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Hargreaves: withholding tax on rollover funding under scrutiny

Tax Journal

November 2021

Speed read

In ***Hargreaves***, the FTT considered a list of concepts central to the applicability of UK withholding tax on interest payments. In finding that the interest had a 'UK source', the FTT gave consideration to where a practical person would consider the source to be, having regard to the underlying commercial reality. Further, the FTT found that the interest was 'yearly' as the loans had a measure of permanence and were regarded by the original lenders as an investment in the borrower's business, despite being separate as a matter of law and generally repaid on an annual basis. Whilst the FTT's views on UK source should not surprise practitioners, its focus on the subjective intentions of the parties when determining whether the interest was 'yearly' raises new questions and uncertainties. The availability of treaty relief and beneficial entitlement to interest payments were also considered in noteworthy circumstances, and the FTT ultimately applied a ***Ramsay*** purposive construction broadly to uphold HMRC's assessments relating to interest paid to a UK resident.

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The courts frequently consider tax planning which would be unlikely to be put in place these days. Their discussion of the fundamental principles underlying that planning will however often be of general applicability. The FTT decision in *Hargreaves Property Holdings Ltd v HMRC* [2021] UKFTT 390 (TC) is a case in point: its scrutiny of a financing structure may well affect how ordinary course finance is structured in light of the UK taxation of 'yearly' interest paid to overseas creditors.

The company was a UK resident parent of a property investment group; crucially, during the time that HMRC's disputed assessments relate to, it received all its income and capital gains from property located inthe UK. In 2004, it entered into a scheme to bring about a more advantageous tax position with regard to its financing arrangements, intended to result in a mismatch whereby the company would obtain tax relief for interest payments which in turn would not be subject to UK tax as the payments were intended to be paid gross to a non-UK recipient.

In short, loans granted by lenders connected with the company were documented on terms that apparently sought to take them out of scope of the withholding tax obligation in ITA 2007 s 874; the right to receive interest and principal under the loans were then assigned to a Guernsey resident company, and the proceeds from such assignments were used by the original lenders to grant new loans to the company. Within days, the company would repay the interest and principal to the assignee. No claim for treaty relief was made in respect of the interest payments, and no direction was given by HMRC to that effect.

In respect of some of the later loans, a further step was introduced whereby the Guernsey entity would in turn assign the right to receive interest to a UK resident company, and the company would pay the interest to that assignee.

This process was repeated on a near-annual basis, and during the five years subject to HMRC's assessments, the company was making the interest payments without any deduction on account of UK withholding tax. At the FTT hearing, directors of the company conceded that there was no commercial purpose to the refinancing structure other than the tax advantage.

'UK source' interest

The FTT swiftly and convincingly established that the interest payments in question were 'arising in the UK' for the purposes of ITA 2007 s 874. While the leading decision in *The National Bank of Greece SA v Westminster Bank Executor and Trustee Company (Channel Islands) Ltd* [1971] AC 945 had established that the source of an interest obligation should be identified by reference to the position which existed at the time when the obligation originally arose, the Court of Appeal in A*rdmore Construction Ltd v HMRC* [2018] EWCA Civ 1438 had stressed that the particular factors on which the source question was decided in the earlier case should not be regarded as an exhaustive list. Following the decision in *Ardmore*, the FTT considered whether a practical person would regard the source as in this jurisdiction or elsewhere, paying regard to the underlying commercial reality in which this question arose.

Having identified only a limited number of factors that pointed away from a UK source – including that payments were required to be made outside the UK and that the loans were governed by, and enforceable in, a jurisdiction other than the UK – the judge concluded that those were outweighed by the indicators that suggested the interest was arising in the UK. Above all else, the question fell to be decided by the fact that the company was resident in, and carried out its business exclusively in, the UK. This meant that, even though the interest payments were required to be made outside the UK, the underlying commercial reality was such that they were necessarily funded out of assets and profits from activities in the UK, and any enforcement proceedings would ultimately have to be enforced against such UK assets and profits. Unsurprisingly, following *Ardmore*, the non-UK residence of the creditor was not considered to be of any relevenance here.

The meaning of 'yearly'

The second question to be determined for the purposes of establishing whether a *prima facie* obligation to withhold income tax had arisen – whether the interest was 'yearly' – was arguably less straightforward, and the precedent set by it less clear. In light of the oral evidence, the judge found as a fact that, while in theory the original lenders could have declined to advance new loans to the company each time the refinancing structure was implemented, the enquiries made to this effect were a formality and the lenders thought

of their advances as forming part of the company's long-term financing. This finding was given a great deal of weight in reaching the ultimate conclusion on this point: applying *Goslings and another v Blake (Surveyor of Taxes)* (1889) 2 TC 450, a business-like approach took priority at the expense of a 'dry legal assessment of the documents.' The FTT justified its reasoning by noting that the five propositions for 'yearly' interest that had been set out in *IRC v Hay* (1924) 8 TC 636 could point in different directions: for example, it is possible for a loan to provide that it is technically repayable on demand, but even so the parties can intend and expect it to last for a considerable period of time.

One may question whether it is correct to disregard the fact that the loans are separate as a matter of law in those circumstances

In considering the relevant interest in question, the FTT emphasised the purpose of the parties in entering into each loan, which was held to be a question of fact. Arguably, this focus on the parties' subjective intentions and motives went beyond the approach suggested by the authorities cited. It led the FTT to conclude that even though the loans were generally repayable on demand or otherwise on short notice, and most of them were repaid on an annual basis, the interest was nevertheless 'yearly' as the loans had a measure of permanence and were regarded by the original lenders as an investment in the company's business.

This decision leaves open the question whether the outcome would have been any different had the original lenders properly considered each new loan being granted as part of the refinancing arrangements. To a degree, the facts of the case were rather specific in that the lenders apparently had longer-term financing ambitions that were structured to result in a desired tax outcome. Even without such tax drivers, it is plausible that rollover loan renewals may be approved without considerable thought being given to the merits each time; this is especially true where the amount of the advances are rolled. One may question whether it is correct to disregard the fact that the loans are separate as a matter of law in those circumstances.

The FTT assured that it had not disregarded the separate legal existence of each loan in coming to its conclusion. Rather, the point made was that such loans should not be viewed in isolation when considering whether they were intended to comprise part of a longer-term funding arrangement. This is a somewhat confusing proposition in that it is not clear what weight, if any, should actually be given to the separate existence of successive loans, each of which may be granted on a shorter-term basis.

Treaty relief

Having established that the withholding tax obligation at ITA 2007 s 874 was in point, the FTT then considered whether such obligation was displaced on account of the UK-Guernsey double tax treaty. While the company had argued that the interest was not subject to UK tax by virtue of the industrial and commercial profits article in force at the relevant times, the FTT addressed the question by focusing on the company's tax liability and hence whether the company was entitled to pay interest gross in the circumstances. On the facts, the company had not established that the UK/Guernsey double tax treaty applied to relieve it from its withholding tax obligation because it had not made a claim for double tax relief and HMRC had not issued a direction to the effect that the interest could be paid gross. This finding is a sobering reminder for taxpayers of the importance of adhering to the procedural steps in establishing a right to rely on treaty relief.

The FTT's repeated references to the company not having made a claim for treaty relief are notable, and not fully explained in the judgment. The statutory provision setting out the requirement for a claim is found in TIOPA 2010 s 6(6): in effect, it provides that relief from income tax pursuant to double tax arrangements requires a claim – but the statute does not specify by whom such claim should be made. HMRC's standard procedure for granting treaty relief requires the recipient of the income in question to submit a claim; the payor would not be primarily involved in this procedural step.

Beneficial entitlement in UK statute

Lastly, the FTT considered whether the UK resident assignee was beneficially entitled to the company's interest payments for the purposes of the withholding tax exemption at ITA 2007 s 933. This requires the UK company to be beneficially entitled to the receipt. Taxpayers and practitioners will no doubt welcome the FTT's clear comments to the effect that the meaning of beneficial entitlement in the context of UK statutory interpretation is the more traditional interpretation of the term found in the

High Court's decision in *Indofood International Finance Ltd v JP Morgan Chase Bank NA, London Branch* [2006] STC 192, as opposed to the Court of Appeal's subsequent decision in the same case which set out a so-called international fiscal meaning of beneficial ownership in the context of a double tax treaty. This distinction between construction of the phrase as a matter of English law and the concept in treaty interpretation of an international fiscal meaning echoes the Upper Tribunal's comments in *BUPA Insurance Ltd v HMRC* [2014] UKUT 262. However, the FTT also emphasised that the provision was required to be construed in accordance with the *Ramsay* principle *(Ramsay (WT) Ltd v IRC* [1981] 1 All ER 865).

At the hearing, the evidence presented about the UK resident assignee and its role in the refinancing structure had been scant, and the FTT found as a fact that there was no business purpose to its involvement. It followed that a purposive construction of the statute, applied to these facts, meant that the artificial step comprising the assignment of the right to receive interest should be disregarded in determining who was beneficially entitled to the interest.

The result was that, for the purposes of ITA 2007 s 933, it was held that the UK resident assignee was not beneficially entitled to the interest to the extent of the amount it had paid to the assignor for the assignment. In the FTT's view, this conclusion was supported by the House of Lords' decision in *IRC v McGuckian* [1997] 3 All ER 817, in which an assignment of a right to dividends was held to be an artificial step that was disregarded when determining the nature of a sum received. It will be interesting to see, if this judgment is appealed, whether the Upper Tribunal will consider whether *McGuckian* enables the existence of the assignment to be ignored to this extent; it is likely that the company will dispute the point strongly.

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As a final step, the FTT considered whether the UK resident assignee was beneficially entitled to the interest to the extent it exceeded what it had paid to the assignor for the right to such interest. Here, it applied the *Indofood HC* meaning of the concept and held that the assignee was beneficially entitled to that part of the interest as it had not received it as nominee. The finding that the assignee was only beneficially entitled to this small part of the interest – even when it was not passing on the receipt and had already acquired (and paid for) the interest element – is interesting.

In effect, therefore, the FTT applied a *Ramsay* purposive interpretation so as to determine the scope of the transaction and hence the interest to which the payee could be beneficially entitled once the impact of the artificial step – the assignment – had been taken into account. When the essence of the actual transaction had been uncovered in this way, the statute was then construed so that beneficial entitlement to the interest arising from that actual transaction was given its usual English law meaning. Arguably, this was wholly in line with the essence of the *Ramsay* analysis as set out in *Barclays Mercantile Business Finance Ltd v Mawson* [2004] UKHL 51; namely, to 'give the 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 ... answered to the statutory description.' Read as such, the decision does not suggest that the meaning of beneficial entitlement as a matter of English law has changed. What it does indicate is that it can give rise to what may seem an odd conclusion: namely, that an assignee of interest on a loan carrying accrued interest is not the beneficial owner of that interest, when paid, even in the absence of an obligation to pay it on.

Originally appeared in Tax Journal 26 November 2021.

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