Q&A

Court of Appeal in *Hargreaves Property Holdings Ltd v Revenue & Customs.*

Author details

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The Court of Appeal (CA) has dismissed the taxpayer's appeal in *Hargreaves Property Holdings Ltd v Revenue and Customs* [2024] EWCA Civ 365, agreeing with the First-tier Tribunal (FTT) and the Upper Tribunal (UT) that the company should have withheld UK income tax from interest payments on loans from overseas lenders.

Why wouldn't tax have needed to be withheld?

The company originally put forward several reasons why the UK's withholding tax (WHT) rules didn't apply, but by the time the case reached the CA these had been narrowed down to saying that this was because the payments were not 'yearly interest' and/or a UK resident company was 'beneficially entitled' to the interest.

But weren't the lenders overseas?

Yes, but following tax planning advice various arrangements had been put in place for the periodic refinancing of the loans. In many cases, these involved the right to accrued interest being assigned to a UK resident company shortly before being settled. The company argued that this meant the statutory exemption from the WHT rules for interest payments to which a UK resident company is 'beneficially entitled' applied.

The CA (like the FTT and UT) disagreed, holding that the facts of the case fell outside the scope of the exemption, construed purposively.

So the problem was that this was tax planning?

Not exactly. There was no suggestion a 'motive test' could be read into the statutory wording, although the CA did not think that Parliament could be taken to have intended that the exemption extend to a company whose involvement was entirely tax-motivated and not only lacked any commercial purpose but had no practical or real effect.

The CA therefore read the phrase 'beneficially entitled' as requiring the recipient to have an entitlement which carried at least some of the benefits that might derive from the right to receive interest.

The company's fundamental difficulty here was that the tax planning context and lack of any real evidence to the contrary had caused the FTT to find that there was no business purpose to the UK payee's involvement, which the CA described as 'ephemeral'.

The CA noted that there was no evidence to suggest it could benefit from the funds it received or was exposed to any (upside or downside) risk in relation to these, and that it was unknown whether its obligation to pay for the interest was simply dependent on its receipt or if it derived any meaningful profit from its participation.

What does that mean for other taxpayers?

Good question. This exemption is widely relied on in practice. Even in wholly commercial arrangements it is not uncommon for a UK company receiving interest to have related costs which will reduce (potentially substantially) the net income on which it is taxed.

The impact of this case in these scenarios has been an area of focus – and of some concern - following a suggestion by the UT that the exemption may not apply in situations where in substance the interest received by the UK resident company is paid on to an overseas entity.

Helpfully, the CA, adopting a slightly more nuanced view of the role of the exemption within the broader WHT regime, has distanced itself from this suggestion, making clear that the fact that expenses may offset some or all of the income will not by itself prevent the exemption applying. What matters is that the entitlement to the interest is an entitlement with benefits.

For example...?

The CA briefly considered two other cases (*Khan v HMRC* [2021] EWCA Civ 624 and *Good v HMRC* [2023] EWCA Civ 114) involving individuals receiving payments used to settle corresponding liabilities.

Although the CA saw these cases as having little direct relevance (as concerned with a different statutory test), it did note in passing that both recipients obtained 'real benefits' because they had thereby been enabled to meet their liabilities. (As noted above, there was no evidence that the recipient in the present case was obliged to pay for the interest if not received.)

What about the 'yearly interest' point?

The requirement to deduct tax only applies to 'yearly interest', but as the company pointed out, the loans in this case were repayable on demand and in some cases were repaid in less than a year.

The CA quickly rejected this argument, noting that it was long-established that what mattered in this context was a business-like rather than dry legal assessment. Here there was a pattern under which loans were routinely replaced by a further loan from the same lender in the same or a larger amount and that enquiries made of lenders as to whether they wished to carry on lending were mere formalities. On a business-like assessment, the loans could not be viewed in isolation as short-term advances, even in the cases where these did in fact last less than a year.

The CA's agreement with the FTT and UT that it was insufficient to focus narrowly on the terms of the loans was hardly surprising but is nonetheless a helpful reminder of the correct approach.