

## Source of interest

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Andre Anthony reviews the Upper Tribunal's decision in *Ardmore Construction* on the multi-factorial test in determining the source of interest.

The question of when an interest payer must withhold UK income tax on the sum seldom comes before the courts. In the recent Upper Tribunal decision of *Ardmore Construction Ltd and others v CRC* [2015] UKUT 633, the judge gave weight to the residence of the debtor and the source of payments in determining the source of interest, disregarding the lender's residence and the place where credit is provided. The tribunal applied Lord Hailsham's multi-factorial test in *Westminster Bank Executor and Trustee Co (Channel Islands) Ltd v National Bank of Greece SA* 46 TC 472, which set out a nonexhaustive list of relevant factors to consider.

### *Perrin v HMRC*

The case was a combined appeal from two decisions of the tax First-tier Tribunal.

The first case, *Perrin* (TC3363), concerned the taxpayer paying interest in respect of a loan to an Isle of Man pension scheme. The taxpayer argued that the interest had arisen 'from a source outside the UK' so, under ITA 2007, s 874, there was no obligation to withhold income tax.

The First-tier Tribunal reviewed a wide range of authorities, not just *National Bank of Greece*. It refrained from applying a specific test or methodology for determining source of interest, preferring to identify a list of general principles flowing from the authorities cited. Acknowledging that ascertaining where interest had arisen involved the weighting of different factors, the tribunal held that the residence of the lender or place from which the money was lent and the proper law of the obligation were of little relevance in determining the source. The place of actual or stipulated payment may be relevant, but was of little weight.

Although the tribunal found that the place of source of interest was not determined by the general rule about the situs of debts, situs remained a relevant factor. Indeed, it considered the residence of the debtor to be important because of its centrality to determining situs. Likewise, the place of jurisdiction is relevant due to its relevance to situs, although its significance may be diminished if the place of substantial enforcement is different.

Other relevant factors included the location of any security, the place of contemplated enforcement and the contemplated source or substantive origin of the funds for the payment of the obligation. This final factor was of greater significance than the place at which payment was to be made.

Rejecting the taxpayer's contention that ITA 2007, s 874 was not relevant, the tribunal held that the interest had arisen in the UK, especially given that the taxpayer was resident in the UK and the source of funds for payment or enforcement of the loan originated from the UK.

### KEY CONTACTS



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### KEY POINTS

- Lord Hailsham's multi-factorial test in the *National Bank of Greece* case applies to the source of interest.
- Decision supports HMRC's *Savings and Investment Manual* (SAIM9090).
- Court disagreed that the residence of the debtor and the location of their assets are most important.
- Residence is only one factor.
- Will HMRC revise its guidance in SAIM9090?

## *Ardmore Construction*

The second case, *Ardmore Construction Ltd* (TC3580), concerned a complex financing structure, which involved the taxpayer making payments of interest on loans to various off shore entities.

Placing great weight on the *National Bank of Greece* case, the First-tier Tribunal applied a multi-factorial approach in concluding that the interest payments in question had arisen in the UK. The tribunal was particularly influenced by the fact that the taxpayer was UK resident, the place of enforcement of the debt was the UK and that the situs of the debt, although not determinative, was in the UK. Also, the fact that payments of interest were funded by the income of the taxpayer's UK trading activities accorded them a UK source or origin. The tribunal expressed caution, though, in considering the Commonwealth and Privy Council decisions cited by counsel, given the differences in taxation systems across these jurisdictions.

### The appeal

The taxpayers in *Perrin* and *Ardmore Construction* appealed on three principal grounds.

First, on the basis that the source of interest should depend on the 'nationality' or 'residence' of the loan instrument. Second, if contrary to the first ground, the proper test ought to be multifactorial, too much weight should not be placed on the residence of the debtor. Third, the place where credit is provided is the source of interest.

### Upper Tribunal's decision

The Upper Tribunal held that the House of Lords' decision in *National Bank of Greece* remains the only one that binds the lower courts on this issue. In that case, Lord Hailsham resolved the question of the source of interest by applying a multifactorial test.

Although the test is not one that can be distilled into a convenient set of definitive factors, the Upper Tribunal identified nine that were relevant:

- residence of the debtor;
- residence of the original guarantor;
- location of the security originally provided;
- ultimate or substantive source of discharge of the debtor's obligation;
- residence of the creditor;
- place where credit was advanced;
- place of payment of the interest;
- jurisdiction in which proceedings might be brought to enforce the interest obligation; and
- proper law of the contract.

Subject to more general comments by the tribunal on the absence of a hierarchy of materiality, the tribunal also implicitly acknowledged that not all of these factors carried equal weight, with the final five listed above usually carrying less than the others.

For completeness, the tribunal made clear that the legal situs of the debt was not relevant in determining the source of interest for purposes of withholding tax, a position consistent with ITA 2007, s 874(6A), which applies to any payment of interest made on or after 17 July 2013.

Applying the multi-factorial test to *Perrin* and *Ardmore Construction*, the Upper Tribunal dismissed both appeals, finding no material error of law in the decisions of the First-tier Tribunal.

## Multi-factorial test prevails

The question of whether interest has a UK source has generated limited case law over the years. As such, this trio of decisions from both tribunals on the subject are welcome. The Upper Tribunal's decision in particular establishes beyond doubt the primacy of Lord Hailsham's multi-factorial test when determining the source of interest and is commendable for its clarity and the consistency of its approach with the judgment in *National Bank of Greece*.

Although the Upper Tribunal's decision is largely in line with HMRC's *Savings and Investment Manual* (SAIM9090), it is not a complete vindication of the Revenue's approach.

SAIM9090 represents HMRC's published guidance on when the obligation to deduct tax from UK-sourced interest arises. It states that whether tax should be deducted from interest paid on an overseas loan depends on all the facts and on exactly how the transactions are carried out. Also, it provides a list of factors that should be considered in deciding whether interest has a UK source.

Of these factors, which are derived from *National Bank of Greece*, SAIM9090 lists 'the residence of the debtor and the location of his/her assets' as being the most important. HMRC justifies this hierarchy on the basis that, along with the location of the debtor's assets, the residence of the debtor will influence where the creditor will sue for payment of the interest and repayment of the loan. Under SAIM9090, 'residence' is not confined to tax residence, but extends to residence of the debtor for the purposes of jurisdiction.

The Upper Tribunal disagreed with this approach. It argued that no support can be found from *National Bank of Greece* for a link between jurisdiction and residence. Instead, that case stands for the proposition that the residence of the debtor is a factor regardless of whether that place is the jurisdiction in which the parties may bring proceedings.

The tribunal put beyond doubt that residence is only one factor, whether considered in isolation or when combined with the question of the location of the debtor's assets, in determining the source of interest. Residence cannot be elevated into the most important factor.

In the tribunal's opinion, the question of the source of interest is multi-factorial, requiring consideration of all of the relevant factors and circumstances. Critically, the tribunal made clear that *National Bank of Greece* did not determine any hierarchy of materiality or weight *vis à vis* all the relevant factors. Therefore, none can or should be inferred.

### HMRC's response?

It remains to be seen whether HMRC will revise its guidance in SAIM9090 as a result of the Upper Tribunal's remarks on the absence of a hierarchy of relevant factors when determining the source of interest.

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