



TC03363

Appeal number: TC/2012/08902

*Income Tax – deduction of tax on payment of interest arising in the UK –
s874 ITA.*

**FIRST-TIER TRIBUNAL
TAX CHAMBER**

ANDREW COLIN PERRIN

Appellant

- and -

**THE COMMISSIONERS FOR HER MAJESTY'S Respondents
REVENUE & CUSTOMS**

TRIBUNAL: JUDGE CHARLES HELLIER

Sitting in public at 45 Bedford Square WC1B on 11 and 12 December 2013

**Patrick Way QC and Michael Firth instructed by Blackstar (Europe) Ltd for the
Appellant**

**Richard Vallat, instructed by the General Counsel and Solicitor to HM Revenue
and Customs, for the Respondents**

DECISION

1. Section 874 Income Tax Act 2007 ("ITA") provides:

5 "(1) This section applies if a payment of yearly interest arising in the UK is made

 ... (d) by any person to another person whose usual place of abode is outside the United Kingdom.

 (2) The person by or through whom the payment is made must, on making the
10 payment, deduct from it a sum representing income tax on it at the basic rate in force for the tax year in which it is made ..."

2. The issue in this appeal is whether interest paid by Mr Perrin to an Isle of Man recipient arose in the UK. HMRC say it did and that Mr Perrin should have deducted tax on making payment under section 874; Mr Perrin says that it arose in the Isle of
15 Man and that tax was not deductible.

The facts

3. There was no dispute about the facts.

4. Mr Perrin lives in Essex with his wife and family. It is not disputed that he was resident and domiciled in the UK. He is the managing director of Hemisphere Freight
20 Services Ltd ("Hemisphere"), a UK resident company which provides logistics services across the world, and which, in addition to its UK presence has a team in Hong Kong and China. He has a controlling interest in Hemisphere¹. Mr and Mrs Perrin own premises used by the company.

5. In October 2009 Hemisphere made contributions to an Employer Funded Retirement Benefit Scheme (an "EFRBS"). That EFRBS in turn made a transfer of funds to a second EFRBS ("EFRBS 2"), whose principal beneficiary was Mr Perrin, and whose trustee was Blackstar (Isle of Man) Ltd, a company incorporated and resident in the Isle of Man.
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6. On 5 November 2009 Mr Perrin and Blackstar as trustee of EFRBS 2 entered into a loan agreement (which I shall describe later) under which the trustee lent Mr Perrin £198,000 on 5 November 2009, making payment from its Isle of Man bank account to an Isle of Man bank account of Mr Perrin.
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7. Further loans were made to Mr Perrin by the trustee on 11 November 2009, 22 June 2010 and 6 October 2010. I was not shown the loan agreements for these loans

¹ Mr Perrin told me that he was the sole shareholder of Hemisphere; in their skeleton argument HMRC say that he was the majority shareholder in Perrin Group Holdings, a UK resident company, which was the parent of Hemisphere. Nothing turns on the difference: Mr Perrin had a substantial interest of some sort in Hemisphere.

but understood that they were in similar terms to that for the first loan, and that the moneys paid under them were paid between the same accounts.

8. In all Mr Perrin borrowed some £650,000 from EFRBS2. Most of that money Mr Perrin lent to Hemisphere interest free, but he invested about £150,000 in stocks and shares and retained about £81,000 in his Isle of Man bank account. That sum was sufficient to pay interest on the borrowing for a few years.

The terms of the loan agreement.

9. The loan was not guaranteed by anyone.
10. The loan agreement provided:
- 10 (1) that the loan was to be unsecured;
- (2) interest was payable at 4.75% annually in arrears
- (3) that repayment should be made on 4 November 2014, the day before the fifth anniversary of the making of the loan;
- 15 (4) that repayment (or prepayments) should be made to a bank account specified. Unfortunately the details of the bank account were not specified in the agreement;
- (5) that no variation of the agreement would be effective unless in writing and signed;
- 20 (6) that the agreement would be "governed by and construed in accordance with the laws of the Isle of Man" (clause 10.1); and
- (7) that the parties "irrevocably submit to the jurisdiction of the Courts of the Isle of Man for the settlement of all disputes or claims" in connection with the agreement (clause 10.2).

Interest Payments

- 25 11. Mr Perrin paid interest of £2796.26 in January 2010, and of £23,403.18 on 11 February 2011. Each of these payments was made from his Isle of Man bank account to an Isle of Man bank account of the trustee.

- 30 12. Mr Perrin left £81,000 in his Isle of Man bank account. After the 11 February payment of interest there was some £56,000 left. This, if left in the account would have been enough to pay the interest on £650,000 for about the next 23 months – so that, for the period from January 2013 to 4 November 2014 (the repayment date) some other source for the payment of interest (and for the repayment of principal) would have been required. However the account shows other withdrawals in February and March 2011 which meant that interest for later periods would have to have been
- 35 funded from other accounts.

13. I was not told what plans Mr Perrin had for the eventual repayment of the loan, but apart from the Isle of Man bank account and his interest in EFRBS 2, Mr Perrin's assets and sources of income were almost wholly to be found in the UK.

14. The rules of EFRBS 2 provided that benefits became payable to Mr Perrin on retirement from Hemisphere after he attained an age over 50. He was born in 1967 and so would attain 50 in 2017, although there was an indication that his retirement date had been specified as 15 May 2032. Both dates fall after the repayment date for the loan. If Mr Perrin died before retirement, the trust deed provided that the trustee would realise the trust assets and apply the trust fund for the benefits of named beneficiaries. The named beneficiaries included Mr Perrin's wife and family and also his personal representatives. The trust deed permitted Mr Perrin to express a wish as to who should benefit on his death. There was no document before me in which he had expressed such a wish in relation to EFRBS 2, but there was a letter to the trustees of EFRBS 1 requesting that if he died before retirement all the fund should go to his wife. I think it likely that there was a letter in the same terms to the trustees of EFRBS 2.

15. Whilst it was possible that the trustees might make new loans to Mr Perrin as the original loans fell due, and also loans to cover interest payments, and that this process might continue until his eventual retirement, it seemed to me that if the trustees sought to enforce the payment of interest or capital, having obtained judgment in the Isle of Man, the principal place of enforcement would have been England, and that if Mr Perrin died, England would be the place where the trustees "realised" their right to interest before appointing the fund to any named beneficiary.

16. Thus it seemed to me that it is likely that it would have been contemplated that funds for the payment of interest and capital would come principally from Mr Perrin's UK assets.

The Appeal

17. Tax which should be deducted under section 874 is assessable on the payer under section 963 ITA. On 14 March 2012 HMRC assessed Mr Perrin for the income tax they say he should have deducted in making the payments of interest. Mr Perrin appeals against those assessments.

18. In the remainder of this decision I discuss some details of the statutory provisions and then consider issues relating to the situs of a debt before turning to the cases on where income arises.

The Legislation

19. I have already set out subsections (1) and (2) of section 874. Subsection (3) of that section makes it subject to sections 875 to 888, and among those sections, section 884 provides that:

"The duty to deduct ... under section 874 does not apply to a payment of interest which is chargeable to income tax as relevant foreign income."

20. "Relevant foreign income" is, by section 884(2) and 989, given the meaning in section 830(1) to (3) ITTOIA 2005; and that section provides:

"(1) In this Act "relevant foreign income" means income which:

(a) arises from a source outside the United Kingdom, and

5 (b) is chargeable under any of the provisions specified in subsection (2) (or would be so chargeable if section 832 did not apply to it).

"(2) ... (e) Chapter 2 of Part 4 (interest)."

21. Section 832(1) provides:

10 "(1) This section applies to an individual's relevant foreign income [to which the remittance basis applies]

subsection (2) , as amended after 2008, is now in this form:

"(2) For any tax year in which --

(a) the individual is UK resident and

(b) any of the relevant income is remitted to the United Kingdom,

15 income tax is charged on the full amount of the relevant foreign income so remitted in that year".

22. This statutory chain poses a number of questions:

20 (1) Does the exclusion from section 874 of the relevant foreign income (that is to say income arising from a source outside the UK), mean that income arising from a source outside the UK could nevertheless be "interest arising in the UK"? In other words, is there a difference between "arising from a source in the UK" and "arising in the UK"?

25 (2) What is the effect the words in parentheses in section 830(1)(b) given that the effect of section 832 is to charge income to tax, not to remove it from the charge?

(3) What does "chargeable" to tax mean in section 884 ITA and section 830(1)(b) ITTOIA; does it mean capable of being charged to tax in appropriate circumstances, or actually giving rise to a tax liability? Is it possible that if not charged to tax it cannot be foreign source income?

30 23. The parties urged me not to worry about these problems. They were broadly in agreement that the answer to the question before me was no different whether it was "did the interest arise in the UK", or "did the interest have a UK source", and whatever muddle the legislature had got itself into in amending section 832 ITTOIA it made no difference to whether Mr Perrin should have deducted tax on his interest
35 payments.

24. Subject to one point I intend to take their advice. This point is that I see a marginal distinction between "arising in the UK" and "arising from a source in the UK" (or as the case may be outside the UK). The emphasis of the first question is:

5 *where* did it come from? And of the other: *what* did it come from? It is therefore possible that the interaction of the provisions suggests that interest which arises from a source outside the UK might nevertheless arise in the UK, and it may indicate that the situs of the debt which gives rise to the interest is not determinative of where the interest arises.

Proper Law, Jurisdiction and Enforcement

10 25. There was some discussion before me of these concepts and the way they were used in relation to the situs of a debt. It was suggested that they were not always used with precision or uniformly in all the relevant sources. I shall endeavour to use them as I describe below.

26. The proper law of contract is the law in relation to which it is to be interpreted. In the case of the loan agreement that is the law of the Isle of Man.

27. The State in which a person may be sued in order to determine the extent of his liabilities under the contract is the State with jurisdiction.

15 28. A judgement may be enforced in a State where the courts of a State permit or require the debtor's assets to be applied to satisfy the obligations decreed by that judgment (whether or not a judgment of the courts of that State).

20 29. These may not be the meanings of the words intended by the judges in some of the cases. Thus Lord Denning in the Greek Bank case (see below) said that a particular liability was "enforceable by action in the English Courts and recoverable by execution against [the debtor's] assets in England": thus using enforcement for what I would call jurisdiction, and recoverability for what I would call enforcement. But I find it helpful to view the statements they make against these concepts, although the distinctions between them may not have been important on the facts of the cases.

25 30. I was taken to Council Regulation EC No 44/2001 and the revised Lugano Convention which govern the assumption of jurisdiction (these instruments use "sue") and enforcement (which is the word used in these instruments) of judgements by the courts of States governed by, or signatories to, those instruments. For a contract of the nature of the loan the relevant articles have the effect that the Courts of the debtor's state of domicile have exclusive jurisdiction unless the parties, one of whom is domiciled in a relevant state, have agreed that the courts of that state should have jurisdiction, in which case those courts generally have exclusive jurisdiction. By those Instruments' common article 32, any judgement given by a court in the state with jurisdiction may be registered in another state and enforced in that state.

35 31. I was not shown anything which made the Isle of Man a party to, or bound by, either Instrument, and the trustee is domiciled in the Isle of Man. If the instruments do not apply, the approach of the UK courts would, in the circumstance of a clause such as 10.2 of the loan agreement, be to stay proceedings, leaving jurisdiction with the Isle of Man courts, unless it was shown to be just and proper otherwise to continue.
40 On the basis of the facts before me I believe that the UK courts would eschew jurisdiction and I assume that the Isle of Man Courts would assume it.

32. I conclude that the Isle of Man Courts would take jurisdiction over any dispute in connection with the loan agreement and that the UK courts would decline jurisdiction.

5 33. By section 9(1) of the Administration of Justice Act 1982, a judgement of the Court in the Isle of Man may be registered and enforced by the courts in the UK. Thus a judgement of the Isle of Man Courts in relation to the loan agreement would be enforceable both in the UK against Mr Perrin's assets in the UK, and in the Isle of Man against Mr Perrin's assets in the Isle of Man.

The Situs of a Debt.

10 34. There is some attraction to the proposition that since interest is payable in respect of a debt it arises from the debt and therefore arises from the place of the debt - the situs of the debt; or at any rate that the considerations relating to the determination of situs might be relevant to the determination of the place, or the location of the source, from which it arose. At this stage I turn simply to the question
15 of the situs of a debt.

35. Dicey, Morris and Collins 15th Edition states the rule thus:

"Rule 129(1) Choses in action generally are situate in the country where they are properly recoverable or can be enforced."

I note the use of "recoverable" and "enforceable" as alternatives in this passage.

20 The authors then say that the paragraphs which follow are thought to have general utility but are not always applicable. This is the first of those paragraphs:

25 "(1) Debts. Subject to the exceptions set out below, a debt is situated in the country where the debtor resides. The reason usually given is that the country of the debtor's residence is normally the place where the creditor can enforce payment."

36. The principle that choses in action are situate generally in a country where they are "properly recoverable or can be enforced" is of long standing. The authors of Dicey cite *New York Life Insurance Co v Public Trustee* [1924] 2 Ch 101 as authority for it. In that case all three judges of the Court of Appeal quoted the Rule 129(1)
30 formulation from a previous edition of *Dicey* with approval. Pollock MR said "I attach great importance to those words ... because I think they have been carefully chosen in order to indicate the effect of a number of decisions". He referred to *Attorney General v Lord Sudeley* quoting a passage ending "if, although the debtor is resident abroad, legal proceedings could be taken here which would, in law, directly
35 order and enforce the payment here of the debt, the debt is an asset [in the UK]."

37. In the same case Warrington LJ (at 114) said that the rule of law for simple contract debts was that situs was determined by the residence of the debtor at the material moment: "that has been well settled for a long time and I think the reason for that is that it is the residence of the debtor which determines the place where he can
40 be sued, prima facie at all events, and is the place where the means of satisfying any

judgement may be discovered, but whatever the reason is, there is no doubt that that is the rule." [my underlining].

38. And Atkin LJ said that the reason for choosing the residence of the debtor was because that was the place where the "creditor could, in fact, enforce payment of the debt".

39. In *Kwok Chi Leung Karl v Commissioner of Estate Duty* [1988] STC 728 (PC) Lord Oliver said:

" ... it is clearly established that a simple contract debt is locally situated where the debtor resides - the reason being that that is, prima facie, the place where he can be sued (see *New York Life Insurance Co v Public Trustee* [1924] 2 Ch 101, per Warrington LJ at 114)."

I pause here to note that Warrington LJ said more than that that was a place where "he can be sued" - see the underlined words above.

Lord Oliver then cites the general rule in relation to choses in action from Dicey and Morris which is quoted above, and continues:

"That will normally be where the debtor resides, although there are exceptions. ... in the instant case however where the instrument evidencing or creating the obligation is nonnegotiable and where it is in any event payable only on presentment abroad, there can be no reason for departing from the general rule that the chose is situate where it can be enforced and that can only be in the place where the debtor resides and can be sued."

40. Mr Firth says that Lord Oliver makes clear that it is the place which possesses jurisdiction over the contract which is the place of situs and that that is "normally" the place of the debtor's residence. Thus if the country with jurisdiction is not in fact the country of residence the normal rule does not apply and the obligation is situate in the country with jurisdiction. The country of enforcement is not relevant.

41. I agree that Lord Oliver allows that there may be exceptions to the normal rule. His language does not however suggest to me that the place of what I have called enforcement is irrelevant.

42. In *Hillside (New Media) Ltd v Baasland* [2010] EWHC 3336 (Comm) Mr Firth says that Andrew Smith J applied the same jurisdiction rule to determine the situs of Hillside's obligation as being in England:

" The general rule stated in Dicey, Morris & Collins in *The Conflict of Laws*, 14th Ed, Vol 2, Rule 120 is that "choses in action are generally situated in the country where they are properly recoverable and² enforceable". Although at common law this principle led to the general rule that (with some exceptions that are irrelevant for present purposes) debts are situate where the debtor

² Andrew Smith J refers to the 14th edition of Dicey, and quotes "and"; in the 15th edition and the 3rd edition (quoted in *New York Life*) "or" is used

resides (see Dicey, Morris & Collins, loc cit, at para 22-026), its application in a case such as this, where the debtor is a corporation and the case is covered by the Lugano Convention, depends, as I see it, upon the debtor's domicile. That is the primary ground on which the Court takes jurisdiction under article 2 of the
5 Lugano Convention. The domicile of a corporation ... depends upon where it has its seat and this in turn depends on where it was incorporated and has its registered or other official address or where its central management and control is exercised."

43. Thus, Mr Firth says that Andrew Smith J applied the jurisdiction rule to
10 determine situs, not the residence test. That, he says, demonstrates that where the residence "shortcut" does not fit with the overriding principle of jurisdiction the general rule gives way. Mr Firth seeks further support in the comments of the authors of Dicey & Morris that the rules for the determination of the situs of debts were established before the Regulation or the Lugano Convention and their suggestion that
15 effectively residence should be interpreted to take account of the Convention.

44. In none of these cases has the tension been addressed between the place of
20 expected enforcement of the debt and the place in which a court would have jurisdiction to declare the debt due. The language used by *Dicey*, "recovery" and "enforcement" was said by Pollock MR to be carefully chosen; Warrington LJ spoke of the place where the means of satisfying judgement was found, and Atkins LJ, the place of enforcement. There is to my mind in all these statements some elision of the concepts I have called jurisdiction and enforcement; and that is because, although
25 judgement must precede enforcement, the distinction was not in question in the particular cases. There is no suggestion in any of them that obtaining judgement in a particular country would not lead to the satisfaction of judgement in that country, rather the reverse.

45. In the case of Mr Perrin's debt, the "normal" residence rule coincides with the
30 reason for the rule. Mr Perrin's assets were principally in England and it would be in England that the trustee would be likely to recover and enforce the debt if the occasion arose. It seems to me that there is no reason to displace that normal rule because of the jurisdiction given to the Isle of Man Courts. I would, if it were necessary, distinguish *Hillside* on the basis that Hillside was an English company with premises and staff in England, and that no consideration of the difference between the place of jurisdiction and the place of enforcement was made or was relevant to the
35 decision. I conclude that the situs of Mr Perrin's obligations was in England.

The Authorities on "arising"

46. I shall deal with the cases to which I was referred in chronological order.

(1) *Colquhoun v Brooks* 2 TC 490 at 499

47. In this case Lord Herschell said:

"The Income Tax Acts themselves impose a territorial limit; either that from which the taxable income is derived must be situated in the United Kingdom, or the person whose income is to be taxed must be resident there."

5 48. Lord Herschell was dealing with Income Tax Acts which were considerably shorter and less prescriptive than those which now apply. But in relation to the interest income in the present appeal the definition of "relevant foreign income" in section 830 imposes the same limitation (a "source outside the UK") and the words of section 874 impose a similar one ("arising in the UK").

(2) *CIR v Viscount Broom's Executors* 19 TC 667 (1935)

10 49. Lord Broome borrowed money from Earl Kitchener. Lord Broome resided mainly in Kenya. On his death his executors who were in the UK paid interest on the debt to Earl Kitchener. Finlay J cited Lord Herschell's dictum; he considered that the situs of the debt was where the debtor was found, and was willing to assume that during Lord Broome's life the situs of the debt was abroad so that no tax was
15 deductible from the interest paid. But he held that the interest paid by the executors was "out of a source arising in this country" because (1) the executors were resident in the UK and administering the estate here, and (2) the payments were made by them in London from a bank account in London to a bank account in London or to Earl Kitchener in London. It was therefore a payment out of sources in London.

20 50. Mr Vallat says that *Broome* shows that the substantive origin of the funds for a payment is an important factor. Mr Way says that the judge's approach to situs was a little simplistic, but it was significant that he adopted a multifactorial approach: in which the place where payment was made was a relevant factor.

25 51. I am uncertain whether Finlay J's allusion to the payment from a bank account in London is to be taken as meaning that the simple act of payment through such a bank account is relevant: the context was the administration of the estate which was being carried on in London; I agree with Mr Vallat to the extent that what was relevant was that there was a real source of funds in the UK. I agree that Finlay J did not regard situs as conclusive. Finlay J's conclusion that the source of the interest
30 could change must, of course, be read as subject to the decision of the House of Lord in the Greek Bank Case.

(3) *Westminster Bank Executor and Trustee Co (Channel Islands) Limited v The National Bank of Greece SA* 46 TC 472 (1970) (the "Greek Bank Case").

35 52. A Greek bank with no UK branch issued sterling bonds secured on Greek assets with interest payable in London. Another Greek bank, with no UK branch, guaranteed the bonds. The proper law of the bonds and the guarantee was English. After the Second World War, The National Bank of Greece became the successor of the guarantor. It was resident in Greece but had a branch in London, and that branch could be compelled to honour the guarantee; although the Greek courts would not
40 allow a bondholder to sue for or recover principal and interest. The new guarantor, The National Bank of Greece, paid sums equal to the interest due. The question was whether it should deduct tax.

53. In the High Court Donaldson J held that the original bank's payments would have been outside the withholding tax provisions as they were of income arising from securities outside the UK but that the payments by the National Bank of Greece's London branch "clearly" arose in the UK.

5 54. In the Court of Appeal Lord Denning asked whether the payments were "income arising from securities outside the UK". If they were, there would be no withholding tax. He held that they were. In words foreshadowing those of Lord Hailsham, he said (page 486 D to I) that these were bearer bonds of an international character which character did not change with events. The Greek residence of the
10 debtor, the Greek security and the Greek guarantor made the interest income arising from securities outside the UK despite the fact that the payment was now only recoverable in England.

55. In the House of Lords, Lord Hailsham, who made the only speech, started with Lord Herschell's dictum and accepted that "the only question of substance ... was
15 whether or not the source of the payments ... was or was not situated within the UK ... If it were it would not be taxable ... since it would then either be a foreign security within Case IV or a foreign possession within Case V and not taxable". He then says:

"I have come to the conclusion that the source of the obligation in question was situated outside the United Kingdom. That obligation was undertaken by a
20 principal debtor who was a foreign corporation. That obligation was guaranteed by another foreign corporation which ... had no place of business within the UK. It was secured by lands and public revenue in Greece."

56. Pausing there, I note that Lord Hailsham has segued from considering the "source of the payments" to the "source of the obligation". It seems to me that he must
25 regard them as the same.

57. Continuing, he explained that although payment on the original bonds was to be made in London it would have been remitted or reimbursed from Greece. He plainly regarded this as significant. (This I think is in contrast to the later actual payments by the London branch of The National Bank of Greece which Donaldson J had held
30 "clearly" to have a UK source: there is a difference between funds merely passing through a bank account in a particular place, and funds which originate from activities or assets held in a particular place. In the latter case it can be said that the substantive origin of the funds is in that place.)

58. Having set out the contention that the payer now had a branch in London which
35 was the only place at which payment could then be made he said:

"I do not see how an obligation originally situated in Greece ... could change its location either by reason of the fact that one guarantor was substituted for another, or by reason of the fact that the second guarantor ... acquired a London
40 place of business, or by [the actions of the Greek government] ... The [holders of the bonds] acquired no obligation different from that of the original guarantor ... In my view the bond itself is a foreign document and the obligation to pay

principal and interest to which the bond gives rise were obligations whose source is to be found in this document."

59. Lord Hailsham's dismissal of the effect of changing guarantor means that the principal importance of his analysis for Mr Perrin's appeal lies in the factors which persuaded him that by reference to the original bond and guarantee, the source of the payment was situated outside the UK.

60. There was some discussion of the last sentence in the quote above from Lord Hailsham's speech in which he characterises the bond as a "foreign document". Mr Way viewed this as a revelation of another factor to be put in the balance pointing to some extent to consideration of the situs of the original debt as being relevant. Mr Vallat, noting that the bonds were bearer instruments, and therefore were situated where they were found, viewed it as a summary of Lord Hailsham's conclusions about the nature of the obligations. I agree with Mr Vallat. Lord Hailsham as I have noted regards the source of the payment as being the same as the source of the obligation; this sentence seems to me to reflect his description of the obligation - the bond - which arises from his earlier analysis.

(4) *Poldi (UK) Ltd v IRC* (25 November 1985).

61. Poldi, a UK incorporated and resident company, borrowed from a Czech bank to buy property in the UK on which the loan was secured. The Special Commissioner said that it was likely that the loan interest would be paid from Poldi's UK resources, and in relation to the provision of security in the agreement he said that:

"the very existence of the provision of security in the Agreement is significant. It indicates that [the lender] recognised that the ultimate enforcement of its rights would have to take place in England (with the assistance of the English courts): the forum provisions of [the agreement] notwithstanding".

The loan agreement also had a clause under which disputes were to be referred to arbitration in Czechoslovakia. The Special Commissioner regarded this as having small weight having regard to the fact that Poldi had no assets there against which payment could be enforced. He held that the payments had a UK source.

(5) *Commissioner of Inland Revenue v Hang Seng Bank Ltd* 1990 STC 733

62. This case concerned whether trading profits made by dealing in debt securities in markets outside Hong Kong arose or derived from Hong Kong. Lord Bridge, giving the judgement the Privy Council, said that the place in which the profit was derived was always a question of fact and that it was not possible to lay down precise rules

"but if the profit was earned by the exploitation of property assets, as by letting property, lending money or dealing in commodities or securities by buying and selling them at a profit, the profit will have arisen in or derived from the place where the property was let, the money was lent or the contracts of purchase and sale were effected".

63. Mr Vallat says that the Greek Bank Case was not considered by the Privy Council and that the case concerns trading profit. Mr Way says that just as a loan made within Hong Kong gives rise, on Lord Bridge's analysis, to interest with a Hong Kong source, interest made on a loan made by an Isle of Man trustee within the Isle of Man must have an Isle of Man source.

64. The issue before the Privy Council related to dealings in securities on overseas exchanges; Lord Bridge's statement that interest arose where the money was lent does not appear to me to be a definitive exposition of the place of the source of interest, but an analogy helping him on his way to his conclusion in relation to the dealings in the securities. In particular it does not seem to me that he is equating the place of the advance of the principal of a loan with the place of the source of the interest; once that is allowed it seems to me that the question: Where is the money lent? is effectively shorthand for: Where is the source of the obligation which gave rise to the interest?

(6) *Hafton Properties Ltd v McHugh* [1987] STC 16

65. This case was cited to me for the Special Commissioner's analysis of the source of interest. This question did not arise for consideration in the High Court.

66. The interest in question arose from a US\$ loan made to a US company and secured on a mortgage over a US property. The interest was paid out of the rental income from the property. But the interest in question was paid after the property had been transferred, subject to the mortgage, to a UK company. The Special Commissioner regarded the obligation as of an American character even if the UK company had become the debtor, and was "fortified" in that conclusion by the fact that the situs of a speciality debt such as that on a mortgage was where the mortgage deed was found.

67. Thus the Special Commissioner regarded the situs of the debt as important but not conclusive. He does not make explicit which of the features of the interest payments were more or less important in reaching the conclusion that they had an American character, but his explicit acceptance that the interest was paid for from the rents of the property and did not go through the UK (p21 g-h) suggests that the source of the funds for payment and whence payment came were not irrelevant.

Summary

68. Acknowledging my indebtedness to the Special Commissioner in *Poldi* in relation to Lord Hailsham's speech in the Greek Bank Case, I draw the following conclusions from these cases:

(1) The place of the source of interest is not determined by the general rule about the situs of debts - if it were, then, because the application of that rule would have been straightforward in that case, Lord Hailsham would have applied it without reference to other considerations;

Lord Hailsham's statement that he could not see how "an obligation originally situated in Greece...could change its location", rather than being a comment on

the situs of the debt, reflects Lord Herschell's requirement that "that from which the interest derives must be situated in the United Kingdom". That is not an express reference to situs, but the linguistic similarity between situs and situated indicate a close affinity between the concepts and that situs is – or the rules for determining situs are - relevant to determining the source of interest.

5

I discussed in paragraph [24] the difference between the statutory formulations "arising in the UK" and "arising from a source in the UK". To the extent that this suggests that the statutory focus in section 874 is on where the interest arises rather than what it arises from, it seems to me to support the conclusion that situs is not determinative.

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(2) As a result, the ascertainment of where interest arises involves the weighing of different factors.

This was the approach in *Broome*, and appears to have been that of Lord Hailsham (and Lord Denning) in *The Greek Bank Case*. That was the approach adopted in *Poldi* and *Hafton*.

15

(3) The residence of the lender or place from which the money was lent is of no relevance (*Hang Seng*).

(4) The proper law of the obligation (which in the *Greek Bank* case was English) was not mentioned by Lord Hailsham, is not relevant to the question of situs, and can be given very little, if any, weight (*Poldi*).

20

(5) The residence of the debtor is an important factor. It is a central consideration in the determination of situs. It was taken into account in *Broome*, regarded as important by Lord Hailsham, and the Special Commissioner in *Poldi* described this factor as one of the first magnitude. Where the debtor is a company the place of a branch may be relevant: that indicates the importance of the source of funds which provide for payment.

25

(6) The place of jurisdiction is relevant, because it is relevant to situs. But even in relation to situs its importance may be reduced if the place of substantial enforcement is different.

30

In the *Greek Bank Case* it had been argued that because the only place in which the obligation of the new guarantor could be "discharge or enforced" was in London, the source was in the UK. Lord Halsham did not say that this was generally an irrelevant consideration but dismissed it on the grounds that the original nature of the obligation was Greek and that it could not change. It seemed to me that he accepted, or at the very least did not reject the proposition, that otherwise the place of jurisdiction or enforcement could be relevant.

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In *Poldi* an arbitration clause of similar effect to a jurisdiction clause was regarded as having little weight because enforcement would not be in the same country.

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(7) The location of any security is relevant.

It was treated as relevant in *The Greek Bank case* and in *Poldi* and *Hafton*.

The place of any security reflects the place of ultimate enforcement of the creditor's rights (*Poldi*).

(8) The place of actual or stipulated payment is relevant, but of little weight.

5 It was possibly a consideration in *Broome*, but Finlay J's assessment took into account that the payment in that case was made from a London bank account – from funds in London – as well as payment being in London

It was eschewed by Lord Hailsham in favour of a consideration of the ultimate source of the funds for payment.

10 It was referred to in *Hafton* (the money did not pass through the UK) but not as a determining factor.

(9) The place of contemplated enforcement is a relevant factor

15 I have referred to the Special Commissioner's conclusion in *Poldi* that the place of ultimate enforcement was important. It seems to me that Lord Hailsham's mention of security does have the effect which the Special Commissioner attributed to it. It reflects in some measure the possible uncertainty in the situs rule about the meaning of "properly recovered and enforced", and indicates to me that the contemplated source of payment (the "ultimate enforcement" as the Special Commissioner called it) is a significant factor.

20 (10) The contemplated source or substantive origin of the funds for the payment of the obligations is relevant and of greater significance than the place at which payment is to be made. (I prefer "substantive origin" to "ultimate source" as the latter suggests a continual chain of digging, and comparison with proximate and economic source.)

25 This reflects the greater weight Lord Hailsham gave to the place from which the funds would have come (Greece) to fund the payment of the interest by the guarantor's branch in London.

This is consistent with Donaldson J's finding that payments by the London branch of the Bank of Greece would have a UK source: see [57] above (he was considering the payments separately from the original obligation on the bonds).

30 The contemplated source of funds was relevant in *Hafton*.

Application to the facts.

69. The parties agree that the determination of where the interest arose on Mr Perrin's loan was an exercise in weighing up a number of factors.

35 70. Although the place stipulated for payment may have some relevance, in this case there was no such place specified in the loan agreement.

71. The following factors appear to me to be relevant:

(1) The proper law of the agreement. This was that of the Isle of Man. This factor however I judge to be of very little weight.

(2) The place in which payment was actually made, namely, for the two payments at issue, the Isle of Man. I regard this as of little weight.

(3) The jurisdiction in which judgement could be obtained, namely the Isle of Man.

5 (4) The country in which Mr Perrin was resident, namely the UK.

(5) The country from or in which Mr Perrin's obligations to pay would be contemplated to be enforced or would substantively originate, namely the UK.

72. Taking all these together I conclude that the interest arose in the UK and did not arise from a source outside the UK. The factors of residence and the source of funds for payment or enforcement outweighed that of jurisdiction and actual payment. In particular I do not regard the fact that the two interest payments at issue in this appeal were made from Mr Perrin's Isle of Man bank account as having substantial weight. Lord Hailsham equated the source of payment with the source of the obligation. The obligation he refers to must comprise the totality of the loan obligations not simply some of the payments of interest; those interest payments do not have a separate source from the obligation to pay capital, and that seems to me to be in the UK.

Conclusion

73. I dismiss the appeal.

Rights of Appeal

74. This document contains full findings of fact and reasons for the decision. Any party dissatisfied with this decision has a right to apply for permission to appeal against it pursuant to Rule 39 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009. The application must be received by this Tribunal not later than 56 days after this decision is sent to that party. The parties are referred to "Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)" which accompanies and forms part of this decision notice.

30 **CHARLES HELLIER**
TRIBUNAL JUDGE

RELEASE DATE: 26 February 2014

35 Amended to correct clerical mistakes, slips and omissions under Rule 37 (4 March 2014)