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Hargreaves Property: What Does the Latest Decision Mean for UK Withholding Tax?

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By **Adam Blakemore**
Partner | Tax

In many respects, the Upper Tribunal's decision in *Hargreaves Property* [1] will not have surprised tax practitioners as the decision reaffirms best practice considerations around a number of fundamental concepts in relation to UK withholding tax. However, the decision also raises questions concerning the interpretation of the UK's statutory withholding tax exemptions.

Facts

The case concerned a UK tax resident company, which was the ultimate parent company of a UK property group (Hargreaves Property Holdings Ltd ("Hargreaves")). Hargreaves had received financing from connected overseas lenders. Following tax planning advice, the terms of the loans were amended so that: (i) the loans were repayable on 30 days' notice by the lender or any time by the appellant; (ii) all payments were made in Gibraltar from a source outside the UK; (iii) no assets in the UK were secured; and (iv) Gibraltar or Jersey was the governing law and the courts of Gibraltar or Jersey had exclusive jurisdiction.

Shortly before the interest was paid by the borrower, the lender also assigned for consideration its right to interest to a third party. Initially, the third party was a Guernsey company ("Storrier") or Guernsey trusts. In later years, the loans were assigned to a UK resident company ("Houmet"). The consideration for the assignment was an amount equal to almost all of the interest which Houmet received.

Together, these changes were made with the intention of ensuring that the interest was:

- in the case of interest paid to the Houmet, regarded as being paid within the statutory exemption under the Income Tax Act 2007 ("ITA 2007"), section 933 (*i.e.* interest paid to UK resident companies) and specifically that Houmet was "beneficially entitled" to the interest;
- in the case of interest paid to Storrier, protected by the UK-Guernsey double tax treaty;
- not regarded as "yearly interest"; and
- not regarded as having a UK source.

The Upper Tribunal's decisions on each of these issues are considered below.

Beneficially Entitled

Under section 933 ITA 2007, interest paid to a UK resident company that is "beneficially entitled" to such interest may be exempt from the obligation to withhold on account of UK income tax.

Hargreaves contended that Houmet was "beneficially entitled" to the interest for the purposes of section 933 ITA 2007, notwithstanding that Houmet had an obligation to pay an almost similar amount to Storrier as consideration for the assignment of the loans.

Hargreaves argued that "beneficial entitlement" should be interpreted in accordance with its ordinary English law meaning as given by Evans-Lombe J in *Indofood* [2], and specifically that a contractual obligation to pay income on to

a third party should not preclude beneficial ownership (this being the case even though both parties and the First-tier Tribunal ("FTT") recognised that the definition adopted by Evans-Lombe J was not upheld on appeal [3]).

The Upper Tribunal considered that the words should be construed "in their statutory context and with regard to their purpose" and went on to consider that Houmet should not be regarded as beneficially entitled to the interest given its lack of business purpose in the transaction. The Upper Tribunal went on to hold that the exception at section 933 ITA 2007 is "for the benefit of 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." This interpretation raises questions as to whether this has narrowed the scope of the UK's domestic statutory exemptions and imported an interpretation that is more consistent with the "international fiscal meaning" that was found in Indofood.

Double Tax Treaty

Hargreaves argued that notwithstanding that the UK-Guernsey double tax treaty did not contain an interest article, the business profits article exempted the interest paid by Hargreaves to Storrier from the obligation to withhold on account of UK income tax. In any event, HMRC contended that two procedural requirements needed to be satisfied, in order for the UK-Guernsey double tax treaty to be relied upon, were not met. Firstly, that Storrier, as the recipient of the interest, did not make any claim for relief, and secondly that Hargreaves, as the payer of the interest, was not issued with a statutory notice for payments to be made gross. The Upper Tribunal upheld the decision of the FTT that both a claim for relief and corresponding direction from HMRC must be issued in order for the benefits of the business profits article of the UK-Guernsey double tax treaty to be relied upon.

Whilst the completion of procedural formalities in order to enable reliance on the interest articles of the UK's double tax treaties (such as under HMRC's double tax treaty passport scheme) is a familiar process, *Hargreaves Property* serves as a salient reminder that the obligation to comply with certain procedural formalities can extend to other articles of the UK's double tax treaties.

Yearly Interest

The obligation to withhold on account of UK income tax applies where, amongst other things, the interest is regarded as "yearly interest." A number of loans received by Hargreaves were advanced and repaid within a year. The FTT gave consideration to the fact that the loans were unsecured, and repaid on a regular basis within, or very shortly after, a year from the initial advance. The Upper Tribunal agreed with the FTT's decision that the loans were intended to form part of Hargreaves' longer-term financing arrangements when considered from "a business-like rather than a dry legal assessment of its likely duration." [4] Accordingly, the Upper Tribunal held that the interest was "yearly interest" in respect of which an obligation to withhold on account of UK income tax could arise.

This aspect of *Hargreaves Property* reiterates that structuring longer-term financing arrangements as a series of shorter-term loans is ineffective in avoiding the obligation to withhold on account of UK income tax.

UK Source

Another fundamental requirement which must be satisfied in order for an obligation to withhold on account of UK income tax is that the interest "arises in the UK" – that is, whether the interest has a UK source. Here it was held that the interest had a UK source given that Hargreaves was a UK resident company and carried on its business exclusively in the UK, notwithstanding the changes that had been made to the terms of the loan relating to where the payments were made from, the governing law and jurisdiction for enforcement proceedings each being outside the UK.

Given the Court of Appeal's decision in *Ardmore* [5], the decision of the Upper Tribunal in *Hargreaves Property* was also unsurprising on this ground.

Final Thoughts

Whilst the Upper Tribunal's decision in *Hargreaves Property* has reaffirmed best practice considerations when dealing with a number of questions relating to UK withholding tax, the reasoning for the decision relating to the issue of "beneficial entitlement" will require more careful consideration, particularly in the context of intragroup financing arrangements and given that permission to appeal has been refused.

[1] *Hargreaves Property Holdings Limited v HMRC* [2023] UKUT 120 (TCC)

[2] *Indofood International Finance v JP Morgan* [2005] EWHC 2103 (Ch).

[3] [2006] EWCA Civ 158.

[4] *Lindley LJ in Goslings and Sharpe v Blake (Surveyor of Taxes)* (1889) 23 QBD 324, 23.

[5] *Ardmore Construction v HMRC* [2018] EWCA Civ 1438.