United Kingdom

Upper Tax Tribunal Confirms Obligation to Withhold Tax from Interest Paid to Non-Resident Company

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The UK's Upper Tribunal has published its decision in Hargreaves Property Holdings Limited v. HMRC [2023] UKUT 00120 (TCC), ruling that a UK tax resident company should have withheld tax from interest paid to a non-resident company based in Guernsey.

(a) Facts. A UK property group of companies financed its activities with loans from different lenders. The loans were changed so that the loan interest was paid from a non-UK source and the rights to the loans and interest on them were assigned for consideration to a Guernsey company or to Guernsey trusts. The interest and the loans were repaid using sums advanced by the lender which was paid for by the funds received from the assignment of them. The cycles of assignment, repayment and re-advance were repeated. In later years some payments were made to a UK resident company.

The UK's tax authority, His Majesty's Revenue and Customs (HMRC) considered that the parent company, Hargreaves Property Holdings Ltd, should have withheld income tax (about GBP 2.79 million) under section 874 of the Income Tax Act 2007 (ITA 2007). This had not been done and therefore tax assessments were issued. The company lost its appeal before the First-tier Tax Tribunal and appealed to the Upper Tribunal.

(b) Issue. Section 874 notes that a person must deduct income tax at the basic rate from yearly interest if, among other things, this is paid "by any person to another person whose usual place of abode is outside the United Kingdom".

The company had four grounds of appeal:

1. The interest payments to the UK tax resident company in later years were within the statutory exception to the withholding tax obligation in section 933 of the ITA 2007.
2. Payments to the Guernsey company were protected by the double taxation agreement with the United Kingdom.
3. Some of the loans were for less than a year so the interest was not "yearly interest" and thus not caught by section 874.
4. The source of the interest was outside the UK so did not arise in the United Kingdom under section 874.

(c) Decision. The Upper Tribunal considered the above four points and decided as follows:

1. Although interest was paid to a UK resident company, it was obliged to make payments to a non-resident company for the assignment of the loan. It was therefore only beneficially entitled to any excess payment over that obligation.

2. There was no protection under the double taxation agreement, particularly as no claim had been made and no ruling had been issued by HMRC that interest could be paid without deduction.
3. Although some loans were for less than a year, they were part of a series of loans in similar terms and with the same lender and were thus "yearly interest".
4. Following the decision of the Court of Appeal in *Ardmore Construction v. HMRC* [2018] EWCA Civ 1438, the Upper Tribunal held that the interest payments were funded out of assets situated in and profits of activities conducted in the United Kingdom.

Accordingly, the Upper Tribunal dismissed the company's appeal and held that tax was payable.
