ITI Submission to Revenue on the Draft TDM on the payment and receipt of interest and royalties without deduction of income tax (Part 08-03-06) – withdrawal of Revenue's confirmation

05 August 2020

At the TALC Direct/Capital Taxes meeting of 25 June 2020, Revenue stated that Revenue's confirmation which provided for interest payments to be paid without the deduction of withholding tax, under section 246(3)(cc) TCA 1997 to a qualifying company (as defined by section 110 TCA 1997) will be withdrawn, even in circumstances where the interest is paid into a bank account, of the qualifying company, outside the State. Revenue stated that they are not prepared to ignore the requirement in the legislation that the interest *"be paid in the State"* but they are willing to accept a submission from practitioners on the issue.

The submission below follows the note the Institute emailed to Revenue on 3 July 2020 regarding this matter.

Interest paid in the State

S.246(3) TCA 1997 grants an exemption from the application of withholding tax on interest in certain circumstances. Generally, these exemptions turn on who the interest is paid by, who the interest is paid to, or the instrument with respect to which the interest is paid. A number of these exemptions refer to *"interest paid in the State"* to or by certain persons (or class of persons). The question, therefore, arises as to how one should interpret the reference to *"interest paid in the State"* when assessing eligibility for the relevant exemption.

Imposition of withholding

In order to properly understand the usage of the term *"interest paid in the State",* it is necessary to place that language in the context of the requirement to apply withholding tax to which the relevant exemption applies. This obligation to apply withholding tax to payments of the yearly interest is set out in S.246(2) TCA 1997:

"Where any yearly interest charged with tax under Schedule D is paid –

a) *by a company, otherwise then when paid in a fiduciary or representative capacity, to a person whose usual place of abode is in the State, or*
b) *by any person to another person who usual place of abode is outside the State*

The person by or through whom the payment is made shall on making the payment deduct out of the payment a sum representing the amount of the tax on the payment at the standard rate in force at the time of the payment…."

The question of whether a particular payment of interest is charged with tax under Schedule D is essentially a question of whether or not the interest payment concerned has an Irish source and,

consequently, is within the scope of Irish taxation. There is an extensive body of caselaw assessing where interest can have its source and, in broad terms, that case law would indicate that you should generally look to the legal situs of the debtor (*i.e.* where that debtor is legally situated) and, consequently, where that debt might be enforced. These two matters do not always overlap perfectly as, for example, a debt secured on an Irish property might be enforceable in Ireland notwithstanding that the debtor might be legally a foreign person (and, therefore, potentially the debt might also be enforceable in a foreign jurisdiction).

Usual place of abode

As noted, the obligation to impose withholding tax under subsection 2 arises in two instances. Firstly, it applies to payments made by a company to a person whose usual place of abode is in the State. Secondly, it applies to payments made by any person to another person whose usual place of abode is outside the State.

The references to a person's *"usual place of abode*" is somewhat archaic but given the context (*i.e.* the imposition of taxation) it seems reasonable to conclude that these are intended to make references to the person's tax residence. If this section were being drafted today, you would likely expect that the formulation used would be with reference to tax residence rather than the use of the phrase "place of abode".

Indeed, it is implicit in some of the newer exemptions provided for in S.246(3) TCA 1997 that the imposition of tax in the first instance was with reference to the person's tax residence rather than some other meaning of that person's "usual place of abode" (e.g. subsection 3(h) exempts payments to qualifying non-resident companies and, therefore, pre-supposes they were in scope of subsection 2 in the first instance). Similarly, some of the older references in subsection 3 apply the same language as in subsection 2. For example, subsection 3(c) applies to: "interest paid to a person whose usual place of abode is outside the State…..". As such, it seems reasonable to conclude that the reference to a person's "usual place of abode" is synonymous with their tax residence status.

Exemptions

In summary, therefore, withholding tax is imposed in respect of yearly interest where that interest is within the charge to Irish tax under Schedule D (i.e. has an Irish source) and either the payer is a company (in which case withholding tax is applied to all recipients) or the payer is an non-corporate person (in which case the withholding tax is only applied to a person whose usual place of abode is outside of the State (i.e. a non-resident person.)

Subsection 3 then lays out a series of exemptions from the imposition of withholding tax where certain conditions are met, or circumstances arise. Within these, a number are stated to apply in respect of *"interest paid in the State".*

These exemptions are:

- Interest paid in the State on an advance from a bank carrying on a bona fide banking business in the State
- Interest paid in the State by a company to certain lending companies that are taxed on a trading basis in respect of that activity
- Interest paid in the State by a company to certain 51%+ associated companies
- Interest paid in the State to an investment undertaking
- Interest paid in the State to a qualifying S.110 company
- Interest paid in the State to certain exempt approved pension schemes

A review of earlier codifications of this section (e.g. in Finance Act 1974), contain only "*paid in the State"* exemption i.e. interest paid in the State on an advance from a bank carrying on a bona fide banking business in the State.

Over time the section was expanded, and additional exemptions were included and those that were applicable to payments to Irish residents (or persons carrying on business in Ireland) were generally formulated in the same way as the banking exemption referred to above.

A reasonable presumption about this formulation is that it was designed to address a situation where interest is payable to a foreign bank operating in Ireland through a branch. In such a situation it would be possible that an Irish borrower might do business with the head-office and therefore pay interest to the head office and not the Irish branch. In such circumstances Irish taxation might not have been applicable to the interest received by the bank and, therefore, the only real opportunity for the Irish tax authorities to impose tax would have been the imposition of withholding tax on the payment. (The exemption from interest withholding tax in subsection 3(h) which might deal with many of those circumstances had not been enacted yet and, therefore, the question of treaty claims, and recovery of tax would have been dealt with through a different mechanism.)

In this context, exempting payments made to a bank which was either Irish resident or carrying on business in Ireland where that payment was made to that Irish operation would make sense given that the recipient would have been within the charge to Irish tax in respect of the interest and paid Irish corporation tax on its profits. Importantly, however, the mere location of the bank's accounts into which the interest was paid would not be determinative (i.e. a foreign bank operating in Ireland through a branch could not avoid Irish taxation by merely directing its customers to pay interest into a foreign bank account.) There is some support for this in UK case law albeit the UK equivalent legislative refers to *"interest payable in the State"* on an advance from a bona fide bank carrying on business in the state. Therefore, the question answered by the Courts was different and looked at where interest was capable of being paid and not where it was paid. Nevertheless, there are some useful insights in the cases.

The Maude case

The case of *Maude v Commissioners of Inland Revenue* considered the applicability of the UK exemption from withholding tax in respect of *"interest payable in the United Kingdom"* to a qualifying bank.

The Appellant was resident in Guernsey (and not in the UK) and part of the income was subject to United Kingdom Income Tax (and had a UK source). She arranged with the manager of the local branch of National Provincial Bank (a UK based bank) where she had an account for an overdraft. No specific terms were arranged as to payment of interest but in fact interest was always paid (without deduction of tax) by debiting the Appellant's branch account.

The UK tax authorities asserted that the exemption did not apply because the interest on the overdraft was payable in Guernsey. The Appellant contended that the Guernsey branch was an integral part of the National Provincial Bank, that she would have been entitled to pay the interest at the head office in London and that the interest was therefore "payable in the United Kingdom".

The High Court agreed with the Appellant on the grounds that, in the absence of any special provision to the contrary, the Bank could not have refused to accept payment of the interest at its headquarters in London, and accordingly that the interest was payable in the United Kingdom.

The Hafton Properties case

In the *Hafton Properties Ltd v McHugh (Inspector of Taxes)* case, a loan was advanced to a UK resident by an Isle of Man bank and was secured on UK property. The bank had no office or representation in the UK.

The borrower (*Hafton Properties*) paid interest (without withholding tax) to a firm of London solicitors representing the bank who had made the original introduction. These payments were made through the delivery of cheques or bank drafts by the borrower's solicitors to the bank's solicitors in the UK.

The tax authorities took the view that the payments made by the taxpayer company to the bank were made to a person outside the United Kingdom meaning that the exemption from withholding tax in respect of *"interest payable in the United Kingdom"* to a qualifying bank carrying on a bona fide banking business in the UK did not apply (the tax authorities also argued that the Manx bank was not carrying on a banking business in the UK).

The borrower appealed this decision and the Court agreed with it in respect of the question of where the interest was payable. Addressing this point, the judge said:

> *"…was the interest payable on the [bank] advance 'payable in the United Kingdom'? [Counsel for the Inspector of taxes] contended that it was not so payable: that it was 'payable' in the Isle of Man where the credit undoubtedly ended up at the end of the day. I dare say it was, but as Maude v IRC [1940] 1 KB 548, 23 TC 63 shows, that does not mean that it was not also in the relevant sense 'payable' in the United Kingdom. A sum is 'payable' wherever a good tender can be made.*
>
> *In the present case there was clearly an arrangement between the parties that the payment should be made in London. What [the banks' solicitors] thereafter did with the cheques or drafts is in my view not in point. In fact I do not think that anything hangs on the form of payment, because I feel sure that had [the borrower's solicitors] attended with an attache case full of pound notes that would have been equally accepted in payment. I accordingly decide that issue in Hafton's favour."*

Interpretation

A distinction between the UK law on which these cases was based and its Irish equivalent is that the Irish law looks at where the interest is "paid" whereas the UK provisions look at where the interest is "payable". Therefore, the UK rules are more liberal and allow for a review of all possible places where the interest is capable of being paid – indeed the very fact that interest was capable of being paid in a place other than where it was paid was critical in the *Maude* case.

The difference in language limits the direct application of the *Maude* case to the Irish equivalent and unlike in a situation where one person transfers money from their account to a recipient's account, in the *Maude* case, the interest was paid by virtue of amounts being deposited in the Appellant's own bank account and the bank settling her overdraft as a consequence. The absence of separate accounts means that it is not immediately obvious how to apply this judgement to a situation where there are separate accounts. That said, it does support the position that the question whether interest is *"paid in the State"* looks to where the payment is due and accepted.

In the *Maude* case the interest was due and accepted in Guernsey as that was where the bank processed the discharge of the obligation. The UK Courts considered that, hypothetically, the

payment could have been accepted by the London head-office whereas in Ireland the different language in the statue narrows the interpretation to location of actual acceptance. Note, however, even if the Appellant actually presented herself to the London branch with a cash payment, the judgement does not say that would have been "paid" in the UK – the Court did not explore (because it did not have to) how such a payment would, in practice, have been processed and accepted, in particular whether the matter would be referred internally to the Guernsey branch to be dealt with. Instead the Court was allowed to entertain a range of hypotheticals – for example had the bank had a branch in Germany, for instance, it presumably also have concluded that the interest was payable in Germany – whereas an Irish Court would have to consider what actually happened with the discharge of the specific liability.

The judgement in the *Hafton Properties* case does offer some additional insight. That judgement confirms that one can look at a broad range of arrangements (which might not be formally stipulated but which exist in practice) and turns on the fact that the bank was able to accept payment in the UK (even though it was done through their solicitor) meant that the interest was paid in the UK (and hence payable in the UK). The fact that those bank drafts or cheques might then have been transferred to the Isle of Man before being deposited and credited to the account of the lender is not considered to be relevant (as stated by the judge: "What [the banks' solicitors] thereafter did with the cheques or drafts is in my view not in point.").

Again there are some limitations in the application of the judgement because the Court was able to entertain a range of hypothetical possibilities and therefore potentially allows for a broader interpretation of when something is payable in the State to more than just a situation where the bank is resident in, or operating through a branch in, the State. However, it does not opine on where interest which is *payable* in many jurisdictions is actually *paid*. The judgement might be criticised for the fact that it assumes that presenting a cheque or draft is definitive payment whereas had the cheque been declined or had the draft been a forgery the bank would rightly assert that payment had not been made. Had the Court considered this then surely the location where the bank's personnel (or agents) accepted that good payment had been made and discharged the corresponding liability should have been a key factor (whether or not the bank's solicitors in the *Hafton Properties* case were in a position to do so is, unfortunately, not explored).

Nevertheless, the judgement clearly indicates that the question of where either party's bank account is located is not determinative – this is demonstrated by the fact that the case did not turn on any of the following:

- the location of the person who signed the cheque when they signed it (creating an instruction to the bank to pay the stated sum to the payee stated thereon);
- the location of the person who requested a bank draft from the bank when they made that request (instructing the bank to draw such sum form the borrower's account and issue a draft payable to the named payee); or
- the location of the bank (or its employees) who issued the draft or processed the payment when the cheque or draft was returned to it by the payee's bank for payment.

Similarly, the location of the payee's bank accounts is not considered relevant (as it is not discussed).

It follows that the location of the payer's or payee's bank accounts is not relevant to the question of whether interest is *"paid in the State*".

Furthermore, in the absence of sending an agent (such as an employee or solicitor) with payment for delivery to the payee, the question of where the interest is paid must surely turn on where the bank

accepts that payment has been made and the obligation discharged. This is not synonymous with where the bank accounts into which the amounts are received as the mere fact that payment is received into a particular account cannot be read as acceptance of payment – the payment must be processed and the related obligation recorded as settled with final acceptance of this being made by the management personnel responsible for that particular loan (*i.e.* by those persons managing that part of the business to which the loan / advance is assimilated to which the interest is due).

Conclusion

Viewed in this light, the references to *"interest paid in the State"* can clearly be shown to have their origins in the taxation status of the recipient rather than anything specifically linked to the legal situs of payment or bank accounts.

The logic here is straightforward. The requirement for either a company or an individual to apply withholding tax arose in the first instance because the payment was by a company or because the recipient (the foreign bank) had its usual place of abode outside of the State. However, where the interest would be taxed in Ireland (which would be the case for interest due to an Irish bank or to an Irish branch of a foreign bank), an exemption from withholding tax could be applied without adversely affecting exchequer returns.

Furthermore, a non-resident bank with an Irish branch which loaned monies to an Irish resident could not claim to be outside of the charge to Irish corporation tax on its branch profits simply because that branch happens to use a foreign bank account. Clearly if the lending activity were property assimilated to the Irish branch (i.e. where the interest was due to the Irish branch rather than its head office) then that branch would need to pay Irish corporation tax on its branch profits irrespective of the location of its bank accounts.

Thus, where an Irish bank receives interest which is due to it from customers, acceptance of payment is made by the bank in Ireland (interest paid by a foreign customer to a foreign branch might not fall within this but then it likely would not be within the scope of withholding tax in the first instance; thus, this statement is generally true for interest within the scope of withholding tax). Where a foreign bank operates in Ireland through a branch, payments from the branch's customers in respect of amounts due to the Irish branch are accepted and obligations discharged by its Irish branch (and Irish taxes payed on those profits) irrespective of the location of the bank's accounts.

In practice, therefore, the reference to *"interest paid in the State"* is not in reality imposing an additional requirement in respect of the payment of interest to an Irish bank or to a foreign bank's Irish branch but is, in effect, referring to payments due to such banks which, by definition, will always be paid in the State where the income is assimilated and due to an Irish bank (taxed on its worldwide income) or an Irish branch within the charge to tax in the State on those branch profits.

This formulation of this exemption appears to simply have been copied and replicated when other exemptions were introduced in respect of interest payment to other persons within the charge to Irish tax on such interest. Again, the same logic can be applied: if the interest is due to this Irish tax resident person / Irish branch of a non-resident person, then the interest will, by definition, be paid in the State and as Irish taxes will be due by the recipient on the interest, it makes sense that an exemption from withholding tax could be applied to simplify administration without eroding the tax base.

It is notable that the phrase *"interest paid in the State"* is not used in all of the exemptions in subsection 3 – i.e. the exemptions in respect of interest paid to the SBCI, NAMA, the NTMA, NTMA

Managed Funds, and interest paid to Home Building Finance Ireland. There may or may not be a conscious policy choice here. On the one hand, these are recent exemptions and it could simply be the case that the draftsman did not consider the inclusion of the phrase necessary. Alternatively, a decision not to refer to interest being paid in the State might have been made on the basis that these were either Government bodies or effectively were organs of the Government (e.g. the NTMA essentially being an extension of the Minister of Finance). As such, concerns around whether or not Irish tax would or would not be paid are potentially less relevant in these circumstances.

The interpretation set out above is also consistent with how the other withholding tax exemptions in subsection 3 (i.e. those relating to non-residents not operating in Ireland through a branch or persons resident anywhere) are framed. These exemptions do not refer to the interest being *"paid in the State"* as the recipients referred to in those subsections either would never have been able to satisfy the requirement (in the case of non-residents not operating in Ireland through a branch) or would not have needed to (in a case where exemption is provided irrespective of residence).