deal with this first issue. The FTT decision was effectively in the appellant’s favour on that particular point, it being common ground that the FTT had proceeded on an assumption that Storrier *was* entitled to the benefit of Article 3(2) of the UK/Guernsey double taxation agreement in relation to all the interest it received from the appellant. HMRC were content to proceed on the basis of that assumption for the purposes of the appeal before us, without making any concession more generally that the assumption was correct. The issues for us to decide are therefore issues (ii) and (iii).

Discussion

51. We start with the issue of whether a claim was required. Was the effect of Article 3(2) of the UK/Guernsey an arrangement “for determining the income or chargeable gains to be attributed to non-UK resident persons” which fell within s. 6(2)(d) TIOPA, as the appellant argued? Or was it a “relief from income or corporation tax” under s. 6(2)(a) as HMRC argued, such that a claim was required pursuant to s. 6(6)?

52. The appellant’s case on this must, in our view, be rejected. We start by noting the context in which the rival subparagraphs (a) and (d) sit in s. 6(2) TIOPA: namely a provision which gives effect to the double taxation arrangements. The menu of categories presented at (a) through to (g) accordingly reflect the different functional types of provision typically found in double taxation agreements. As Mr Vallat submitted, (and as the FTT in essence accepted at §117) the operation of the business profits Article 3(2) simply switches off a UK tax charge that would otherwise apply. The provision therefore plainly amounts to a relief. By contrast, s. 6(2)(d) references the exercise of attribution of income that must take place where for instance a non-UK enterprise has a permanent establishment in the UK. Double taxation agreements typically contain provisions specifying how that attribution

is to be done (for instance through the arms' length principle); subsection (d) gives effect to those provisions.

53. We are reinforced in that conclusion (as was the FTT) by the reasoning of the Upper Tribunal in *Davies v HMRC* [2020] UKUT 67 (TCC), §§81–84. The question there was whether the business profits article in the UK/Mauritius double taxation agreement (drafted similarly to exclude the taxation of enterprise profits except in as much as they were attributable to a permanent establishment) would operate as a relief under provisions analogous to s. 6 TIOPA. Although the Tribunal's conclusion on that point was *obiter* (because the Upper Tribunal concluded the relevant article of the agreement did not apply to the income in question), its reasoning was set out following full argument on the issue. The Upper Tribunal considered that *if* the appellants there had been able to rely on the business profits article, then they would have had to claim relief under the equivalent of s. 6(2)(a) TIOPA. In fact it seemed to the Tribunal "a paradigm case of relief". The Tribunal's explanation of why the other paragraphs did not apply included consideration of the analogue to s. 6(2)(d) TIOPA. As the FTT in this appeal correctly noted, while the main issue in the *Davies* case was different, the issue of whether a claim would have been required if the business profits article was engaged was in point (§§120–122).

54. The appellant also argued that a claim requirement could not have been intended, as it would make international commerce unworkable given the daily volume of international transactions. We agree with HMRC that this concern does not arise in practice. Mr Vallat referred us by way of example to HMRC's Double Taxation Treaty Passport Scheme. This is an administrative simplification to the claim process designed to assist certain overseas lenders to access, on an ongoing basis for a fixed period of time, double taxation agreement relief from withholding tax on loan interest payments. Mr Vallat also pointed to provisions in ss. 875–888 of the Income Tax Act 2007 setting out exceptions to the withholding obligation covering commercial lending in the ordinary course of business, which would cover interest payments to and by banks and building societies.

55. Turning to the remaining issue of the application of Regulation 2(2) of the DTR Regulations, we reject the appellant's arguments that a payer of interest can make gross payments relying on a double taxation agreement, even where HMRC have not made any direction under Regulation 2(2). Mr Way's reliance on the use of the word "may" is misconceived. The use of the word "may" simply reflects the fact that a direction under Regulation 2(2) is only needed if a claim for relief is made.

56. Moreover, if Mr Way's interpretation were correct, there would be no purpose to a direction under that Regulation: a payer would be relieved from withholding whether or not a direction was made. That this is not how the legislative scheme works is all the more clear from Regulations 3–9 of the DTR Regulations, which set out the further consequences of a Regulation 2(2) direction notice being made. As the FTT pointed out, these other provisions would make no sense if a payer could pay gross even though no direction had been made.

57. The FTT thus made no error in concluding that the UK/Guernsey double taxation agreement did not disapply the withholding tax obligation, given the absence of either a claim for relief or a Regulation 2(2) direction by HMRC. This ground of appeal therefore fails.

Ground 3: Loans of less than a year

FTT decision and the appellant's arguments

58. Section 874 applies if a payment of "yearly interest" is made. The appellant accepted that in respect of a number of loans where the period between advance and repayment was well in excess of

a year, the interest was "yearly" in nature. In relation to some of the relevant interest payments, however, the loan duration was either less than a year or only a little over than a year, and for these the appellant contended that the FTT was wrong to conclude that the interest was "yearly".

59. The meaning of "yearly interest" in s. 874 and its predecessors has been the subject of extensive judicial consideration stretching back more than a century, resulting in a number of case-law propositions regarding the characteristics of yearly interest, as contrasted with interest which did not fulfil that definition which the courts have commonly referred to as "short interest". In *HMRC v Joint Administrators of Lehman Brothers International* [2019] UKSC 12 the Supreme Court surveyed that case-law, noting at §23 (by reference to Lindley LJ's comments in *Goslings and Sharpe v Blake (Surveyor of Taxes*) (1889) 23 QBD 324) that "the question whether the interest is 'yearly' or 'short' depends upon a business-like rather than a dry legal assessment of its likely duration."

60. The Supreme Court went on to endorse Lord Anderson's summary in the Inner House Court of Session Case *IRC v Hay* (1924) 8 TC 636, 646 as "remaining the best convenient summary of the jurisprudence about the meaning of yearly interest, in the context of interest which accrues due over time whether purely contractual or statutory in origin" (§§30 and 33). The *Hay* propositions included the following:

(1) Interest payable in respect of a short loan is not yearly interest (*Goslings*).

(2) In order that interest payable may be held to be yearly interest in the sense of the Income Tax Acts, the loan in respect of which interest is paid must have a measure of permanence, such that it is in the nature of an investment (*Garston Overseers v Carlisle (Surveyor of Taxes)* [1915] 3 KB 381).

(3) The loan must have a "tract of future time" (Lord Johnston in *Scottish North American Trust Ltd*, 1910 Session Cases 966, 973) and must not be one repayable on demand (*Gateshead v Lumsden* [1914] 2 KB 883).

61. In addressing the significance of the loan's investment-like nature, an issue that been debated in subsequent cases, the Supreme Court confirmed and endorsed "the concept of addressing the yearly interest question by reference to a perception whether the source of interest can properly be regarded as a form of investment" (§26).

62. Applying the above principles, the FTT agreed with the appellant that the loans fulfilled an important commercial need for its business. In contrast to institutional lending, the loans were unsecured (leaving the appellant's assets unencumbered and therefore available as security for other financing). In addition, as the loans were with parties connected to the appellant, they could be raised quickly and at minimal cost (§78). The FTT also took account of the fact that the loans were repayable on demand, and were indeed repaid on a regular basis within or very shortly after a year from each initial advance (§79).

63. Nevertheless, the FTT considered that the loans were intended to form part of the longer-term funding of the appellant and were regarded by each lender as an investment in the appellant (§79). In particular, in the light of the evidence which it analysed in detail, the FTT found that each loan was part of a sequence which represented the provision by the relevant lender of part of the fixed capital of the business. That was why, as one of the appellant's directors had explained at the hearing, the pattern was for the repayment of each loan to be funded out of the proceeds of a new advance from the same lender (§81). The FTT found, on the basis of that and the other evidence before it, that each lender made a "continuous provision of finance" to the appellant over a lengthy period, such that the

financing from each lender "had a permanency which belied the apparent short-term nature of each loan" (§82). In the circumstances, the loan funding "was not temporary in nature but was part of the long-term funding" of the appellant. From the lenders' perspective, the evidence suggested that the lenders regarded their loans as part of their long-term capital in the appellant's business, and therefore "in the nature of investments" in the appellant (§86).

64. The FTT concluded (at §88) that the interest on the loans was yearly:

> "In particular, the loans made by each Lender satisfied the *Hay* tests relating to a measure of permanence, a 'tract of future time' and being in the nature of an investment. … although each individual loan was short-term in nature, the loans provided by each Lender, when taken together, provided financing to the Appellant with a measure of permanence which had a 'tract of future time' and that financing was in the nature of an investment for the Lender in question."

65. The FTT went on (at §90) to disavow any suggestion that its conclusion relied on recharacterising the multiple consecutive loans as one single long-term loan:

> "I am perfectly content to recognise the independent existence of each loan from the other loans made by the same Lender which preceded or succeeded that loan. … However, the fact that each loan had an independent existence and was repaid after a period of approximately one year does not mean that each loan should be viewed in isolation and with blinkers when the question of whether or not it was intended to comprise part of the long-term funding of the Appellant – and, hence, whether it gave rise to 'yearly' interest – falls to be addressed. Instead, that loan needs to be examined in context and in the light of all the circumstances in which it was advanced and repaid. And, once one does that, the long-term nature of the relevant funding becomes apparent."

66. Mr Way argued that the FTT erred in reaching those conclusions. The interest was (he said) plainly short interest given that the loans had independent existence, were commercially driven, and were repaid with a period of around (or less than) a year. It was relevant that on each occasion before the repayment/readvance pattern took place an enquiry was made of the relevant lender as to whether it wished to continue providing funds to the appellant. Mr Way also contended that the FTT had erred by considering the loans "when taken together".

Discussion

67. We reject the appellant's submissions. Consistent with the established case-law principles discussed in *Lehman*, the FTT considered the duration of the loan from the point of view of its permanence and whether it had the nature of an investment. We disagree with Mr Way's contention that the FTT's analysis amounted to a dry legal assessment rather than a business-like approach: quite the contrary, the FTT was at pains to look at the commercial substance rather than the bare legal form of the arrangements. In that regard, none of the factual features of the loans (including their duration) detracted from the analysis that, in commercial substance and effect, the individual loans were made by the lenders to provide long-term funding and had the nature of an investment. As the FTT noted, the enquiry of each lender as to whether they wished to continue providing funds was a mere formality, as the appellants' witnesses had "candidly admitted in their evidence", because the repayment of each loan had to be funded from somewhere. While theoretically a lender could have declined to make a new loan to fund the repayment of the previous loan, in practice that never occurred (§87, referring back to the main findings of fact at §16(15)).

68. While Mr Way argued that there was a genuine business reason for the loans to be short term, in that they were mostly personal loans which were unsecured and therefore at risk, the FTT found as a fact (as we have recorded, above) that the loans were in the nature of long-term funding, and were

regarded by the lenders as long-term capital investments in the appellant. No challenge is made to those findings of fact, which were based on a comprehensive and detailed assessment of the evidence before the FTT.

69. Nor do we consider that the authorities support the appellant's emphasis on the duration of the loans being less than (or only a little over) a year. Quite the contrary, the fact that the courts are instructed to take a business-like approach rather than a dry legal one, and that the relevant concepts of permanence and investment nature are open to judgment and involve matters of degree, indicate that the assessment must focus on the commercial substance of the arrangement rather than the precise duration of the loan. Indeed, as is apparent from the consideration of the case-law in *Lehman*, that was the case from the earliest of the authorities to consider the issue.

70. We acknowledge that none of the authorities cited to us concerned a series of loans equivalent to the facts of the present case. In our view, however, the FTT correctly applied the general principles to the particular facts before it. A business-like approach to the question of each loan's permanence and investment nature was required. That in turn entailed consideration of the context in which each loan took place, namely that each loan was one of a series of loans in similar terms and with the same lender. There was no reason as a matter of principle to ignore that context. On the contrary, the particular circumstances of the pattern of repayments and advances involving the same lenders were clearly relevant to the characterisation of the individual loans, in so far as questions of their permanence and investment nature were concerned. That was the specific and legitimate sense in which the FTT considered the loans "when taken together".

71. The FTT was right to reject an approach which assessed each individual loan "in isolation and with blinkers". The appellant's case would, by contrast, amount to precisely the dry legal assessment of the individual loans which the Supreme Court noted was disavowed in *Goslings*. It would also mean that the withholding tax provisions could be avoided by the simple device of restructuring a long term investment as a series of short term loans for no purpose other than the avoidance of the provisions, which cannot be something which the provision intended.

72. This ground of appeal therefore fails.

Ground 4: The source of the interest

FTT decision and the appellant's arguments

73. Section 874 applies to interest "arising in the United Kingdom", raising the question of whether the interest has a UK source or not. In *National Bank of Greece v Westminster Bank* [1971] AC 945 the House of Lords dealt with and weighed up the various factors that might be considered in determining the source of payments of interest. That case was subsequently analysed (alongside others) by the Court of Appeal in *Ardmore Construction v HMRC* [2018] EWCA Civ 1438, where Arden LJ confirmed that the question of source involved an "acutely fact-sensitive" multi-factorial test.

74. In *Ardmore* the UK-resident taxpayer was lent a sum under a facility letter by Gibraltar trusts. As set out by Arden LJ at §16, the factors pointing in favour of Gibraltar as the source of the interest were the place where the loan was made, the location of the trusts' bank accounts, the governing law and jurisdiction clauses in the facility letter, the place of residence of the creditors, and the absence of security in the UK. Conversely, the connecting factors to the UK were the physical source of the funds for paying the interest, the location of the assets on which any judgment in Gibraltar would be

enforced, the location of the borrower's business and its bank accounts, and thus the place from which interest was paid, and the absence of any security over foreign property.

75. As to the correct approach Arden LJ said that the court should ask "whether a practical person would regard the source as in this jurisdiction or elsewhere", and referred to the need to have regard to the "underlying commercial reality", in a case concerning a commercial transaction. In other types of transaction, she suggested that the question should be what was the source "from a practical, or realistic, point of view" (§§37–38). Applying those principles, she upheld the conclusion of the Upper Tribunal that the source of the interest was in the UK, noting that the search was for "the source of the interest rather than a search indirectly for the source of the loan." The funds paid over as interest derived from funds generated in the UK, where the business of Ardmore was located, all the available assets to meet the liabilities to the lender were in the UK, and the enforcement of any judgment following default would therefore be in the UK. The links with Gibraltar were, by contrast, relatively insubstantial (§42).

76. After considering both the *Bank of Greece* and *Ardmore* judgments, the FTT considered that the practical person would consider "the underlying commercial" reality here to be that the interest had a UK source. The non-UK factors were the facts that payments were made outside the UK, any debt enforcement proceedings were required to be brought in a jurisdiction outside the UK, and the governing law of the loan agreements was non-UK. Those factors were, however, outweighed by the more significant factors that the debtor (i.e. the appellant) was a UK resident company and carried on its business exclusively in the UK, meaning that the interest payments were funded out of assets situated in and profits of activities conducted in the UK, and that any judgment obtained in enforcement proceedings would necessarily have to be enforced against assets situated in and profits of activities conducted in the UK (§§49–52).

77. On that basis, the FTT could see no meaningful distinction between the facts in *Ardmore* and the situation of the appellant. It noted that the Upper Tribunal and Court of Appeal in *Ardmore* had accorded greatest weight to the factors of debtor residence, location of the assets out of which interest would be paid, and location of assets against which judgement would be enforced (all pointing towards the UK), whereas little weight was ascribed to the location where interest payments were to be made, and governing law and exclusive jurisdiction clauses, which pointed away from the UK (§§54–55).

78. In arguing that the FTT's decision was wrong in law, Mr Way maintained the points relied on before the FTT, namely that the creditors were outside UK (and non-resident when interest was paid), the loans had exclusive foreign jurisdiction provisions, the law of the agreements was non-UK, there was no UK security for the loans, and that both debtor's and creditor's bank accounts at the time interest was paid were outside the UK. He acknowledged that the debtor's (i.e. appellant's) residence was in the UK, but contended that this was "downplayed" by the existence of the foreign jurisdiction clause, his logic being that the debtor's location was only relevant insofar as that was where (absent the foreign jurisdiction clause) litigation would begin.

Discussion

79. In considering whether the FTT made an error of law, the first point to note is that as the issue of source of interest requires a multi-factorial evaluation, the appellate tribunal should be slow to interfere with that evaluation. As Arden LJ noted at §40 of *Ardmore*, the appellant had to satisfy it that the evaluation of the Tribunals was wrong in the sense that they left a material factor out of account, took a matter into account that should have been left out, misdirected themselves in law or fact, or reached a perverse conclusion.

80. In our judgment, the appellant's submissions under this ground come nowhere close to that threshold.

81. As regards the FTT's approach, it considered the issue from a "practical, or realistic, point of view" by considering the perspective of a "practical person", noting how they would see the "commercial reality" of the various factors pointing respectively to the non-UK and UK sources and weighing those up. In doing so, the FTT addressed each of the factors relied on by the appellant. There can therefore be no complaint that the FTT did not take account of the relevant factors.

82. To succeed, therefore, the appellant must show that the FTT misdirected itself in law or reached a conclusion that was perverse in deciding the weight that should be given to the debtor location in the UK, vis-à-vis factors of creditor location, governing law and exclusive jurisdiction which pointed away from the UK. But the FTT's attributions of weight in that regard reflected both the attribution of weight adopted by the Court of Appeal in *Ardmore* in relation to the very same factors, and Arden LJ's justification for doing so. It can hardly be said, therefore, that the FTT misdirected itself in relation to weight or that its conclusion on that point was perverse.

83. As to the argument that the significance of debtor location should be "downplayed" by the existence of the foreign clause, this point was specifically addressed but rejected by Arden LJ in *Ardmore* (as the FTT noted at §38). She explained that the exclusive jurisdiction provisions would only matter if there was a default, and in that case the enforcement of any judgment following default would take place in the UK. Precisely the same reasoning applies in the present case.

84. Mr Way sought to distinguish *Ardmore* (as he had done in the FTT) on the basis of the circular nature of the transactions in issue there, contending that the funds which the Gibraltar trusts lent to Ardmore had in fact originated with Ardmore. The FTT rejected that distinction as being erroneously premised on the importance of the residence of the creditor (§§56–57). It was clearly correct to do so, in view of the Court of Appeal's emphasis in *Ardmore* on the source of the interest rather than the source of the loan.

85. The FTT therefore adopted the correct approach, and on the facts before it was plainly entitled to reach the conclusion that the interest payments arose in the UK. None of the appellant's arguments suggests that the FTT left out of account any material factor, took any immaterial factor into account, misdirected itself in law, or reached a conclusion that was perverse. Accordingly this ground too must fail.

DECISION

86. The appeal is dismissed.

MRS JUSTICE BACON
JUDGE SWAMI RAGHAVAN

Release date: 26 May 2023