

# UK Tax Round Up

June 2023

**Welcome to June's edition of our UK Tax Round Up. Several interesting cases have been reported this month, including a range of issues relevant to UK withholding tax on interest being considered in *Hargreaves*. HMRC has also launched two noteworthy consultations, one on the UK's permanent establishment and transfer pricing rules and another looking at SAYE and SIP share schemes.**

## UK Case Law Developments

### Gross up clause applies by reference to tax actually paid

In *Davies v Novatrust*, the High Court (HC) found that the tax gross up provision in a pension contract operated by reference to the tax actually paid and not by reference to the tax payable in principle payable.

Mr Davies claimed against Novatrust, his pension administrator, for failure to correctly apply the tax gross up to his pension payments as required by his pension agreement. The agreement provided that Novatrust would make pension payments to Mr Davies so that "after deduction of tax levied at the highest rate applicable" Mr Davies would be left with an agreed net amount. The agreement did not explicitly state what the "highest rate applicable" was, how the gross up payment was to be calculated or that Mr Davies was required to provide any supporting information to Novatrust.

Mr Davies argued that he should be grossed up by reference to the highest marginal rate of income tax payable in the UK, regardless of the actual effective rate of income tax on his pension payments.

Novatrust's position was that the gross up was not intended to provide Mr Davies with a windfall and so it should apply by reference to the tax actually payable. Novatrust also argued that it was implied that Mr Davies would provide information to enable Novatrust to determine the applicable gross up required, which Mr Davies had refused to do.

Not surprisingly, the HC found in favour of Novatrust on both points on the basis that the intention of the gross up was clearly to make Mr Davies whole and no more and the implied requirement to provide Novatrust with sufficient information was necessary for the gross up to operate as intended and for Novatrust to be in a position to calculate the gross up payment required.

While the actual effect of gross up clauses will depend on their terms and context, this case does serve as a helpful reminder that, depending on the facts, it may be appropriate to include specific drafting setting out in some detail exactly how a gross up payment is to be calculated to give certainty to each party and to state what information might be required by the payer to allow to it confirm that it is making the correct payment.

## **Interest subject to UK withholding tax as UK source and yearly interest**

In *Hargreaves v HMRC*, the Upper Tribunal (UT) has dismissed the borrower's appeal against the decision of the First-tier Tribunal (FTT) that interest payments paid by the borrower were subject to UK withholding tax (WHT). Our [November 2021 Round Up](#) summarises the facts of the case and the FTT's decision.

In short, a UK resident company borrowed sums from two Gibraltar resident family trusts under a Gibraltar law loan agreement. The UK borrower's main source of income used to fund its interest payments under the loans was from its UK properties. Just less than annually, each existing loan would be repaid using a new loan and the interest receivable under the existing loan would be assigned by the Gibraltar trusts to either a Guernsey company or a UK company for consideration so that the interest was actually paid to the Guernsey or UK company and the Guernsey or UK company made a (virtually) matching payment to the Gibraltar trust.

These arrangements were implemented by Hargreaves with a view to ensuring that WHT was not payable on the loan interest on the basis that (i) the interest was “short” rather than “yearly” so that WHT did not apply to the interest payments (since WHT only applies to yearly interest) and/or (ii) the interest was not UK source and/or (iii) in the case of interest assigned to the Guernsey company, the UK/Guernsey double tax treaty (the DTT) provided for an exemption from UK tax for “business income” notwithstanding that the borrower had not received gross payment directions from HMRC in respect of the interest payments and/or (iv) in the case of interest assigned to the UK company, the exemption from WHT on payments to UK resident companies applied.

The UT held against Hargreaves on all counts.

In relation to (i), the UT agreed with the FTT that, in determining whether the interest on each loan was “yearly”, the wider arrangements between borrower and lender which had the intention of providing long term financing to the borrower had to be considered and it was not the correct approach to view each loan in isolation. On this basis, the UT viewed the interest under the loans as long term and so, “yearly” rather than “short”. While the meaning of “yearly” interest has been debated by UK courts for more than 100 years, the decision reached by the UT in this case is hardly surprising given the repetitive advance and repayment of the loans on a near annual basis.

In relation to (ii), the UT held that, applying the multifactorial test discussed in the *Ardmore* case, the interest was UK source. In particular, the UT agreed with the FTT that the UK residence of the borrower and its source of funding for its interest payments being receipts from UK real estate were (much) more significant than the jurisdiction of the lenders and the Gibraltar governing law and exclusive jurisdiction clauses in the loans that Hargreaves sought to rely on. Given how rarely the courts have considered the question of “source”, the consistent application by the FTT and UT of the *Ardmore* principles (including, in particular, the relative weighting of the relevant factors) provides taxpayers with greater certainty in this area, noting that the UK source indicators in this case were clear.

In relation to (iii), the UT held that the DTT could not be relied on as a basis for exemption from WHT in this case. The FTT had held that the DTT could, in principle, apply to interest payments (notwithstanding the absence of a specific article dealing with interest in the DTT at the relevant time) through the business profits article in the DTT but that, as a procedural matter, a claim for relief from WHT would need to be made by the person entitled to the interest and a direction from HMRC authorising gross payment would need to be received by the borrower, neither of which happened in this case given the very short period between the assignment of the interest to the Guernsey company and its payment. The UT agreed with this on the basis that the exemption from WHT under the DTT was a “relief” from UK tax for the Guernsey company recipient rather than a provision for determining the income attributable to the Guernsey company (the former requiring a claim for relief to be made and the latter not).

In relation to (iv), the UT agreed with the FTT that the purposive construction required to be applied to UK statutory provisions following the *Ramsay* principle should be applied to the entire sequence of transactions under the arrangements and the question of whether the UK company assignees were “beneficially entitled” to the interest payments. On this basis, and giving due consideration to the purpose of the exemption from WHT for interest paid to a UK company, the UT held that the UK company could not be considered the beneficial owner of the interest for the purposes of the relevant UK statutory provisions where it had recently been assigned the interest for consideration equal to the interest that it would receive. Accordingly, the UK corporate exemption from WHT did not apply.

Although the decision reached by the UT on this point might be regarded by taxpayers as opening up a much broader range of circumstances when the UK corporate exemption from WHT does not apply, it is clear from the decision that it is the wider commercial and practical reality of the facts that need to be considered when seeking to determine who is “beneficially entitled” to a payment of interest.

### **Inability to evidence deductibility criteria leads to denial**

In *Swiss Centre Ltd v HMRC*, the FTT found that payments made to an Irish government agency were not deductible for UK corporation tax purposes as either loan relationship debits or amount paid to enhance the value of a property that was sold. In a lengthy judgement turning heavily on the specific facts, the FTT found in favour of HMRC in respect of deductibility arguments under both the loan relationship rules and chargeable gains rules. Leaving aside the complicated fact pattern and technical analysis, the particular significance of the case to taxpayers might be the more practical takeaway that the claimant's position in the case was significantly hampered by a combination of the complexity of the entities and individuals involved with the taxpayer group and a lack of clearly documented evidence in its favour.

Swiss Centre Limited (SCL) was part of a group of companies referred to in the judgement as the 'MAR Connection', a property investment and development business. SCL owned the Swiss Centre in London and the MAR Connection held many other properties across the UK and Ireland. The MAR Connection group companies, including SCL, entered into a number of complex intragroup financing and guarantee arrangements.

The MAR Connection group was heavily leveraged and, following the 2008 recession, had a number of materially underwater loans. The Irish National Asset Management Agency (NAMA) subsequently acquired a substantial portion of the MAR Connection's Irish bank debt.

The MAR Connection and NAMA agreed that, following the sale of the Swiss Centre, SCL would make a payment to NAMA in respect of some of the debt acquired by NAMA and would then be released from the remainder of its debt and certain other MAR Connection group companies would be released from debts guaranteed by SCL.

SCL argued that the aggregate amount of these payments was deductible, either under the loan relationship rules or in calculating the chargeable gain realised on the sale of the Swiss Centre.

Due largely to the complex interdependency of the arrangements between the MAR Connection group companies, the two individuals who controlled the group and certain trust arrangements that they had entered into, the FTT found in favour of HMRC on both of these arguments and, accordingly, no deduction was allowed.

Of interest, however, is the manner in which the complex interaction of SCL's involvement in the arrangements with both its own business and the activities of the wider MAR Connection group, the fact that a number of the intragroup transactions were undocumented and that often there were no board minutes or other corporate authorisation documents evidencing SCL's decision making processes or intentions undermined SCL's ability to convince the FTT that the payments were either deductible as expenses of its loan relationships or related transactions or "wholly and exclusively" for the purpose of enhancing the value of the Swiss Centre.

While it seems unlikely, given the overall facts, that the FTT would have been persuaded by SCL's arguments irrespective of the evidence available, the case is a reminder to taxpayers of the importance of contemporaneous record keeping, including both corporate governance documents and transaction documents which set out clearly the nature of the relevant transactions and the commercial reasons behind them.

## **Other UK Tax Developments**

### **Finance Bill 2024**

HM Treasury has announced that draft legislation for Finance Bill 2024 will be published on 18 July 2023. We will report on the proposals once they are available.

### **Annual employment related security (ERS) return deadline 6 July**

Online ERS returns must be submitted online to HMRC by 6 July in respect of the 2022-23 tax year.

An ERS return requires disclosure of certain acquisitions of shares, grants of options, carried interest and coinvestment interests and certain other events and transactions by employees and directors that occurred in the prior tax year. In certain cases an ERS return must be submitted even when no relevant events and transactions have occurred. Penalties apply in the event of a failure to comply.

### **HMRC announces increase in interest rates**

As a result of the Bank of England's decision to increase the base rate to 5%, HMRC has announced that its late payment interest rate will increase to 7.5% and that its repayment interest rate will increase to 4% from 11 July 2023.

HMRC consultation on permanent establishments and transfer pricing (and other matters)

HMRC has launched a wide-ranging [consultation](#) to seek views on simplifying and clarifying existing UK tax rules regarding certain cross-border arrangements involving the UK.

In particular, HMRC is considering whether to more closely align UK permanent establishment and UK transfer pricing rules with OECD Model principles.

Under current UK law, a non-UK business carrying on a trade in the UK through a dependent agent will cause the non-UK business to have a UK permanent establishment and be subject to UK corporation tax on its profits attributable to that permanent establishment, with a dependent agent being an agent that is authorised to do business on the company's behalf in the UK and which habitually exercises that authority. Aligning UK legislation with OECD Model principles would broaden the UK dependent agent test to additionally include agents who habitually agree contracts which are entered into without modification (even if the agent doesn't actually execute the contract itself), potentially bringing more non-UK businesses into the scope of UK corporation tax. This could, for instance, be significant for private funds with a non-UK general partner or manager and a UK investment advisor depending on how involved the investment advisor was with negotiating relevant contracts for the fund.

An important and related point is that the consultation states that the investment manager exemption (IME), which treats UK investment managers as being agents of independent status where the requirements of the IME are satisfied, should be retained and any inadvertent impact of the proposed changes to the UK permanent establishment rules on investment fund managers that rely on the IME should be taken into account so that the IME continues to achieve its intended purpose.

In relation to transfer pricing, HMRC is considering more closely aligning the UK rules which assess whether a transaction is “arm’s length” with the OECD Model transfer pricing terms. The current UK rules look narrowly at whether the “provision” (i.e. contractual relationship) under a particular arrangement between connected parties is arm’s length, whereas the OECD Model looks at the commercial and financial relations between the entities more generally. This would not be expected to amount to a fundamental change to the UK’s transfer pricing rules, and whether it would increase or decrease the deemed UK taxable profits under any arrangements would depend entirely on the facts.

Also of note is that HMRC is looking at simplifying the rules for determining whether two entities are connected for transfer pricing purposes (and therefore within the scope of the rules) and considering whether to exclude all UK to UK transactions from the scope of transfer pricing other than where a non-arm’s length transaction gives rise to an overall reduction in tax (for example, because the relevant contract parties pay different rates of tax). The UK to UK transfer pricing rules were introduced in order to comply with EU rules and their repeal would be a welcome simplification.

The deadline for responses to the consultation is 14 August 2023.

## **HMRC consultation on SAYE and SIP share schemes**

HMRC has launched a consultation to seek views on the UK’s two all employee tax advantaged share schemes, the Save As You Earn (SAYE) and Share Incentive Plan (SIP) schemes.

SAYE is a savings share scheme under which employees can save up to £500 a month over a three or five year period with the savings used to buy shares at a discount of up to 20% to market value without triggering income tax or national insurance liabilities.

SIP is a share scheme which allows participating employees to be given and/or purchase certain shares which, if held in trust for five years or disposed of earlier in certain specified circumstances, will not be subject to income tax or national insurance liabilities and will be exempt from capital gains on sale.

The purpose of the consultation is to explore reasons for the limited and, if anything, waning use of the SAYE and SIP schemes by UK businesses with a view to ensuring these regimes do not have specific and/or unnecessary deterrents to adoption.



The deadline for responses to the consultation is 25 August 2023.

## Other Tax Developments

### DAC 8: EU agrees approach on cryptoasset reporting

The Council of the European Union has agreed on an approach to bring cryptoasset transactions within the scope of the Directive on Administrative Co-operation (DAC), to be known as DAC 8.

The DAC sets out automatic exchange of information requirements in the EU. Many of our clients will be particularly aware of the so-called DAC 6 rules, which require reporting of potentially aggressive cross border tax arrangements and which are less relevant in the UK (but not in EU jurisdictions) as a result of Brexit.

In response to a perception that tax authorities have insufficient information to ensure that taxes are properly collected on cryptoasset transactions, the proposed DAC 8 rules would require all service providers (including those not located within the EU, so including the UK) to report on certain cryptoasset transactions (including certain transactions involving non fungible tokens) carried out by their EU resident clients. Unlike DAC 6, which applies only to cross border transactions, the reporting obligation would cover both cross border and domestic transactions.

The DAC 8 proposal would need to be approved by all EU member states to be passed and, if it were, it would not come into force until 2026 at the earliest.

#### [Related Professionals](#)

---

- **Stephen Pevsner**  
Partner
- **Robert Gaut**  
Partner
- **Richard Miller**  
Partner
- **Catherine Sear**  
Partner
- **Frazer Money**

Partner