## Ardmore and UK source income

**Contrary to HMRC's view, the debtor's residence is not the most important factor when determining whether income has a UK source.**

The recent case of *Ardmore Construction Ltd and Perrin v HMRC* [2015] UKUT 633 (reported in *Tax Journal*, 24 November 2015) was concerned with the meaning of income arising in the UK and therefore whether it was subject to the deduction of tax at source. The classic authority on this matter is the celebrated *Greek Bank* case (*Westminster Bank Executor and Trustee Company (Channel Islands) Ltd v National Bank of Greece* (1970) 46 TC 472).

In the *Greek Bank* case, the debtor was a foreign company; there was a guarantee by another foreign company, secured on foreign assets; and payment was to be made outside the UK to persons outside the UK. The only reason that anybody suggested that the interest should be regarded as arising in the UK is that the guarantor subsequently acquired a branch in the UK and, for various practical reasons, it could only be enforced in London. The House of Lords decided that the interest did not arise in the UK.

Over the years, HMRC developed its thinking on this subject. The latest version of its manuals explains its current view, which is that the source of income depends on a number of factors, namely:

- the residence of the debtor;
- the location of the debtor's assets;
- the place of performance of the contract and the method of payment;
- the competent jurisdiction for enforcement;
- the proper law of the contract; and
- the location of any security.

HMRC considers the residence of the debtor to be the most important factor, along with the location of the debtor's assets, because that will be where the creditor will sue for payment. It also says that the residence of the debtor determines the competent jurisdiction.

The Upper Tribunal considered the *Greek Bank* case in detail and concluded that the residence of the debtor was not the most important factor. Furthermore, it said that there is no support for the proposition that there is a link between jurisdiction and residence. This seems directly contrary to the approach of HMRC.

One aspect of this case was that Mr Perrin had received unsecured loans from a trust in the Isle of Man and the question was whether the interest payable was interest arising in the UK. Mr Perrin was resident in the UK. However, the proper law of the agreement was the Isle of Man; the place in which the payment was actually made was the Isle of Man; the jurisdiction in which judgment could be obtained was the Isle of Man; and the payment of interest was made by Mr Perrin from funds in the Isle of Man.

The Upper Tribunal said that residence is one factor and there are other factors to be taken into account. However, having taken all those other factors into account, the Upper Tribunal concluded that the source is where the debtor is resident. It said that the proper law, the jurisdiction of enforcement and the place of payment are of little or no weight. One might consider that if all the other factors which have to be taken into account have little or no weight, they do not really have to be taken into account at all. This pretty much only leaves the residence of the debtor to be the single conclusive factor.

There was an interesting passage in the judgment relating to specialty debts. The tribunal referred to the distinction between the situs of a simple debt and a speciality debt. It acknowledged that different rules apply to each type of debt and the traditional distinction has been that a speciality debt is regarded as situated where the instrument is physically located. (This is no longer relevant for income tax purposes, because ITA 2007 s 874(6A) makes the situs of a speciality debt irrelevant for income tax purposes.) However, it would seem to follow that the old rules still apply for inheritance tax – in contrast to the view taken by HMRC since 24 January 2013 that both simple debts and speciality debts should both be regarded as situated where the debtor is resident. ■

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## The year of living digitally

**One word we will be hearing a lot in 2016 – and indeed over the next few years – is digital.**

I have long been an advocate of digital tax and business administration and while I do not think that the past is always a guide to the future, two lessons I draw from the evolution of tax e-filing over the last 20 years are that gaining a genuine understanding of business processes at the earliest possible stage and thorough testing are both critical components of success.

HMRC's ambitious – some would say revolutionary – 'making tax digital' project distinguishes two classes of taxpayer: personal and business.

The vision for personal digital tax accounts seems entirely logical. If HMRC or another government department holds information, the individual's personal digital tax account should be pre-populated with it. Initially HMRC will pre-populate PAYE information, but over time will include state pension and bank/building society interest. Presumably, this will then be extended to other taxable state benefits and – with appropriate powers to require returns of information – dividend and similar income. There will be significant challenges in terms of maintaining data accuracy, making provision for the digitally excluded, ensuring agent access in tandem with taxpayer access ab initio, and in defining the degree of care a taxpayer will need to take in checking the accuracy of a pre-populated return. There will also, I suspect, still be many cases requiring further data input from taxpayers and agents for some years to come. This development is one that I think most individual taxpayers will rightly welcome.

Turning to businesses, many embraced digital accounting decades ago and the majority now maintain their records electronically. Many small and micro businesses however still prefer manual record keeping and do not bank online or use email or the internet. However, under the plans announced in December, digital record keeping will, unless there is a change of heart, be mandatory for all such businesses by 2018. This, for some, will be a massive change.

The timetable HMRC has set itself is challenging. It might have been less challenging to begin with larger businesses, where digital record keeping is routine and then work gradually down, while increasing the numbers of micro and smaller businesses transitioned voluntarily (and based on a proven business case for doing so rather than compulsion).

Putting the issue of compulsory digital record keeping – which is opposed by a number of professional and representative bodies, including ICAEW – to one side for the moment, 'making tax digital' needs to deliver for all who use it: businesses, HMRC and agents. That will only happen if all stakeholders work closely together to establish, understand and then try to overcome the issues and barriers; and this will also be the best way to identify opportunities. Thorough research will be needed to better understand the genuine and serious concerns small and micro businesses have, and I welcome the fact that HMRC has asked